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Inside the Predatory State:

The rationale, methods, and economic consequences of kleptocratic regimes

Douglass North (1981) defines the predatory state as 'the agency of a group or class; its function [is] to extract an income from the rest of the constituents in the interest of that group or class.' (p. 22) This state attempts to maximize government income subject to the constraints posed by its bargaining position, the transaction costs involved, and the rate of time preference of the ruling group. (Levi 1988, Chapter 2). The bargaining position depends on the coercive, economic and political resources at its disposal. The transaction costs are those connected with negotiating binding contracts with the citizens and enforcing these contracts. The rate of time preference, finally, is intimately connected with the size of the plunder. No government can prey heavily on the population over a long period of time without risking to be disposed of and, conversely, a predatory government that holds power for a short period only will presumably squeeze more out of the citizens per unit of time than one looking forward to a long time in power.

Security of rule, on the other hand, should go hand in hand with a low rate of time preference.

Exactly how common the predatory state is remains unclear. It is more than a slight exaggeration to contend, as Margaret Levi does, that all rulers are predatory. (Ibid., pp.4, 48). Still, the category is far from an empty one. Examples abound across time and space. Limiting the perspective to the more or less contemporary period yields names like Trujillo in the Dominican Republic, the Duvaliers in Haiti, the Somozas in Nicaragua, Amin in Uganda, Mobutu in Zaire, Bokassa in the Central African Republic, the Shah of Iran, Marcos in the Philippines and Ceaușescu in Romania, to mention but a few of the well-known rulers who all deserve the epithet of kleptocrats. Much of what is going on in the former Yugoslavia and the republics emerging from the Soviet Union also bears clear traces of fighting over the spoils that come with the presidential office and the power to tax the inhabitants of a certain territory.

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Predatory states tend to create ill-functioning rule systems – systems that do not provide incentives for productive activities. The transaction costs connected with the exchange of goods and services increase, because predation is based on interference with the market mechanism rather than with enhancing its efficiency. Property rights are usually not well-defined, and political decisions are frequently substituted for the decentralized market system. The degree of uncertainty with respect to rules and outcomes increases and the entire incentive system is distorted. The result is on the one hand an inefficient resource allocation and low (or negative) growth and on the other a redistribution of income in favor of the ruling group, to the detriment of the majority of the population.

Rulers or ruling groups who conceive of political power as a simple vehicle for personal enrichment make the decisions in the predatory state. At the same time, the citizens normally have no say. They face difficulties when it comes to organizing themselves politically and push for reforms that are not in the interests of the power holders. No one can rule alone, however. Even dictators have to make all sorts of deals with groups who can support them in different ways and who in return claim special favors, notably monopoly positions of various kinds.

The purpose of the present essay is to lay bare the rationale that underlies the predatory state, to give some examples of methods that have been employed in the income maximization process, and to analyze some of the economic consequences of large-scale predation. Let us begin with a quick sketch of the principles upon which the logic of predation rests.

Rent Creation at the Top

Probably no gospel has been preached more intensively by economists than that of competition, because competition has a number of features perceived as desirable. In the perfect world of the textbooks it produces a Pareto optimal situation – one which cannot be improved upon from the welfare point of view. It is, however, well known that reality often is a far cry from the textbook world. Real people, acting within the limits drawn up by the institutions of the real world, often compete in a way that leaves plenty to be desired from the welfare point of view.

This is the case not least when competition assumes a political, rather than an economic, character. Selfish action by producers, consumers and factor owners easily produces results which both citizens and analytical economists perceive as negative. Instead of reducing production costs and improving product quality, producers lobby for special favors from the decision-making politicians, typically in the form of some interference with the market mechanism, i.e. they concentrate their efforts on *reducing* competition within the economic arena and on carving out protected niches where profits are good. Once artificial scarcities have been created, the possibility that someone can get something for nothing arises. Competition will shift out of the purely economic sphere and move into the political one instead. The existing rents will be sought and there will furthermore be lobbying for measures that allow new rents to be created. The economy moves further and further away from the competitive equilibrium. The attraction of directly unproductive, profit-seeking activities (DUP activities) increases in relation to that of producing goods and services desired by the citizens.¹

1. See Olson (1965), Bhagwati (1982).

Thus, to the extent that the lobbies are successful, rents will be appropriated by the resourceful and entrepreneurial. These do, however, not have to be individual producers or even groups of producers. The existence of the predatory state is also intimately related to the existence of rents. In a perfectly competitive environment there is no place for kleptocracies. However, it is a well-known result in economic theory that the rents sought by individual agents can be transferred to the state, e.g. by an auctioning system that makes the privileges end up in the most efficient hands, i.e. in the hands that are most willing to pay for the rents. This fact is appreciated by predatory governments, because they can make systematic use of it by using the regulatory power of the state to create rents which may be traded for money to interested parties or appropriated directly by themselves. Steven Cheung (1996) even goes as far as to argue that most regulations and controls come into effect simply because they facilitate corruption (i.e. private incomes for those who create them): 'In most countries, controls or regulations that do not bear on corruption are not going to last very long because people in power will not support them.' (p. 2)

Be that as it may. What is established beyond doubt is that 'corruption can develop into a system. It can become a permanent institution. In other words, the rights to corrupt can be well-defined. These rights can be well-defined to the point that they become actually transferable, assignable, inheritable, saleable. (Ibid., p. 4.)' Such are the ways of the predatory state. Rents are not *sought* by the government. They are *created* with a

deliberate purpose in mind: private income maximization for those individuals who create them, i.e. those who run the state, and are hence transferred to the latter group. The state turns into a machine for grinding out private fortunes based on DUP activities.

