

The Dark Side of Private Ordering: An Institutional and Empirical Analysis of Organized Crime

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This Article provides theoretical and empirical support for the claim that organized crime competes with the state to provide property rights enforcement and protection services. Drawing on extensive data from Japan, this Article shows that, like firms in regulated environments everywhere, the structure and activities of organized criminal firms are significantly shaped by state-supplied institutions. Careful observation reveals that in Japan, the activities of organized criminal firms closely track inefficiencies in formal legal structures, including both inefficient substantive laws and a state-induced shortage of legal professionals and other rights-enforcement agents. Thus, organized crime in Japan—and, by extension, in other countries where significant gaps exist between formal property rights structures and state enforcement capacities—is the dark side of private ordering.

Regression analyses show negative correlations between membership in Japanese organized criminal firms and (a) civil cases, (b) bankruptcies, (c) reported crimes, and (d) loans outstanding. Professors Milhaupt and West interpret these data to support considerable anecdotal evidence that members of organized criminal firms in Japan play an active entrepreneurial role in substituting for state-supplied enforcement mechanisms and other public services in such areas as dispute mediation, bankruptcy and debt collection, (unorganized) crime control, and finance. They offer additional empirical evidence indicating that arrests of gang members do not curb the growth of organized criminal firms. Their findings may have a significant normative implication for transition economies: efforts to eradicate organized crime should focus on the alteration of institutional incentive structures and the stimulation of competing rights-enforcement agents rather than on traditional crime-control activities.

Organized crime is flourishing. It thrives in transition economies; it persists in developed nations; it prospers under globalization. Criminal groups may control 40 percent of the Russian economy, for example.¹ In Japan, the influence of organized crime extends from prostitution to golf course development, from banking and securities

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¹ Louise Shelley, *Paying the Price*, *The Russian* 14 (Apr 1997).

to disaster relief.² In the United States, mob developments continue to make front-page headlines.³ In recognition of the severity of the problem, both the United Nations and the G8 have begun to devote resources to combating international organized crime.⁴

Why does organized crime emerge, and what function does it play in an economy? Despite a growing recognition of the vulnerability of developing societies and emerging democracies to this problem, and continued study of the phenomenon in mature economies, no consensus exists even on the definition of organized crime,⁵ much less on the

² See, for example, Henry Sender, *Mafia Capitalism: Just the Tip of the Iceberg?*, Japan J 25 (1991).

³ See, for example, Raymond Bonner with Timothy L. O'Brien, *Activity at Bank Raises Suspicions of Russian Mob Tie*, NY Times A1 (Aug 19, 1999); Joseph Berger, *Gotti Pleads Guilty to Rackets Charges on Eve of His Trial*, NY Times A1 (Apr 6, 1999).

⁴ See M. Cherif Bassiouni and Eduardo Vetere, eds, *Organized Crime: A Compilation of U.N. Documents 1975–1998* (Transnational 1998); Diane Coyle, *The Dark Side of Globalisation Where the Black Economy Thrives: Diane Coyle on Why the G8 is Worried About Crime*, The Independent 24 (May 14, 1998).

⁵ Academic definitions abound. One leading organized crime text defines organized crime merely as “a nonideological enterprise that involves a number of persons in close social interaction, organized on a hierarchical basis for the purpose of securing profit and power by engaging in illegal and legal activities.” Howard Abadinsky, *Organized Crime* 7 (Nelson-Hall 2d ed 1985); another posits that “[o]rganized criminal groups are simply business organizations operating under many different management structures and dealing in illegal products.” Denny F. Pace and Jimmie C. Styles, *Organized Crime: Concepts and Control* 21 (Prentice-Hall 2d ed 1983). Richard Posner defines organized crime as “criminals organized into illegal firms . . . operating in such criminal fields as loansharking, prostitution, gambling, and narcotics but also in legitimate fields as well, and employing violence and the corruption of police as key business methods.” Richard A. Posner, *Economic Analysis of Law* 242 (Little, Brown 4th ed 1992). Diego Gambetta describes the Italian mafia as “that set of firms which (1) are active in the protection industry under a common trademark with recognizable features; (2) acknowledge one another as the legitimate suppliers of authentic mafioso protection; and (3) succeed in preventing the unauthorized use of their trademark by pirate firms.” Diego Gambetta, *The Sicilian Mafia: The Business of Private Protection* 155 (Harvard 1993).

