



## **The problem of blackmail: a critique of Coase, and the case for blackmail markets**

F.E. Guerra-Pujol

*Barry University Dwayne O. Andreas School of Law*

Correspondence address: [eguerra@mail.barry.edu](mailto:eguerra@mail.barry.edu)

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### **Abstract**

Although Coase (1988) is correct to point out the pervasive nature of blackmail in the process of exchange, his feeble attempt to distinguish between “blackmail incidental to a business relationship” and “ordinary blackmail” is off the mark for several reasons. First, the practice of blackmail is just another example of bilateral monopoly, regardless of the setting in which it takes place. Second, Coase’s condemnation of blackmail is based on non-falsifiable moral intuitions. And thirdly, the problem of blackmail is reciprocal in nature: the victim of blackmail is just as much a cause of the problem as the blackmailer is. The author concludes the paper by proposing the creation of “blackmail markets.”

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## THE PROBLEM OF BLACKMAIL: A CRITIQUE OF COASE, AND THE CASE FOR BLACKMAIL MARKETS

F.E. GUERRA-PUJOL<sup>1</sup>

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“Treason doth never prosper, what’s the reason? For if it prosper, none dare call it treason.”<sup>2</sup>

Practices indistinguishable from blackmail, although not called by that name, are permitted in areas of conduct where the law is enforced privately rather than publicly.<sup>3</sup>

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### INTRODUCTION

Although the epigram quoted above refers to the high crime of treason, it applies equally to the problem of blackmail, for while there are few reported cases of blackmail on the law books, the problem of blackmail is far more common than most commentators are willing to concede. In fact, blackmail—broadly defined as a transfer of resources from *A* to *B* in return for *B*’s not carrying out a threat—is part and parcel of the process of exchange. But it is precisely because blackmail, thus defined, is so common that none dare call it “blackmail.”<sup>4</sup> Although there is extensive literature on the law of blackmail, in this paper, we take a non-normative approach to the problem of blackmail.<sup>5</sup> First, we argue that blackmail is fundamentally a problem of bilateral monopoly: just as the victim must deal with blackmailer, the blackmailer must deal with the victim. Next, we explain why the problem of blackmail is “reciprocal [in] nature.”<sup>6</sup> Lastly, we propose the creation of “blackmail markets” for the acquisition and transfer of legal rights to secrets.

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<sup>1</sup> Associate Professor, Barry University Dwayne O. Andreas School of Law. The author is sincerely grateful to Professor Lee Benham for bringing Coase’s 1987 lecture to his attention during the 2005 Ronald Coase Workshop in Barcelona, Spain. In addition, thanks to Salvador Antonetti, Elodie Bertrand, and Carlitos del Valle for helpful comments on a previous draft of this paper.

<sup>2</sup> THE OXFORD DICTIONARY OF QUOTATIONS 362 (Elizabeth Knowles ed., Oxford University Press 1999) (1991) (quoting John Harrington).

<sup>3</sup> Richard A. Posner et al., *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. LEGAL STUD. 83, 83-128 (1978).

<sup>4</sup> See, e.g., MIKE HEPWORTH, *BLACKMAIL: PUBLICITY AND SECRECY IN EVERYDAY LIFE* 20 (Routledge & Kegan Paul) (1975).

<sup>5</sup> See, e.g., Walter Block, *The Legalization of Blackmail: A Reply to Professor Gordon*, 30 SETON HALL L. REV. 1182, 1182-1223 (2000).

<sup>6</sup> Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 1-2 (1960).



## I. BLACKMAIL AND BILATERAL MONOPOLY

In the timeless words of Adam Smith, “the propensity to truck, barter, and exchange one thing for another...is common to all men.”<sup>7</sup> But Adam Smith forgot to mention that just as trade is “common to all men,” blackmail tactics (i.e., bluffs, threats, deception, and the like), the keeping of secrets, and attempts to reveal secrets are all part and parcel of the process of exchange.<sup>8</sup> That is, rather than constituting an extraordinary or rare event, like murder or armed robbery, the problem of blackmail is far more widespread and commonplace than one would like to believe. Stated formally, the practice of blackmail (defined broadly as the transfer of resources from *A* to *B* in return for *B*’s promise not to carry out a threat) is an essential part of the process of exchange.