This machine may even display increasing returns.² Setting up the rent-creating and rent-extracting machine may entail a fixed cost. A bureaucracy including the apparatus for intimidation and repression, and a number of administrative routines covering everything from the contracts with the citizens to the eventual transfer of the booty into the vaults and accounts of the ruler must be created, and this is costly. However, once the machinery is in place the exploitation of the citizens may proceed at a low cost in a standardized and routinized way. It becomes clear who must be paid, the amounts can be standardized and the transaction costs associated with haggling are avoided, and coordination between complementary activities becomes easier which in turn makes it possible to collect more revenues.³

The Methods

Not all rent-creating devices will last. Cheung argues that all regulations and controls are subject to the test of the survival of the fittest – fittest 'in the sense that they serve the people in power, subject to the constraint that they can fool most of the people most of the time. (Cheung 1996:3.)' The former part of the statement is certainly true, while the latter may not always be a good description of reality. The extent to which rulers need to obfuscate what they are up to also depends on

2. See Murphy, Shleifer and Vishny (1993:409).

3. Shleifer and Vishny (1993:605-07).

the extent of their power.⁴ In the following discussion we will give examples of refined methods that do not attract the attention of the citizens and of brutish tricks that fool nobody. The enumeration does not purport to be exhaustive; that is simply impossible. When it comes to the creation of methods that may serve to facilitate predation there simply seems to be no end to human imagination.⁵ We will hence concentrate on some of the most widely employed devices.

Taxation: Taxes of Foreign Trade

The most important method of rent creation at the disposal of a predatory government is the monopoly of taxation enjoyed by all rulers. This monopoly exists in all states, but predatory regimes use this monopoly for other purposes than non-predatory ones. In modern democracies taxation is employed for a host of purposes: revenue, stabilization, resource allocation, redistribution, etc., and governments have to balance all these purposes against each other when they decide what the tax system is supposed to look like. In predatory states, on the other hand, the only consideration that matters is revenue. The problem of optimal taxation is reduced to a single dimension: how to minimize the transaction costs for a given revenue, subject to the condition that taxation must not hurt the members of the ruling group or coalition themselves.

In developing countries in general, the transport and communication systems often leave much to be desired. Predatory states do not constitute any exception to this rule. At the same time, these states tend to be administratively weak and thoroughly

corrupt. These two facts together make it difficult to resort to tax systems displaying any degree of sophistication. What matters for predatory regimes is to minimize the transaction costs for obtaining a given revenue.

Thus, income taxation, other than a purely rudimentary one, usually at a very flat rate, is generally ruled out, as the administration costs for this kind of tax typically run as high as up to 10 percent of the revenue raised. Income taxation requires a relatively large and relatively honest collection and control apparatus on the one hand and widespread literacy and familiarity with paperwork on part of the citizens on the other. Inevitably, the system has to be based on some kind of self-declaration, if administration costs are not to skyrocket. Value added taxes perform better on this count – 5 percent – but better yet are trade-based taxes: a mere 1-3 percent on average according to the World Bank (1988:85.) Taxes on foreign trade are ideal, since these taxes are extremely easy to administer. All that is needed is to set up customs offices where goods leave and enter the country: in ports, airports and border posts.

The superiority of taxes on foreign trade tends to be especially pronounced at low or early stages of development.⁶ Thus, data from the 1970s and 1980s reveal that in the Third World in general, these taxes constitute the most important source of government revenue up to a per capita income of about 850 1991 US dollars. In the interval between 350 dollars and this figure, their share of the total was almost 40 percent. (Tanzi (1987: 217.) In predatory regimes, it could easily

4. For discussion of the role of obfuscation in predatory states, see Danielson and Lundahl (1994).

5. An excellent example is given by François Duvalier in Haiti, a veritable 'innovator in the predatory state'. (See Lundahl (1992), Chapter 12.)

6. See Due (1970:30).

amount to a lot more, however. Thus, between 1868 and 1872, customs revenue accounted for between 93 and 95 percent of the government revenue of the Dominican Republic, and in 1888, the figure was almost as high: 88 percent according to Sang (1991:376; 1987:139). Around the same time (1880), taxes on exports and imports accounted for more than 98 percent of the government revenue in neighboring Haiti, and this share was to decline only slowly, to slightly less than 90 percent in the 1920s, 80-85 percent in the 1930s, 70-75 percent in the 1940s and around two-thirds in the 1950s. (Lundahl 1979:393)

Typically, the heaviest duties are put on necessities, because these are consumed by large population groups and because their demand tends to be price inelastic, so that taxation does not result in large reductions of consumption, whereas luxury imports for the ruling clique are subject to much lower tariff rates. Again, Haiti constitutes an eloquent case in point: for example, from the 1910s up to the beginning of the 1970s, with such commodities as fine liquors being virtually absent from the duty lists and products like cotton textiles, soap and kerosene being heavily taxed. (Ibid., pp. 395-96.)

Smuggling

In countries with heavy duties (or quantitative restrictions) on imports or exports there is also scope for making money by avoiding these and capturing the premia arising, e.g. from the difference between what is paid in the international market and the price at which the goods resell domestically, in the case of imports, or from the export duty avoided, in the case of exports. Best of all are goods that command high prices because

their consumption is prohibited, notably drugs. Thus, the father-in-law of Jean Claude Duvalier, Ernest Bennett, organized during the 1970s and 1980s the smuggling of such goods as sugar, rice, flour, and cotton textiles into Haiti, (Fass 1988:35) members of the family of Jomo Kenyatta as well as the regime of Daniel arap Moi in Kenya have reputedly been involved in smuggling of ivory and gemstones (Williams 1987:86) and, for example, Manuel Noriega in Panama and the present military rulers in Burma have been heavily involved in illicit drug traffic, a traffic which they themselves have sanctioned. (Dinges (1990), Koster and Sánchez Borbón (1990), Lintner (1996))

Tax farming

Perhaps the best way of minimizing the costs for a given tax revenue is to resort to outright tax farming and avoid the costly creation of a tax bureaucracy. The Egyptians, the Greeks and the Romans all used it,⁷ and so did the European states during the late medieval period. During the sixteenth century it even constituted the dominant form of taxation in a number of countries. As it seems, the Ottoman empire used it longer and more extensively than other states.⁸ The system – in Britain known as *indirect rule* – was also used by the European colonial powers in Africa. The responsibility for tax collection was put in the hands of chiefs and other local rulers, who received a share of what they collected. (Tignor (1971), Oliver and Atmore (1972: 162)) More or less elaborate instances of tax farming are also found after the end of the colonial period, as, for example in the Dominican Republic under Ulises Heureaux towards the end of the 1880s, where the customs administration was used in this way,

7. Levi (1988), Chapter 4.

8. Azabou and Nugent (1989:179-80, 182).

(Sang 1987:90) or in Haiti at the beginning of the 1970s in connection with taxation of the sales of agricultural produce in domestic markets. (Duplan and LaGra 1974).