Policy-makers likewise disagree. Since 1992, the United Nations Economic and Social Council Commission on Crime Prevention and Criminal Justice has struggled without success toward a definition. See M. Cherif Bassiouni and Eduardo Vetere, *Towards Understanding Organized Crime and its Transnational Manifestations*, in Bassiouni and Vetere, eds, *Organized Crime: A Compilation of U.N. Documents 1975–1998* xxvii (cited in note 4) (distinguishing organized crime from other criminal groups and legitimate enterprises occasionally employing criminal means). In the U.S., the Racketeer-Influenced and Corrupt Organization Act (RICO), Organized Crime Control Act of 1970, Pub L No 91-452, 84 Stat 941, codified at 18 USC §§ 1961–68 (1994), the primary legal weapon against organized crime in the United States, contains no clear definition of its target. Although it initially included an amendment that would have criminalized membership in the “Mafia” or “La Cosa Nostra,” see Organized Crime Control Act of 1970, S 30, 91st Cong, 2d Sess (Oct 7, 1970), in 116 Cong Rec H 35343 (Oct 7, 1970) (amendment proposed by Representative Biaggi), the amendment was eventually rejected, both on the grounds that it violated the Equal Protection Clause, and because it was an underinclusive definition of organized crime. Id at H 35344–46. See also Gerard E. Lynch, *RICO: The Crime of Being a Criminal, Parts I & II*, 87 Colum L Rev 661, 685–86 (1987) (discussing the constitutional and political drawbacks of criminalizing “mafia” membership only); Gerard E. Lynch, *RICO: The Crime of Being a Criminal, Parts III & IV*, 87 Colum L Rev 920, 937–45 (1987) (discussing “the enterprise

more theoretically fundamental and practically significant questions. Without a richer understanding of the phenomenon, organized crime will continue to thrive because the roots of the problem will remain unexposed.

This Article draws on new institutional economics literature and extensive empirical analysis to show that the structure and activities of organized criminal groups are significantly shaped by the state. Organized crime, we argue, is the dark side of private ordering—an entrepreneurial response to inefficiencies in the property rights and enforcement framework supplied by the state.

A substantial literature has exposed the bright side of private ordering.⁶ Many scholars have shown that over a wide range of human activity, informal norms provide efficient and effective mechanisms to govern conduct. Occasionally a commentator will note that not all private ordering arrangements result in efficient norms, or that private ordering is subject to the same collective action problems that plague formal lawmaking processes.⁷ These cautionary asides in the literature, however, are rare and have never been developed into a robust theory of the organized, private exploitation of defects in state structures. We seek to provide analytical and empirical support for such a theory by focusing on a simple fact: in order to be effective, private ordering often requires the participation of intermediaries who possess information, time, and skill—intermediaries we refer to as rights-enforcement agents and information agents. In the United States, these roles are typically filled by lawyers or other organized professionals, who, to borrow Ronald Gilson's famous phrase, function as "transaction cost engineers."⁸ When property rights and enforcement institutions are

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⁶ See, for example, Robert C. Ellickson, *Order Without Law: How Neighbors Settle Disputes* 280–83 (Harvard 1991) (concluding that value maximizing norms, not law, are central to social order); Mark D. West, *Legal Rules and Social Norms in Japan's Secret World of Sumo*, 26 J Legal Stud 165, 187 (1997) (demonstrating that private rules and norms can effectively be used to maximize wealth); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J Legal Stud 115, 157 (1992) (arguing that private dispute resolution in the diamond industry is superior to recourse to the legal system); Robert Cooter and Janet T. Landa, *Personal Versus Impersonal Trade: The Size of Trading Groups and Contract Law*, 4 Intl Rev L & Econ 15, 21–22 (1984) (arguing that trading groups are a response to inefficient legal structures).

⁷ See Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U Pa L Rev 1643, 1678–94 (1996) (describing "community failures"). See also Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U Pa L Rev 1697, 1698, 1705–10 (1996) (providing examples of inefficient norms).