To his credit, Ronald Coase is the first economist to formally recognize the pervasive nature of blackmail in business negotiations. In his 1987 lecture on the economics of blackmail, Coase acknowledges, “all trade involves threatening not to do something unless certain demands are met” and “negotiations about the terms of trade are likely to involve the making of threats.”<sup>9</sup> In his own words, Coase has stated that “bluff and threats [are] a normal part of business bargaining” and “all trade involves threatening not to do something unless certain demands are met.”<sup>10</sup> Although this insight has received short shrift in the scholarly literature on blackmail, we consider it to be yet another of Coase’s impressive counterintuitive ideas.<sup>11</sup> Nevertheless, while it is true that blackmail tactics are a common part of the process of exchange, it would be more precise to say that blackmail is more likely to occur in specific types of exchanges that occur under conditions of bilateral monopoly.

In essence, a bilateral monopoly is a special type of exchange relation.<sup>12</sup> It arises whenever the parties to a wished-for exchange have to deal with each other—and only each other—in order for the exchange to take place. Stated formally, a situation of bilateral monopoly occurs when there is only one buyer (monopsony) and only one seller (monopoly). The point we wish to make here is that bilateral monopoly dramatically increases the possibility that some form of blackmail will occur. Why? In essence, it is because bilateral monopoly negotiations constitute a form of Prisoners’ Dilemma.<sup>13</sup> In summary, since each party to the exchange wants to keep for himself the largest possible share of the surplus generated by the exchange, both parties may be tempted to defect by resorting to threats and deception in order to thus obtain as much of the surplus as

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<sup>7</sup> ADAM SMITH, SELECTIONS FROM THE WEALTH OF NATIONS 10 (George Stigler, ed., AHM Publishing 1957) (1776).

<sup>8</sup> *Id.* Ronald H. Coase, *The 1987 McCorkle Lecture: Blackmail*, 74 VA. L. REV. 655, 675 (1988).<sup>8</sup>

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 658, 675. Professor Coase’s other notable and original insights include the ubiquity of transaction costs (Coase, 1937) and the reciprocal nature of the problem of harmful effects (Coase, 1960).

<sup>11</sup> See, e.g., Richard E. Romano et al., *A Pedagogical Treatment of Bilateral Monopoly*, 55 S. ECON. J. 831, 831-41 (1989).

<sup>12</sup> See, e.g., ROBERT AXELROD, THE EVOLUTION OF COOPERATION (Basic Books) (1984).

<sup>13</sup> See, e.g., THOMAS SCHELLING, THE STRATEGY OF CONFLICT (Harvard University Press) (1960).



possible.<sup>14</sup> The connection between blackmail and bilateral monopoly is so close that blackmail could be redefined in bilateral-monopoly terms. From this view, the relevant feature of blackmail is not the nature of the information which the blackmailer is threatening to disclose. The relevant feature is that there is only one buyer (the victim) and one seller (the blackmailer) to the transaction, regardless of the setting in which it occurs. As such, the problem of blackmail is not any different from any other type of bilateral-monopoly situation, and threats of blackmail—whether made in the course of a business relationship or in a non-commercial context—will likely arise wherever one observes bilateral-monopoly situation.

One can point to a wide variety of examples to illustrate the intimate connection between blackmail and bilateral monopoly: the decision to settle or go to trial in civil and criminal litigation);<sup>15</sup> a tug that chances upon a disabled vessel);<sup>16</sup> collective-bargaining negotiations on the eve of a strike deadline);<sup>17</sup> the list goes on and on.<sup>18</sup> Consider the following prosaic example, that of a gas company acquiring a right-of-way to build a pipeline. In the absence of some coercive mechanism, such as forced expropriation, the gas company will have to deal with a large group of landowners who own land in the path of the pipeline. Some shrewd landowners will no doubt be sorely tempted to engage in hold-out behavior.<sup>19</sup> By holding out, these shrewd landowners are, in effect, blackmailing the oil company into paying the highest possible price. An even more dramatic example of the connection between blackmail and bilateral monopoly is the problem of parent-offspring conflict in nature. Consider the behavior of birds. An infant needs the parent for food, otherwise it will soon perish, while the parent needs the child in order to maximize the survival of its genes. Their relationship is thus one of bilateral monopoly, and according to one biologist, it can produce “a particularly diabolical form of child blackmail.”<sup>20</sup> Apparently, some infants tend to scream so loudly it is as if they are deliberately attempting to attract predators to the nest. The infant is, in effect, blackmailing the parent for more food.<sup>21</sup>

Thus far, we have seen that blackmail tactics are an integral part of the process of exchange, especially under conditions of bilateral monopoly. Ironically, however, Professor Coase plays down this important insight in his otherwise insightful lecture on blackmail. Coase concedes (correctly, in our view) that “there is not a great deal that can

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<sup>14</sup> THOMAS ULEN ET AL., *LAW AND ECONOMICS* 37 n.8, (HarperCollins) (1988) (“The distinguishing feature of bilateral monopoly is that market price depends on the bargaining abilities of the two parties and is, in general, indeterminate.”).

