The Threat of Violence, Agency Cost and Social Norms in a Moral Hazard Setting.

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The threat of violence as a tool of political economy has a direct and an indirect effect. The direct effect is that of inducing the opponent into using rare resources to defend his position. The indirect effect is the necessity of maintaining control or social cohesion in the face of violence, in particular maintaining support for policies designed to address threat. Both effects would in principle have an impact on economic growth. The direct effect is self explaining. The impact may be positive or negative depending on the multiplier effects of defence spending on the economy.

The impact of the secondary effect can be expressed in two overlapping but not identical processes. The first is that of increase in risk and the way this is diversified both at the individual and the collective level. The second is that of an increase in transaction and agency costs. The threat of violence affects the incentives under which contractual relationships are agreed upon and are monitored in an economy.

Both effects would give rise for vested interest to develop around a climate of violence. The direct effect would imply an accumulation of human and organizational capital and hence a population of voters that would depend on the particular climate to continue for their economic well being. The secondary effect would also lead to the same phenomenon if the support of anti violence policies by the population at large would require some form of compensation. It is this particular effect that is the object of this paper.

The compensation envisaged is not directly pecuniary, but pecuniary effects appear through the adoption of a social norm. The social norm affected is deemed to be the level of liability inherent in a moral hazard problem of monitoring economic transactions. This can be viewed as a form of loose budget constraints, where the degree of laxity in imposing contracts is a political requirement for policy support.

A principal has to choose between expenditure that comes out of his rent to reduce the level of threat and increasing the rent he shares with the agent when limited liability is present, both being risk neutral. The expected level of growth depends on the agent’s effort. The aggressor wishes to reduce the rate of growth of the principals economic well being, amongst other reasons because there will be fewer resources to contest his threat. An increase in the level of threat increases the level of limited liability in transactions. Thus a trade of appears for the principal between reducing the agents receipts by reducing the level of threat or accepting higher agency costs while reducing threat containment expenditure.