Sale of Public Offices

Another well-trying method for reducing transaction costs has been to sell public offices directly to the highest bidders. This method has been extensively practiced in many places. France, Spain, Britain, the Netherlands, Italy, Germany, the Ottoman empire and China all at one time legalized and formalized a system that guaranteed the state an income through the sales of positions within the civil and military administration. In Europe this system culminated during the seventeenth century, above all in France, and, to a lesser extent, in Spain.⁹

The modern variety of the sale of offices is that those who are in the market for a position within the administration bribe those who decide who will be hired, as in the Philippines, where in the mid-1970s a regular market developed with price tags on all jobs, both at the central and provincial levels, and where it would have been possible to raise up to 70 percent more tax revenue by eliminating the corrupt practices associated with this traffic. (Klitgaard 1988:13-21) Another example comes from India, where at the state level administrative personnel pay for being transferred to lucrative positions and where the revenue that this generates tends to 'trickle up' in the administrative and political hierarchy, all the way to the ministerial level. (Wade 1982a, 1982b, 1984, 1985) Nigeria in the early 1960s and the Soviet republics of Georgia and Azerbajdzan

ten years later provide examples of how even positions within the power hierarchy itself may be up for sale. (Andreski (1968:68), Simis (1982:55))

Inflation as a Tax

A time-honored way of taxing the citizens without their consent is by debasing the currency, e.g. by printing paper money. As is well known, inflation is a tax on cash holdings and has been used as such virtually as long as money has existed. The citizens must part with resources in order to obtain money and if that money is not spent immediately on purchasing other resources, they take a loss in terms of purchasing power when the price level increases during the period they hold cash.

Of course, examples abound. Here we will just give two. In the Dominican Republic all governments during the latter half of the nineteenth century, and especially those of Buenaventura Báez and Ulises Heureaux, made systematic use of monetary emissions to solve their immediate fiscal problems. The emissions were made 'without taking into account the necessary regulatory rules that guaranteed a certain stability in the monetary system'. The result was a continuous depreciation of the currency.¹⁰ The second example comes from Idi Amin in Uganda, who may never have understood the theory behind inflationary taxation. In fact, he had his own, home-made variety which he chose to bring out when faced with an increasing budget deficit as a result of unhampered spending: 'By his definition countries could not go broke, because they printed money and could always print more.' When Milton Obote was overthrown by Amin, in 1971, the

9. See Swart (1980), for a comparative analysis.

10. Sang (1987:142-54.) The quotation is from p. 148.

budget deficit amounted to 700 million Ugandan shillings. By 1977, this figure had increased to 3 billion. (Kyemba 1977: 51)

Confiscation

One of the most arbitrary forms of taxation is that of outright confiscation of desirable assets by the ruler. This was extensively practiced, e.g. by Rafael Trujillo in the Dominican Republic¹¹ and Anastasio Somoza in Nicaragua. Richard Millet describes Somoza's very direct approach:

The general almost never 'stole' land, preferring to 'buy' it from the legal owner. The dictator would simply drive up to a house and offer the owner a price, usually about half the real value, for his land. Often the owner would accept the offer, finding discretion the better part of valor, or would even offer it as a gift to Somoza, hoping to gain some political reward in return. Any owner who did not want to sell found himself faced with a campaign of harrasment, tax increases and similar measures until he finally gave in. (Millet 1977:197)

One of the major cases in modern times is again provided by Idi Amin, whose expulsion of the Asians in 1972 was caused by his desire to get at their assets. More than 3,500 companies together with residences and household goods, worth 400 million dollars, were transferred to Amin and his supporters, notably the army. The result had much in common with cannibalism. By 1975 a wave of bankruptcies swept across Uganda. The

looted and gravely mismanaged companies were by then unable to continue in business. Most of the time they had simply been stripped of their assets in the most direct and immediate fashion possible. (Decalo 1990: 175.)

Foreign and Domestic Loans

The alternative to taxation, not only in predatory states but elsewhere as well, of course, is to resort to borrowing, with the difference that, once again, the attraction of loans for a kleptocracy lies in the low transaction costs and not in the possibility of using the budget for countercyclical purposes. The distinction between private and social costs and benefits stands out very clearly here. The benefits accrue to the incumbent ruling clique which only has to negotiate the loan – at whatever terms – whereas the costs of repayment will be the responsibility of the citizens in general, in their capacity as taxpayers.

Two good examples are provided by the Dominican Republic and Haiti during the latter third of the nineteenth century. Both countries floated loans abroad at high discounts, with disastrous financial results. Buenaventura Báez in 1869 and Ulises Heureaux in 1888, 1890, 1893, 1894 and 1897 mortgaged the future of the Dominican Republic, to the extent that in 1905 the foreign debt of the country amounted to 40 million US dollars, and customs revenue to a mere 2.¹² In Haiti, foreign loans were taken in 1874, 1875, 1896 and 1910, and domestic loans in 1874, 1912, 1913 and 1914 on (four occasions), loans which, exactly as in the Dominican case, had to be floated at a heavy

11. See Crassweller (1966:143-44), Vedovato (1986:66).

12. Moya Pons (1980:373-74, 414-15, 443), Sang (1987:296-97).

discount and which all ended up in the pockets of the leading politicians. When the Americans occupied the country, in 1915, Haiti was completely unable to obtain further loans abroad on any terms whatsoever. (Lundahl 1979:367-70.)