⁸ See Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 Yale L J 239, 255 (1984) (arguing that "[l]awyers function as *transaction cost engineers*, devising efficient mechanisms which bridge the gap between capital asset pricing theory's hypothetical world of perfect markets and the less-than-perfect reality").

misaligned, however, these agents may emerge from sources operating outside the bounds of established legal and social norms. Illicit entrepreneurs, then, substitute for state-supplied or state-sanctioned public services, especially as alternative enforcers of property rights. This “dark-side private ordering,” heretofore overlooked by theorists, provides a convincing explanation for the emergence and role of organized crime in both developed and developing economies.

To explore the linkage between state-sponsored institutions and illicit organizations, we provide an in-depth theoretical and empirical analysis of organized crime in Japan. Although caution is warranted when drawing general conclusions from the experience of a single country, Japan provides unusually fertile ground for such a study. Private ordering is often seen as a key component of Japanese policy success in such diverse areas as crime prevention, civil dispute resolution, and labor relations.⁹ Counterintuitively, however, Japan shares important parallels with transition economies: it has an institutional environment rife with incentives for the creation of alternative (illicit) enforcement mechanisms and a very active network of organized criminal groups.¹⁰ Yet unlike virtually any other country, Japan also provides a wealth of relevant but unexplored data on organized crime.¹¹ As explored below, the Japanese experience offers insights into organized crime in environments as diverse as Russia and Sicily.

Multiple regression analysis of the data from Japan supports substantial anecdotal evidence that members of organized crime in that country play an active entrepreneurial role in substituting for state-supplied property rights and enforcement mechanisms in such areas as dispute mediation, real estate foreclosure, corporate monitoring, lending, and (unorganized) crime control. We offer additional empirical evidence suggesting that the success of organized crime prevention may rest more heavily on the design of state-supplied institutions than on traditional anti-crime strategies. Our empirical analysis thus supports a significant normative claim: To combat organized crime most

⁹ See, for example, John Owen Haley, *The Spirit of Japanese Law* 38, 79, 134–39, 199 (Georgia 1998).

¹⁰ See *Twelve Percent of Japanese Consider Mobsters a “Necessary Evil”*, Agence France Presse (Apr 19, 1993) (“According to the Japanese police, the criminal underworld numbers about 90,000 members in 3,300 gangs.”).

¹¹ U.S. data on organized crime is surprisingly sparse. See, for example, David J. Fried, *Rationalizing Criminal Forfeiture*, 79 J Crim L & Criminol 328, 360–61 n 146 (1988) (noting “extreme scantiness and unreliability of the data available” and “extreme uncertainty of the data” about income attributable to crime). Data on U.S. street gangs vary widely as well. See, for example, G. David Curry, Richard A. Ball, and Robert J. Fox, *Gang Crime and Law Enforcement Record Keeping*, National Institute of Justice Research in Brief 1 (June 1994) (detailing problems in definitions, recording, and reporting of gang-related information).

effectively, a state should alter its institutional incentive structure and introduce additional rights-enforcement agents.

Although we rely on the Japanese experience for data, our discussion has more universal import. The state acts as an institutional designer¹² in any economy, determining, among other things, which business activities will be criminalized and which will be actively encouraged. How the state performs in this capacity affects not only the development of legitimate organizations, but of illicit ones as well. In the spectrum of property rights structures and regulated business activities, Japan lies between the United States and more heavily state-controlled systems such as the former Soviet Union.¹³ Each of these systems features its own brand of organized crime, reflecting the institutional environment in which it evolved.¹⁴ The universal point emerging from our study is that where the state fails to get the institutions “right,” it invites dark-side private ordering to fill in the gaps.¹⁵

¹² Masahiko Aoki, *The Japanese Firm as a System of Attributes: A Survey and a Research Agenda*, in Masahiko Aoki and Ronald Dore, eds, *The Japanese Firm: The Sources of Competitive Strength* 11, 30 (Oxford 1994).

¹³ Curtis J. Milhaupt, *Property Rights in Firms*, 84 Va L Rev 1145, 1166, 1177–78 (1998) (arguing that Japan occupies a middle ground with respect to property rights and regulatory policy between the U.S. and South Korea).

¹⁴ In the U.S., organized criminal firms—the mafia among others—have traditionally operated in black market and gray market activities, selling commodities and services that consumers want but that the state declares illegal (creating black markets for drugs or alcohol during Prohibition) or prices out of the market by inefficient regulation (creating gray markets in the garment or transportation industries). Organized crime firms flourished in Nevada until prostitution was legalized, and all over the U.S. under the Volstead Act during Prohibition. See, for example, Humbert S. Nelli, *The Business of Crime: Italians and Syndicate Crime in the United States* 143–78 (Oxford 1976) (describing the crime syndicates that flourished in the wake of the Eighteenth Amendment).