<sup>15</sup> I.P.L. P’ng, *Strategic Behavior in Suit, Settlement, and Trial*, 14 *BELL J. ECON.* 539-550 (1983).

<sup>16</sup> William Landes et al., *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 *J. LEGAL STUD.* 83-128.

<sup>17</sup> See generally AVINSHAH K. DIXIT & BARRY J. NALEBUFF, *THINKING STRATEGICALLY* (1993).

<sup>18</sup> Notice that many legal institutions can thus be explained in light of the problem of bilateral monopoly (cf. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 251, 6th ed. 2003). For the moment, however, I shall ignore the effect of the legal system in reducing the negative effects of bilateral monopoly.

<sup>19</sup> See William C. Strange, *Information, holdouts and land assembly*, 38 *JOURNAL OF URBAN ECON.* 317-322 (1995).

<sup>20</sup> RICHARD DAWKINS, *THE SELFISH GENE* 131 (OXFORD UNIVERSITY PRESS, 2nd ed. 1989).

<sup>21</sup> *Id.* at 131-134.



be done about it” and that, at any rate, business blackmail “does not appear normally to be a serious problem.”<sup>22</sup> Perhaps Professor Coase is simply trying to make a pragmatic point, that blackmail is so common and pervasive in the business world that there is little one can do to reduce the incidence of business blackmail. Indeed, one could argue that the costs of enforcing the law of blackmail in business relationships probably outweigh the gains. Instead, Coase draws an awkward distinction between “blackmail incidental to a business relationship” and “ordinary blackmail.”<sup>23</sup> That is Coase argues that blackmail should be punished in situations in which “[t]he victim *has* to deal with the blackmailer” and in which the blackmailer “causes real harm which reduces the value of production.”<sup>24</sup> The problem with Coase’s analysis, however, is that these two conditions arise in all situations of bilateral monopoly. Thus, if “blackmail incidental to a business relationship” should not be illegal (and we agree with Coase that it should not be), then what is it about bona-fide or “ordinary” blackmail that is so horrible as to constitute a crime? Why are some forms of blackmail perfectly legitimate, while other forms constitute a crime?

In summary, although Coase is correct to note the pervasive nature of blackmail in the business world, his purported distinction between criminal blackmail and business blackmail is fundamentally flawed for several reasons. First, as we have seen, blackmail is just another example of bilateral monopoly, regardless of the setting in which it takes place. Second, Coase’s condemnation of ordinary blackmail is based on non-falsifiable moral intuitions. Third and last, Coase overlooks the reciprocal nature of the problem of blackmail. We discuss these last two objections below.

## II. CRITIQUE OF COASE’S NORMATIVE ANALYSIS

The key question presented in this paper is: Why are business threats (unlike ordinary blackmail) immune from the law of blackmail? Although Coase distinguishes ordinary blackmail from mere business threats (i.e., “blackmail incidental to a business relationship”), he depicts the ordinary kind of blackmail as “moral murder.”<sup>25</sup> Appeals to moral intuition, however, are utterly unhelpful and only serve to confuse our analysis of blackmail. In summary, there are several problems with relying on one’s moral intuition, especially in a paper purporting to offer an economic analysis of blackmail: (i) moral intuitions are not falsifiable, (ii) are question-begging, and (iii) are irrelevant.

First, consider the non-falsifiable nature of moral intuitions. The truth-value of a moral intuition cannot be tested or otherwise confirmed through some objective or impartial procedure.<sup>26</sup> Second, moral intuitions regarding blackmail beg the question,

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<sup>22</sup> COASE, *supra* note 8, at 658.