Aid Blackmail

The modern alternative to foreign loans is foreign aid, which, if it can be had without strings, is ideal, especially for rulers who hold power for longer periods, since it does not have to be paid back. Obtaining untied aid is, however, not easy for predatory rulers. As a rule, unusual circumstances are required, such as during the Cold War, when skilled negotiators could play the two opposing superpowers against each other.

One of the most blatant cases was when the United States in 1962 needed the Haitian vote in the OAS to impose sanctions on Cuba. Papa Doc had by then for a couple of years given the impression that he might defect to the communist camp unless he was not provided with more assistance, and when the opportunity to cash in on his position presented itself he eagerly seized it, at the price of 2.8 million dollars for the Americans. (Heinl and Heinl 1978:617.) Ten years later, Idi Amin found himself in a similar position, with Israel and Great Britain being unwilling to extend aid without controlling where the money went. Amin chose to visit Moammar Khadaffi in Libya where he obtained the coveted funds against throwing the Israelis out of Uganda and assuming a strong anti-Jewish position. (Kyemba 1977:55-56.)

A ruler who attempted to make systematic use of blackmail tactics but who basically failed was Jean-Bedel Bokassa in the Central African Republic (later Empire). He began by converting to marxism in 1969 and the following year launched a pro-communist

foreign policy, professing to build his government on the principles of 'scientific socialism', but when his conversion failed to yield the expected monetary benefits he rapidly made it back to the capitalist camp. Bokassa's next move was to convert to Islam, encouraged by Khadaffi, in the hope of better financial treatment from that camp, only to reconvert to Catholicism once it was obvious that Libya would not be generous enough to him. (Decalo 1989:149-50, 153)

Embezzlement of Aid

If aid cannot be had without strings what has already been obtained can always be diverted to uses not intended by the donors. Examples can be found in present-day Kenya, where several donors have reacted to increased corruption, especially on high political and administrative levels. Nepotism and tribalism loom large, and informal networks between entrepreneurs and public servants, especially in the customs, tax and police administrations, that can be used for diverting public funds, including aid, are well developed. Thus, when aid is allocated to a certain geographical district, the politicians and administrators involved in the decisions often charge the recipient district for their good offices. (SIDA 1994:11.)

It seems, however, that most of the fund diversions take place in connection with tenders and purchases of various kinds. Thus, in Kenya the Swedish aid agency, SIDA, has experienced a number of corrupt practices. Officials responsible for purchase do not use a systematic bidding system but choose arbitrarily among sellers. Purchases are split into smaller parts to avoid resorting to tender procedures. Sellers who are known to offer low prices are excluded from the competition to ensure that those who offer better kickbacks get the orders. Sellers with high prices get contracts, to ensure 'capacity

building'. (Ibid., pp. 20-21.) Other donors report similar problems. (Ibid., pp. 18-19.)

Reallocation of Budgeted Funds; Unbudgeted Funds

A similar trick may be used when it comes to domestic funds. Budgets mean little in predatory states, both in terms of fiscal discipline and in terms of allocation. They can always be exceeded with the aid of the printing press, as discussed above, and when the need arises money can always be taken for whatever purpose from any account. Thus, in the Central African Republic at the beginning of the 1970s, funds

were routinely and casually transferred from one budgetary category to another, either when necessary or when Bokassa's whim so dictated; and development projects literally came to a halt as funds were syphoned off in midstream to accommodate new projects, which in turn ground to a halt at another date. (Decalo 1989:53)

Bokassa was not alone. François Duvalier in Haiti, who ruled by decree most of the time, could and did switch budget items frequently, e.g. in favor of the *tonton macoutes*, and besides made extensive use of the unbudgeted accounts of the *Régie du Tabac*, the government tobacco monopoly, which collected taxes on such items as tobacco, matches, sugar, cement, flour, edible oils, candies, alcoholic beverages and dairy products. In spite of repeated pressure from the international donor community, these funds were never opened to inspection but could be manipulated freely by the president. (Lundahl 1992:287) A third example is furnished by Idi Amin, who employed up to 50 percent of the available government funds to pay and care for the army, although the

available accounts revealed much lower figures. (Decalo 1989:98)

Milking State Enterprises

The alternative to using the government budget is to siphon off funds from state-owned enterprises. Most lucrative is presumably the case when government-owned companies are given monopoly privileges and their revenue is diverted. Thus, Ferdinand Marcos in the Philippines created monopolies for sugar and coconuts that channeled funds directly to the members of the First Family and their friends and relatives. (Hawes 1987:128, Carbonell-Catilo (1986:237) Other enterprises were used in a similar way:

The Marcos era saw proliferation of public enterprises or government-owned and controlled corporations. As in the ... [coconut and ... sugar cases] they were often used as a way of legalizing the privatization of public funds. The largest enterprise, the Philippine National Oil Corporation, for instance, was exempted from auditing controls by a presidential decree. The Philippine Amusement and Gaming Corporation, authorized to regulate operations and to grant gambling franchises, was exempt from taxes, fees and income levies by a presidential decree. (Carbonell-Catilo 1986:238)

Rafael Trujillo also nourished an interest in sugar exports for the sake of family income and finally became the most important exporter of the Dominican Republic. (Vedovato 1986:63) In Guyana, Forbes Burnham nationalized a number of foreign companies in the bauxite and sugar sectors from 1971 to 1976, hereby gaining control over more than two-thirds of the total export revenue of the country that could be used for

payments to the ruling clique and its backers. (Kaiser 1993:53-54) Finally, Haiti during the last years of the Baby Doc regime offers a good example of what may be achieved with the aid of state corporations. Checks of up to 6.8 million US dollars were written out to members of the presidential family and other private citizens, from the tobacco monopoly, the state lottery, the Flour mill, the government gambling commission, the state-owned car insurance company, the telecommunications and electricity companies, the cement factory, etc. 'Duvalierist thieving had absolutely no sense of proportion', summarizes Elisabeth Abbott. (1988:250.)