In the former Soviet Union, the state regulated virtually all economic activity through direct participation in the planning and production processes. Because so much economic activity was so heavily regulated, the activities of criminal firms in the Soviet Union were indistinguishable from the activities of firms that we would consider to be legitimate businesses in well functioning capitalist economies. See, for example, Stephen Handelman, *Comrade Criminal: Russia's New Mafiya* (Yale 1995) (noting that organized crime in the former Soviet Union controlled trade in “spare parts, automobiles, timber, caviar, and gems”). In post-Soviet Russia, organized crime filled the vacuum created by the disintegration of state control. See Louise I. Shelley, *Post-Soviet Organized Crime: A New Form of Authoritarianism*, 2 *Transnational Organized Crime* 122 (1996). As will be shown below, Japanese organized crime plays a role somewhere between that of its counterparts in the United States and Russia: neither operating exclusively in illegal territory nor substituting for a dysfunctional state apparatus.

¹⁵ Organized crime is more limited in the U.S. because the U.S. never went through the type of “overnight” property rights transformations that occurred in Japan and Russia. These rapid property rights developments created greater opportunities to exploit inefficiencies in state structures. Some systems compound the problem of weak property rights enforcement with weak government, which leads to public corruption rather than to privately organized crime. See Andrei Shleifer and Robert W. Vishny, *Corruption*, 108 Q J Econ 599, 615 (1993) (concluding that a weak central government facilitates corrupt agencies and bureaucracies).

To gain a better understanding of the role of organized crime in an economy, we adopt two heuristics. First, we use the term “organized criminal firms” to emphasize the fundamentally entrepreneurial role of organized crime. Second, as more fully developed below, we characterize the private enforcement activities of organized criminal firms as “illicit entrepreneurialism” because it takes place outside the bounds of state ordering, in the shadow of violence.

The Article proceeds as follows. In Part I, we survey the theory of organized crime, which is characterized by lack of agreement on fundamental principles and a shortage of empirical grounding. In Part II, we illustrate the close linkage between rights enforcement and organized crime in Japan in such areas as bankruptcy, property, debtor-creditor relations, and corporate law. Part III presents a formal model to test empirically the relationship between state institutions and illicit entrepreneurialism in Japan. Our regression analysis results are consistent with the theory that organized criminal firms in Japan substitute for state institutions in such key areas as dispute resolution, crime control, and finance. Part IV examines the implications of the Japanese experience and applies those lessons to economies in transition.

I. ORGANIZED CRIME THEORY

The literature on organized crime displays a marked lack of consensus on fundamental issues. As noted above, there is little agreement even on a definition of organized crime, less still on the question of why the phenomenon exists. The result, as one commentator notes, “is a patchwork of ideas, only loosely related to each other and having little consequence for empirical research.”¹⁶

Economic theory has traditionally emphasized the monopoly that organized crime enjoys over illegal products and services. Thus, criminals organize themselves into firms for the same reasons that “legitimate” firms organize: to reap economies of scale or monopoly rents.¹⁷ Organized criminal firm monopolies tend to arise in the same ways as traditional monopolies—economies of scale may dictate that only one firm can effectively serve the market, small producers may merge, and barriers to entry may be created by government regulation and re-

¹⁶ Peter Reuter, *Research on American Organized Crime*, in Robert J. Kelly, Ko-Lin Chin, and Rufus Schatzberg, eds, *Handbook of Organized Crime in the United States* 91, 110 (Greenwood 1994).

