CORRUPTION (WITH A HIERARCHY)

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Abstract

We gain access inside a traffic police battalion to analyze the economics of corruption organized in a hierarchy. We show that the hierarchical component of corruption determines the scope of corruption, mitigates the effect of state officials' changes in income on corruption, and is costly for society. Corruption is vertically organized as follows: the commanders enable street-level agents to collect bribes as private revenue. In exchange, the agents occasionally make financial transfers and, most importantly, escort an agreed number of drivers every day to the police station for the commanders to take bribes—a system they refer to as the "quota system." The bribes collected by commanders through this quota system constitute 75% of total bribe revenue. Using a simple contracting model, we confirm that this quota system is consistent with corruption profit maximization, and examine two predictions. First, vertically organized corruption mitigates the effect of income shocks: experimentally doubling the transitory income of street-level police agents, we find that commanders take 29% of their extra income, dampening the effect of extra income in half. Second, the quota system—the central tool of vertically organized corruption in this context—reduces public service and driver welfare, which we find by experimentally reducing the daily quotas across intersection/days. The findings emphasize the scope of the vertical organization of corruption, suggest that changing the income of state officials to curb corruption could potentially be ineffective in the presence of a corrupt hierarchy, and that the main cost of corruption for society may stem from the contracts that sustain its vertical organization. **JEL Codes:** D23, O1, K42, L33, D73

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