Government Contracts

We have already dealt with how manipulation of government contracts can be employed to divert aid funds to illicit uses. The contract racket does, however, not have to be connected with aid to be useful for kleptocrat rulers. On the contrary, outside the territory covered by supervisory donor eyes, the scope for gains tends to be even larger. Two episodes from Nigeria may be used to illustrate this thesis.

The first took place in 1975 when the military government of General Yakubu Gowon placed a cement order abroad that amounted to two-thirds of the estimated needs of all of Africa and which exceeded the combined production capacity of Western Europe and the Soviet Union, at a price which exceeded the one prevailing in the international market with 15 US dollars per ton, and which allowed freight companies to charge a compensation rate for not being able to unload the merchandise in time which exceeded the normal one with 60 percent. The final cost of this circus to the Nigerian economy amounted to 2 billion dollars, or one fourth of Nigeria's oil revenues in 1975.

(Williams 1987:68-71) The second episode involved oil itself. Between 1979 and 1983, oil was sold to non-authorized dealers at a price that exceeded the official one, who in their turn resold at an even higher price to foreign dealers. In addition, oil shipments intended for specific foreign buyers was diverted to other buyers. Inside Nigeria a shortage of oil ensued. (Ibid., pp. 71-72.)

The Nigerians were not alone in their endeavors. Thus, Ferdinand Marcos is reputed to have received 80 million dollars from Westinghouse for a contract for a nuclear power station, even though General Electric had presented a lower bid, (George 1988:19) and Mobutu Sese Seko presumably got even more from the German rocket company OTAG in 1976, for allowing it to use an area in Zaire which is larger than the entire West Germany. (Kalamiya 1979)

In Haiti, François Duvalier declared himself to be an ardent supporter of foreign investment, but most of the foreign investment that took place during his presidency was in the racket and kickbacks category, like the American venture, to be financed by an 18 million US dollar bond issue, to build a large hotel and an airport in Cap Haïtien, restore some national monuments, and build a broadcasting station etc., the plan to convert the waterfront slum in the capital to a shopping and residential area, the banana export concession to an American company, the project for a highway between the capital and Les Cayes, the jet airport, the casino concessions, and the meat exports by HAMPCO (which involved American politicians). (Lundahl 1992:283-84)

The Consequences of Predation

Predation has consequences both for the distribution of income and wealth, for the

efficiency of the allocation of resources and for investment, migration, technological change and growth. All of them are negative. The most obvious and easiest to deal with is that income and wealth will be concentrated in the hands of the ruling clique, notably in those of the head of state and the presidential or royal family. Thus, Perón in Argentina, Marcos Pérez Jiménez in Venezuela, Trujillo in the Dominican Republic, Ceaușescu in Romania, the Somozas in Nicaragua, José López Portillo in Mexico, the Duvaliers in Haiti, Marcos in the Philippines and Mobutu in Zaire all amassed very respectable fortunes preying on their citizens.¹³

The income and wealth concentration story is a straightforward one which does not require any further analysis. More complicated, however, are the effects of predation on efficiency, factor endowments and growth. Let us next turn to that in some more detail.

Inefficient Allocation of Resources: DUP Activities

In the section on rent creation we pointed out that competition in the political sphere has effects that tend to differ fundamentally from the effects of economic competition, as they usually aim at the creation or seeking of some economic rent not compatible with economic competition. In the predatory state resources will be drawn from the economic to the political sphere. The largest profits are not derived from innovations that reduce costs or create new products, but from directly unproductive activities in the sense of Jagdish Bhagwati (1982) that serve only to redistribute a given pie.

William Baumol has demonstrated how, historically, the institutional system created

by the ruling groups in society tends to determine the kind of entrepreneurship that will dominate in an economy. (Baumol 1990) By 'entrepreneurs' in this case he means persons who are ingenious when it comes to finding ways of increasing their own wealth, power, or prestige. His demonstration has strong relevance for modern predatory states, where resources tend to concentrate in the political sphere. 'Entrepreneurs' gather there, making use of the system, employing resources for obtaining rents instead of for producing goods and services. Thus, the size of GDP is reduced and growth is retarded. 'Entrepreneurship' in the predatory state uses up resources instead of creating them.

In the worst case, profit seeking degenerates into a purely criminal activity, like in Burma, where no efforts are being made to curb the drug traffic but where instead the ruling military has a stake in the business, (Lintner 1996) or in Panama where Noriega played a very active role in moving cocaine from Colombia to the United States. (Dinges 1990, Koster and Sánchez Borbón 1990) Once an economy moves into an equilibrium characterized by a high ratio of unproductive to productive activities, it may be difficult to break out. The economy may be 'trapped' there.¹⁴ The returns to production are negatively affected by the existence of rent seeking that preys on the output. The economy will tend to have multiple equilibria, with those characterized by either small or large amounts of rent seeking relative to production being locally stable, whereas the intermediate positions are unstable. In the former situation, the return to production is high and relatively few people will go into rent seeking. When the share of

13. See Lundahl (1997) for amounts and sources.

14. See Andvig and Moene (1990), Murphy, Shleifer and Vishny (1991), Acemoglu (1995).

unproductive activities is high, on the other hand, so many are preying on those who produce that the return to production has fallen substantially. This also sets a bad precedent for the future:

... if the majority of the current generation choose rent-seeking, the return to [productive] entrepreneurs relative to that of rent-seekers will be reduced in future periods and future generations will be induced to choose rent-seeking, thus giving us history dependence. (Acemoglu (1995), p. 27.)

There is hence a tendency for the predatory state to be self-perpetuating. History becomes an obstacle to change.