¹⁷ Thomas C. Schelling, *Choice and Consequence* 162 (Harvard 1984).

strictions.¹⁸ The primary means for achieving success, economists hold, is extortion.¹⁹

Sociological literature, by contrast, traditionally has focused on the cultural or ethnic linkages that dictate the structure and cohesiveness of organized crime groups, largely bypassing the more fundamental question of why such groups emerge. More recently, sociologists have argued that the primary market for organized crime services is in “unstable transactions in which trust is scarce and fragile,”²⁰ and, more generally, that organized criminal firms arise in societies characterized by a lack of trust.²¹ Thus, for example, the rise in organized crime in Eastern Europe and Russia is explained as an outgrowth of Communism, which is said to have systematically destroyed trust in government.²²

Neither approach, however, is wholly satisfying. First consider the sociologists’ recent fascination with trust. Many of the services that organized criminal firms offer around the world involve not risky black or gray market transactions, but intervention in transactions that ought to be “stable,” in that they are formally supported by the legal system—debt collection or labor dispute resolution, for example. Even more damaging to the proposed correlation between low trust and organized crime is the case of Japan, which no sociologist has managed to explain. Japan has extensive organized crime, yet Japan’s social system is widely viewed as founded on trust. Francis Fukuyama, for instance, defines Japan as a “high-trust society” in which social capital is in abundant supply.²³ Cross-country empirical analyses of trust confirm

¹⁸ See John E. Kwoka, Jr. and Lawrence J. White, eds, *The Antitrust Revolution: Economics, Competition, and Policy* 9–10 (Oxford 3d ed 1999).

¹⁹ See Schelling, *Choice and Consequence* at 160–61 (cited in note 17) (stating that extortion and criminal monopoly are the two types of businesses comprising racketeering).

²⁰ Gambetta, *The Sicilian Mafia* at 17 (cited in note 5). See also Donald Black, *Crime as Social Control*, 48 *Am Soc Rev* 34 (1983).

²¹ Gambetta, *The Sicilian Mafia* at 77 (cited in note 5). See also Diego Gambetta, *Mafia: The Price of Distrust*, in Diego Gambetta, ed, *Trust: Making and Breaking Cooperative Relations* 158, 158 (Basil Blackwell 1988).

²² See, for example, Federico Varese, *Is Sicily the Future of Russia? Private Protection and the Rise of the Russian Mafia*, 35 *Archives Européennes de Sociologie* 224, 225–26, 257–58 (1994).

²³ Francis Fukuyama, *Trust: The Social Virtues and the Creation of Prosperity* 26–28 (Free Press 1995). On the relationship of trust and social capital to institutions, see James S. Coleman, *Foundations of Social Theory* 300–06 (Belknap 1990) (arguing that social capital determines performance of societal institutions); Robert D. Putnam, *Making Democracy Work: Civic Tradition in Modern Italy* 174–76, 184–85 (Princeton 1993) (same, focusing on differences between Northern and Southern Italy); Rafael La Porta, et al, *Trust in Large Organizations*, 87 *Am Econ Rev* 333, 337 (1997) (using World Values Survey data to show that “theories of trust hold up remarkably well when tested on a cross section of countries”).

that characterization and generally cast doubt on the utility of mistrust as a key explanatory variable in the origins of organized crime.²⁴

Turn now to the traditional economic approach. Theorists have cast doubt both on the idea that organized crime relies primarily on extortion, and that monopoly is the best concept to understand the activities of organized criminals. In the past several years, observers have begun to change their perspective on the services provided by organized criminals and the relationship between organized crime and the state. Focusing on Sicily, for example, Diego Gambetta argues that organized criminals deal not in extortion, but in protection, including the protection of contracts in the form of dispute settlement.²⁵ Even more interestingly, he argues that rather than being a monopoly, organized crime competes with the state to provide this service.²⁶

This recent turn in the literature is intriguing on several levels. First, it is consistent with an extensive body of literature emphasizing the entrepreneurial nature of organized crime and thus the general applicability of economic principles to firms engaged in illicit as well as legitimate activities.²⁷ Second, it implicitly suggests that the state's

²⁴ See, for example, World Values Study Group, World Values Survey, 1981–1984 and 1990–1993 (ICPSR 6160) (1994), available online at <<http://www.icpsr.umich.edu/cgi-bin/archive/prl?path=ICPSR&num=6160>> (visited Nov 6, 1999) (covering 45 countries, 379 variables, and nearly 90,000 survey respondents). The survey reports responses to the question, “Generally speaking, would you say that most people can be trusted or that you can’t be too careful in dealing with people?” According to our calculations, 52.5 percent of Japanese respondents answered that “you can’t be too careful,” compared with 47.4 percent in the U.S., a mere 30.6 percent in Sweden, and relatively high 58.0 percent, 60.2 percent, and 61.9 percent figures in Russia, Mexico, and Italy, respectively. Although some general conclusions might be drawn from the high distrust in Italy and other countries that are often said to be plagued by organized crime, Japan’s lower figure is more comparable to that of the U.S.