Distorted Prices and Government Activities

In a decentralized market economy, prices provide information to producers, consumers and factor owners with respect to how they should behave, but it is not always the case that the resulting actions are optimal other than from the private point of view. In situations where the price system has been distorted, e.g. by government action, a divergence between the socially and the privately optimal will arise and this will lead not only to an inefficient allocation of resources, but, by lowering the efficiency of investment, to lower growth as well.¹⁵

This is the case in the predatory state, because kleptocracies base much of their action on measures that distort prices badly. High tariffs are imposed to boost profits, notably in manufacturing. Agricultural producers receive low prices for their efforts while at the same time the high costs of parastatal marketing boards hide substantial

corruption. Agricultural exports are taxed severely unless they happen to come from firms owned by the rulers themselves or their cronies. Real interest rates are negative and credits are systematically channeled to the least needy. Domestic currencies are over-valued, often to the point where the supply of foreign currency is rationed, and whatever is available is allocated to luxury imports by the predators. Arbitrary (often completely illicit) taxes, that end up in the pockets of the members of the ruling clique and their supporters, as well as subsidies to inefficient companies via government contracts distort domestic relative prices.

In this fashion, the allocation of resources within the economic (as opposed to political) sector becomes severely distorted as well. Resources are drawn into activities on the basis of how much the encouragement or punishment of them increases the personal fortunes of the decision makers and those they serve. The desire to minimize the transaction costs of raising a given revenue drives a wedge between private and social profitability of activities and the economy ends up producing too much of the wrong kind of goods and too little of the right kind.

Not only the workings of the market are disturbed by predatory practices, but the allocative efficiency of the government sector as well, in an even more direct fashion, because it is within this very sector that the various rent-creating devices are being concocted. (Tanzi 1995:26) The basic problem in this context is that rules and regulations are applied in an economically arbitrary fashion. Subsidies and taxes hit randomly. Employees are hired not on the basis of their merits but because they have the right connections. The result will be bad

15. Cf. the recently published study by Lal and Myint (1996:66-69).

decisions and mistakes on the one hand and the discouragement of a career in the other hand.

X-Inefficiency

In addition to the allocative inefficiency resulting from price distortions, predation will lead to x-inefficiency, (Leibenstein 1978, 1989) i.e. resources allocated to a given sector could have resulted in a larger output. For example, tariff protection or subsidization will increase profits and weaken the incentives to reduce costs to the corresponding extent, and if tariff protection is coupled with monopoly privileges, this effect will be stronger yet, as proved by the fate of the Haitian state monopoly companies after the end of the presidency of Jean-Claude Duvalier. These, which, as we know, served mainly as a conduit from money to the presidential family, more or less collapsed as their privileges were removed. (Lundahl 1992:408-09.) Confiscation may produce even worse results from the x-efficiency point of view. When Idi Amin had expelled the Asians from Uganda in 1972, those who took over their businesses soon made a mess of them:

The new owners were completely at a loss. They did not know the prices of the items in their shops, and would ask customers, 'How much did you pay for this before?' The customer simply named his own price. Goods were sold off for a fraction of their true value. [...] Many of the owners simply plundered the stocks and left, locking the buildings and sending the keys to the Ministry of Commerce. (Kyemba 1977: 64)

X-inefficiency will arise also within the public sector, as a result of corruption. Tasks will not be carried out without direct payment by the

citizens and the bureaucrats will display great ingenuity when it comes to devising methods that institutionalize this practice. In the predatory state bureaucrats are the agents of the ruler or ruling clique. They are needed because nobody can rule and produce an income alone. This, in turn, means that transaction costs cannot be avoided. The bureaucracy must be paid on the one hand and on the other hand the bureaucrats are likely to be as selfish and corrupt as they can get away with. Corruption flows from the top downwards in the predatory administration. A kleptocrat ruler will usually not be able to prevent his underlings from following his example. All he can do is to attempt to create some method in the madness. It is in this light that we have to view the exhortations by Haitian president Sylvain Salnave (1867-69) to his troops, upon entering Port-au-Prince, putting down an insurrection in 1868: 'Mes enfans, pillez en bon ordre', (St. John 1889:115) and by Mobutu to the Zairian civil servants: 'If you want to steal, steal a little cleverly, in a nice way.' (Gould 1980:xiii)

Distortions of Investment

As pointed out above, predation reduces not only the static efficiency of an economy and the efficiency of investment. It also affects the size of investment, including human capital formation, negatively, and through investment, technological change and other innovations, and thus, ultimately, growth, through this channel as well. This is supported by the available empirical evidence. Paolo Mauro, in a study of 67 countries, for 1980-83, combined indices of corruption, bureaucracy and red tape and the state of honesty in the judiciary and the legal system into a single measure (the unweighted average) of inefficiency. Both this measure and the simple corruption index were found

to be statistically significant negative determinants of both total investment and growth of per capita GDP (controlling, among other things, for per capita income). (Mauro 1995)

Mauro's results require causal explanation. Causation could operate in different ways. In the first place, the volume of private investment will shrink. It goes virtually without saying that an entrepreneur who is contemplating an increase of his production capacity will not undertake the necessary investment unless he knows that he will also be the one reaping the benefits a few years down the road. Predation, however, effectively tends to preclude this. In the best case, only a 'sharecropping problem' will ensue, with the investor finding that he is receiving just a share of the eventual yield, and the smaller this share, the smaller will his investment be in relation to the optimum.¹⁶ In the worst case, he will receive nothing at all and then, consequently, he will abstain from investing altogether.

The volume of public investment may also shrink, unless it is of the kind that provides direct benefits for the ruling clique. However, in that case it may be directed towards creating and enhancing the apparatus that makes predation possible (e.g. the repression apparatus) and hence be of a DUP character, i.e. it will not increase production in the future. If it does contribute to raising productivity, the likelihood is overwhelmingly high that it is not directed to the socially highest-yielding activities but to areas which for one reason or another are interesting for the rulers in private terms. Often the past puts a dead hand over both the present and the future, like when predation has been going on for a long period

and past rulers may have mortgaged the resources of the country by taking foreign loans which the creditors insist will have to be paid off before anything is available for domestic investment. To the extent that infrastructure is lacking or left to decay the productivity and profitability of private investment will also suffer.