A recent study of World Values Survey data for twenty-three market economies finds greater evidence of trust in Japan. Stephen Knack and Philip Keefer examined what they term “trustworthiness,” as measured by responses to questions on civic cooperation. Across societies, they found (unsurprisingly) positive correlations between trust and trustworthiness. Although Japan has relatively low “trust” scores, they found trustworthiness in Japan to be the third highest in the survey, well ahead of the Scandinavian countries and the U.S. Italy placed above the U.S. as well. Stephen Knack and Philip Keefer, *Does Social Capital Have an Economic Payoff? A Cross-Country Investigation*, 112 Q J Econ 1251, 1258–59, 1285 (1997). Compare Toshio Yamagishi, et al, *Uncertainty, Trust and Commitment Formation in the United States and Japan*, 104 Am J Soc 165 (1998) (finding statistically significant evidence that the level of general trust is higher in the U.S. than in Japan); Toshio Yamagishi, *Shinrai no Kōzō* [*The Anatomy of Trust*] 64–66 (Tokyo 1998) (noting differences between natural trust (“lovers’ commitment”) and strategic trust to reduce transaction costs (“yakuza commitment”)).

²⁵ Gambetta, *The Sicilian Mafia* at 16–19 (cited in note 5). See Barbara Alexander, *The Rational Racketeer: Pasta Protection in Depression Era Chicago*, 40 J L & Econ 175, 184–85, 198 (1997) (arguing that the actual Depression era pasta racket in Chicago stands “in sharp contrast to Hollywood portrayals that depict gangsters as crude extortionists”).

²⁶ See Gambetta, *The Sicilian Mafia* at 80 (cited in note 5).

²⁷ In two influential articles, Thomas Schelling proposed that market structures and economic principles generally applicable to all forms of organization apply to illegal markets con-

institutional structure supplies incentives for illicit firms just as it does for legitimate enterprises; thus, firm adaptation is the central problem of economic organization in illegal as well as legal markets.²⁸ Finally, the stylized histories of regions as diverse as post-feudal Sicily and post-Soviet Russia, which Gambetta and others rely upon in developing their arguments, contain interesting parallels with Japanese history, suggesting that societies currently experiencing significant organized crime problems began from a common starting point.²⁹ Even the U.S. experience with organized crime suggests a linkage between ineffective or ill-advised state structures and organized criminal activities.³⁰

Institutional analysis—properly informed by empirical research—is a way to unite the insights provided by existing approaches to organized crime. As Gambetta posits with his theory of substitutes for state enforcement, and implicit in the economic ideas of firm organization, organized criminal firms often arise shortly after the historical establishment of formal property rights regimes.³¹ Post-feudal Japan, for instance, like post-feudal Italy and post-Soviet Russia, is characterized by dramatic increases in formal property rights. Similar to these other countries, post-feudal Japan also is characterized by a weakness of complementary enforcement mechanisms.³² The Japanese transition out of feudalism left a void for private transaction-makers and rights-enforcers that was filled by a hodgepodge of groups, which

trolled by organized criminal firms. Thomas C. Schelling, *What is the Business of Organized Crime?*, 20 J Pub L 71 (1971), reprinted in Schelling, *Choice and Consequence* 179, 182–83 (cited in note 17); Thomas C. Schelling, *Economics and Criminal Enterprise*, 7 Public Interest 61 (1967), reprinted in Schelling, *Choice and Consequence* 158, 162–64. More recently, scholars added to Schelling's governance-structure analysis by applying transaction cost analysis to organized criminal firms. See Annelise Anderson, *Organized Crime, Mafia and Governments*, in Gianluca Fiorentini and Sam Peltzman, eds, *The Economics of Organized Crime* 33, 42–47 (Cambridge 1995); Andrew R. Dick, *When Does Organized Crime Pay? A Transaction Cost Analysis*, 15 Intl Rev L & Econ 25 (1995).

²⁸ For a discussion of firm adaptation in licit markets, see F.A. Hayek, *The Use of Knowledge in Society*, 35 Am Econ Rev 519, 527 (1945).