Not only will the physical capital stock shrink, or at least not increase, but the accumulation of human capital will suffer as well. Predatory regimes usually do not spend on, for example, education, because educated citizens may be more difficult to pacify and indoctrinate than uneducated ones. Kleptocrat rulers usually abhor especially institutions of higher learning where the students are trained in critical thinking (cf. below).

Thus, the supply of education is likely to shrink in predatory states, but the story may not end there. The demand for education is also likely to shrink. The quality of the school system will decline, in the extreme case to the point where education (at least higher education) becomes an inferior good, and the returns will shrink, since the competitive value of a good education will be reduced in a situation where political connections decide who will end up where. If so, investment in human capital is likely to take a different form, one which is strongly biased towards rent-seeking: the formation of what Francis Lui has termed 'political' – privately profitable but socially undesirable. (Lui 1996:28) It becomes more important to learn how to get the right connections than to learn the skills taught in school.

Emigration

Low returns to education will in turn produce brain drain, as when in Haiti in 1960 all the

16. Cf., e.g., Johnson (1950).

nurses that graduated that year left the country. In addition, around two-thirds of all the physicians who graduated between 1960 and 1968 chose to practice abroad and several thousand elementary and secondary school teachers left the country during the same period. (Lundahl 1979:428, 430, 474) Uganda suffered a similar loss when the Asians were forced to exit. Physicians, lawyers, accountants, etc., had to go, and the exodus was not limited to the Asian group alone, but through 1973 and in the years that followed, more physicians, nurses, midwives, university teachers and other professionals opted out. (Kyemba 1977:98-99) In Equatorial Guinea Francisco Macías Nguema in the 1970s ordered

purges and liquidations that decimated most of Equatorial Guinea's intellectual strata. [...] Within a few years of his rise to power, all libraries in the country were closed at his express orders ... Education and intellectuals were viewed as 'the greatest problem facing Africa today.'¹⁷

When Macías Nguema was killed, in 1979, it was estimated that not a single university graduate remained in the country. In addition, common farmers and workers left as the president set up forced labor batallions to make sure that a workforce was available in the cocoa plantations of Fernando Póo. (Decalo 1989:59) Macías Nguema is reported to have been responsible for what 'may represent the largest proportion of any nation ever to go into exile'.¹⁸

Retardation of Technological Change

To the extent that technological change is

embodied in physical or human capital, which is usually the case, the distortions of investment will have a negative effect on innovation as well. In fact, predatory behavior by the state is likely to affect innovative activities more than it affects everyday production:

Private rent-seekers go after existing stocks of wealth, such as land, output, capital, and so on. Bandits steal crops, lawyers sue deep-pocket corporations, and armies invade rich countries. In contrast, public rent-seeking attacks innovation, since innovators need government-supplied goods, such as permits, licenses, import quotas, and so on, much more so than established producers. To start a new firm, an innovator must get business, building, water, and fire permits, tax documents, import licenses if he needs new machinery, and often dozens of other documents ... Innovators' demand for these government-produced goods is high and inelastic, and hence they become primary targets of corruption. (Murphy, Shleifer and Vishny 1993:412-13)

Naturally, kleptocrats will hurt established businesses as well, as has been demonstrated in the foregoing, but that takes a special effort, while innovative activities are hurt almost 'automatically' once the predatory administration is in place. In other words, the transaction costs related to hurting innovators tend to be lower than those arising when a predator goes after established businesses.

Innovation thus tends to be hampered in a variety of ways. Innovators have usually not had the time to establish lobbies and good

17. Decalo (1989:51). The quotation from Macías Nguema was reported by *Africa*, June 1974, p. 22.

18. af Klinteberg (1978:55).

contacts with the rulers. Hence they will be subject to particularly heavy predation. They are often credit-constrained and can ill afford to pay the necessary bribes and 'fees'. Their projects are long-term in nature, which means that predation can take place over a long period. They are also risky. The innovators may thus both have to bear the risk and be expropriated if their projects are successful. (Ibid., p. 413.) Each one of these factors easily makes a potential innovator abstain from carrying out his project.

Weak Predatory States: Breakdown of the Economy

The worst consequences of predation are sometimes found in situations where the kleptocratic regimes are weak. This may produce a total breakdown of normal economic life. The reason is that lower rents tend to be extracted when plunder is undertaken by a centralized monopolist controlling all aspects of exploitation than when unconnected specialized monopolists are at work. (Shleifer and Vishny 1993) The centralized monopolist kleptocracy takes into account that extracting rents from one type of activity may make it possible to extract more rents in other ways. It may not be enough to get a business permit to start production. Import and investment licenses may also be needed.¹⁹ From the point of view of the monopolist government these are complementary activities. Keeping the bribe for the business permit down may increase the volume of inputs that the company wants to import and hence increase the bribe revenues that may be obtained from these. It is hence the sum of the marginal revenues from these two (complementary) activities that must be

equated to the marginal cost of supplying the former good, and the same principle applies to the fixing of the bribe for import permits. This will make marginal revenues fall short of marginal costs for each activity.

Should, on the other hand, the two permits be issued by independent agencies, each one a monopolist in its field, individual marginal revenues will equal marginal costs, and less of each service will be supplied. However, the story does not end here:

The problem is made much worse in many countries by free entry into the collection of bribes. New government organizations and officials have the opportunity to create laws and regulations that enable them to become providers of additional required permits and licenses and charge for them accordingly. Having paid three bribes, the buyer of these inputs learns that he must buy yet another one if he wants his project to proceed. In some cases the officials who have collected the bribe previously come back to demand more ... In these cases, the property rights to his project are not really transferred to the buyer when he pays the bribe. The point is that even the list of the complementary inputs is not fixed, and tends to expand when profitable corruption opportunities stimulate entry. When entry is completely free, the total bribe rises to infinity and the sales of the package of government goods, as well as bribe revenues, fall to zero. (Shleifer and Vishny 1993:606)

The above would be the situation in a weak predatory state where the central authority

19. For a horror story of all steps involved in dealing with the Peruvian bureaucracy in this context, see de Soto (1986), Chapter 5.

cannot detect and police 'independent' building of monopoly empires by the bureaucrats: 'Police states, small oligarchies, and homogeneous societies are ... likely to come closer to joint bribe maximization than more open, less tightly governed and more heterogeneous societies.' (Ibid., p. 609.) Weak rulers, on the other hand, cannot stop the proliferation of 'independent' monopolies and this, in the end, tends to lead to a breakdown of the formal economy, with chaos ensuing, for at least three different reasons.

The first is the one mentioned in the quotation above: the tendency for total bribe revenues to approach zero as the demands by the predators on their prey move towards infinity. Secondly, the 'free entry' into rent-creating activities may be translated into competition with the competitors contesting each others' territories, again driving the rents towards the zero level in the process. Finally, those hit by the spiraling demands imposed by the increasing number of independent monopoly rent creators will attempt to exit from the web of the predators to avoid payment. Peasants will leave the monetary economy and lapse back into subsistence cultivation. Parallel, officially illegal, markets will arise where transactions take place outside the reach of the authorities. Smuggling will crowd legal international trade out. All this will reduce the base for rent creation.

These three mechanisms in different ways undermine the incomes of the predators, forcing the latter to resort to other – usually more direct – methods of obtaining an income: simple theft, extortion, etc., devices which tend to make the formal economy shrink even more and increase shortages, until finally a situation resembling the one prevailing in Uganda towards the end of the Amin presidency ensues, where not

only the predators but also the prey will be forced to employ unorthodox methods to survive:

In addition to the terrible shortages, everything that can be stolen is stolen. A mass of manhole covers disappeared from Mulago Hospital compound overnight; a piece of welding equipment – it must have weighed a ton or more – vanished one weekend. Telephones are prime targets – all the accessories can be used in other electronic equipment. It is almost impossible to find a public telephone in Uganda that works. In Mulago Hospital, even the microscope light bulbs and the hearing aid equipment vanish. So do linen, spoons, cups and plates.

Tires and other accessories are stolen off cars. (Kyemba 1977:139)

Another example comes from the last years of Mobutu's Zaire, where the president had lost control of the provinces and the economy was rapidly moving towards the abyss. An article in a United Nations publication summarizes the situation in the mid-1990s:

Zaire today faces the stark reality of collapsing economy, deepening poverty, growing hunger, pervasive mismanagement and rising ethnic tensions. These difficulties have been aggravated by a six-year political stalemate between supporters and opponents of President Mobutu Sese Seko which has delayed the process of democratization... (Collins 1996:14)

The formal economy had shrunk drastically and such infrastructural facilities as sanitation, transport, and communications had more or less ceased to exist. The economy

had shrunk more than 40 percent since 1988 and between 1989 and 1993 recorded exports were cut in half and imports fell by 75 percent. The *World Development Report* stopped reporting Zairian statistics, since these ceased to have anything to do with reality. The conflicts which had been tearing the country apart since 1990 had resulted in a wholesale destruction of assets through looting and rioting (not least by unpaid soldiers) which was estimated to be in the order of one-fourth of GDP. The public sector was virtually bankrupt and informal economic activities dominated the picture. Four-fifths of all Zairians were dependent on them for their survival. Inflation increased from 20 percent in 1989 to 6,000 percent in 1994.²⁰

When chaos spreads in the economy, the loyalty of citizens towards the ruler decreases. In that situation it is a classic mistake not to increase the amount of repression to ensure that the population remains loyal. Otherwise the probability that he is thrown out of office may increase drastically. (Wintrobe 1990: 858-60) However, this is precisely what weak rulers cannot do. Thus, economic chaos frequently signals the end of the period at the flesh pot, as it did in the cases of Idi Amin, Francisco Macías Nguema,²¹ Jean-Bedel Bokassa,²² Raoul Cédras in Haiti²³ and Mobutu in Zaire.

Conclusions

Rent creation takes on a wide variety of forms in the predatory state. Presently, we have dealt only with a limited number of them. There are, however, plenty more where they

came from. What these mechanisms have in common is that they use resources to redistribute income and wealth without creating any goods or services that are demanded by the general citizen. This is accomplished by interference with the market mechanism which means that resources will not be allocated optimally, either within the private sector or within government. Unproductive activities will drive productive ones out. Prices will be distorted and provide the wrong information with respect to relative scarcity to the agents of the economy. Within each sector less is produced with a given factor endowment. The investment volume shrinks, including that of human capital, and whatever investment there is will be directed towards the wrong activities. Labor will emigrate. Technological change will be retarded.

The worst consequences are frequently found when the predatory regimes are weak. The lack of control over activities and over the physical territory then easily produces chaos and a more or less total breakdown of the formal economy and hence, fortunately, brings about the end of predatory rule itself. On the contrary, as Gordon Tullock has pointed out, 'revolutions' tend to be carried out by people who are close to the incumbent ruler and who are likely to make large personal gains by toppling him. (Tullock 1974:Chapter 5) More often than not they will be predators as well. The history of the predatory state is not an easy one to change. Large shocks may be necessary, and the pressure may have to come from outside. (Gunnarsson and Lundahl 1996:272-75) The international community may have to

20. Ibid. For more details, see Emizet (1996).

21. See af Klinteberg (1978), p. 14, Decalo (1989:55-57), Sundiata (1990:91, 150).

22. Cf. Decalo (1989:158-59).

23. See Lundahl (1996).

face the responsibility if long, drawn-out episodes of governmental plunder are to be avoided in the future.

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