²⁹ See, for example, Handelman, *Comrade Criminal* (cited in note 14) (containing a history of organized crime in Russia); Oriana Bandiera, *Competing for Protection: Land Fragmentation and the Rise of the Sicilian Mafia* (unpublished manuscript dated July 1, 1999) (noting rise of mafia in nineteenth-century transition from feudalism to capitalism).

³⁰ See, for example, Dennis Hevesi, *New Home Costs Found Highest in New York*, NY Times B1 (July 28, 1999) (reporting on study finding “arcane and byzantine” zoning and building codes and organized crime infiltration of labor unions and construction companies to be significant contributing factors to New York City's high home building costs).

³¹ See Gambetta, *The Sicilian Mafia* at 77–81, 252 (cited in note 5) (describing the social circumstances that gave rise to the mafia and arguing that property rights come with a desire to protect those rights with force when necessary).

³² See Philip C. Brown, *'Feudal Remnants' and Tenant Power: The Case of Niigata, Japan, in the Nineteenth and Early Twentieth Centuries*, 15 Peasant Stud 5, 7–10 (1987) (discussing property redistribution techniques such as rent determination and field allocation).

in Japan included an amalgam of disenfranchised samurai, hoodlums, and poor peasants. This mismatch between property rights and enforcement mechanisms leads to organized crime—the dark side of private ordering. In order to develop and provide empirical support for this emergent view of organized crime, we thus focus on the institutional environment that provides fertile ground for illicit entrepreneurialism.

Although there is nothing inherently “illicit” about private ordering, there are several reasons to be concerned about the particular brand of entrepreneurialism discussed in this Article. First, the “legitimate” activity of organized criminal firms is often used to launder income from illegal activities and to hide it from tax officials.³³ Second, the activities of organized criminal firms are often accompanied by the threat or use of violence.³⁴ Third, as a growing body of theoretical literature suggests, private and segmented enforcement of property rights can lead to the entrenchment of small-scale inefficient monopolies, high transaction costs, and a “tragedy of coercion” in which savings from the provision of collective services are dissipated in contests both among firms and between firms and the state.³⁵ Finally, regardless of efficiency concerns, private ordering by organized criminal firms is qualitatively different from conventional private ordering by contract or arbitration. While both avoid resort to governmental institutions, only the latter operates within constraints that are *inherently* legal, because they are legitimized by the same political theory that supports the governing order generally.³⁶ Similarly, while the activities of both organized criminal groups and the state are backed by coer-

³³ See, for example, Kazuaki Morimoto, *Mane-Rōndaringu Kisei no Igi to Dōkō* [Trends in and Significance of Money Laundering Regulation], 1543 *Kin'yū Hōmu Jijō* 6, 9–10 (1999); Hisao Katoh, *Prohibition of the [sic] Money Laundering as a Countermeasure Against Organized Crime Groups (Yakuza or Boryokudan) in Japan*, 7 *Keio L Rev* 21, 34–37 (1994).

³⁴ See A. Mitchell Polinsky and Steven Shavell, *The Economic Theory of Public Enforcement of Law*, National Bureau of Economic Research Working Paper Series No 6993, 3–4 (Mar 1999) (arguing that private enforcement of the law would require force to “gather information, capture violators, and prevent reprisal,” but that the state generally does not want to allow private parties to use such force). See also William M. Landes and Richard A. Posner, *The Private Enforcement of Law*, 4 *J Legal Stud* 1, 31–33 (1975) (discussing inefficiency of allocating criminal law enforcement to private actors). Compare Gary S. Becker and George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 *J Legal Stud* 1, 16–17 (1974) (suggesting that the quality of law enforcement can be improved by “raising the salaries of public enforcers . . . [and] paying private enforcers for performance, or on a piece-rate basis”).

³⁵ Þráinn Eggertsson, *Economic Behavior and Institutions* 36 (Cambridge 1990); Kai Konrad and Stergios Skaperdas, *The Market for Protection and the Origin of the State*, Centre for Economic Policy Research Discussion Paper No 2173 (June 1999) (on file with authors). See also Serguey Braguinsky, *Enforcement of Property Rights During the Russian Transition: Problems and Some Approaches to a New Liberal Solution*, 28 *J Legal Stud* 515 (1999).

³⁶ We are grateful to Gerard Lynch for this insight.