<sup>23</sup> *Id.* at 675. For convenience, we shall refer to the former type of blackmail as “business blackmail” (i.e., threats that are perfectly legal under the law of blackmail) and the latter type of ordinary blackmail as “bona fide blackmail” (i.e., threats which constitute a crime).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> See KARL POPPER, *THE LOGIC OF SCIENTIFIC DISCOVERY* (2<sup>nd</sup> ed. 2002).



why are some forms of blackmail legal and others not. After all, if ordinary blackmail is “moral murder,” then why should “blackmail incidental to a business relationship” be immune from one’s moral condemnation? Last, morality is irrelevant and beside the point. Due to the fact that most people deem blackmail to be morally wrong is of no moment, for notice that we say “most people” instead of “all people.” Presumably, blackmailers themselves (as opposed to their hapless victims) would not object to blackmail on moral grounds. And even if some blackmailers feel remorse, their deeds (as opposed to their thoughts) no doubt speak for themselves.<sup>27</sup> Thus, whether blackmail is morally wrong is neither here nor there; indeed, it is irrelevant to one’s analysis of blackmail. The moral status of blackmail simply reflects that blackmailers as a group are in the minority.

Unfortunately, Coase is utterly unable to separate his moral intuition about the wrongfulness of blackmail from his economic analysis of the problem of blackmail. As a result, his analysis of the law of blackmail crumbles under the weight of his normative views. Instead of condemning some forms of blackmail as “moral murder,” the problem of blackmail should be studied as if it were an ordinary economic transaction or business practice, like the use of exclusive sales agreements, predatory pricing, tying arrangements, etc. Seen this way, as an ordinary economic transaction, one observes that blackmail is just another form of rent-seeking behavior: the blackmailer simply wants to extract a rent from the victim’s desire to protect his reputation.<sup>28</sup> To some extent, the blackmailer is thus no different than a lawyer or a doctor in that he profits from the misfortunes and misadventures of others, while the victim of blackmail is more like an opportunist, or a con-man, since he wants to present to the world a false picture of himself.<sup>29</sup>

Moreover, in addition to putting aside one’s moral intuitions about blackmail, one must also look at the problem of blackmail from the perspective of both the victim *and* the blackmailer. As we shall argue later, blackmail imposes costs on both parties. At first glance the victim appears to be in the position of a poker player who is uncertain about a rival player’s hand, for the victim has no way of knowing whether the would-be blackmailer is bluffing or whether he will carry out his blackmail threat.<sup>30</sup> But now, consider the problem of blackmail from the blackmailer’s perspective. Rather than the victim being at the entire mercy of the blackmailer, it is the blackmailer who is at the mercy of the victim! For as Richard Posner has noted, the main problem for a blackmailer

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<sup>27</sup> See, e.g., Joseph Farrell and Matthew Rabin, *Cheap Talk*, 10 J. ECON. PERSP. 10, 103-108 (1996.)

<sup>28</sup> See e.g., JAMES BUCHANAN, ET. AL., *TOWARD A THEORY OF THE RENT SEEKING SOCIETY* (1980). And in a less obvious way, the victim likewise wants to extract a rent from the blackmailer, since the victim prefers to protect his reputation cost-free.

<sup>29</sup> Consider, for example, the 2006 film “The Inside Man” by the director Spike Lee in which the good guys are the blackmailers, while the villain is the target of the blackmail scheme.

<sup>30</sup> COASE, *supra* note 8, at 675. “The party threatened is [not] likely to have a good idea of whether the threat has to be taken seriously.”



is that he will find it difficult to make his threats credible.<sup>31</sup> In game-theory terms, blackmail is a two-player, zero-sum, non-cooperative game: one player, the would-be blackmailer, wants to persuade the other player, the victim, to pay blackmail by threatening to reveal disreputable information about the victim, but at the same time, the victim would prefer not to have to pay anything to keep his secrets from being disclosed to third parties. In the language of game theory, the victim can either “pay” (cooperate) or “take his chances” (defect). If the victim defects and refuses to pay, the blackmailer will find himself in an awkward quandary. On the one hand, if the blackmailer decides to carry out his threat, he not only walks away empty-handed (because the victim will certainly not pay blackmail once his secret is disclosed), he also exposes himself to criminal prosecution (because the victim, now having nothing to lose, may retaliate by reporting the blackmailer to the police). On the other hand, if the blackmailer refrains from revealing the victim’s secret in order to avoid criminal prosecution and in the hope that the victim will change his mind and agree to pay, he will have been caught bluffing. To the extent he develops a reputation for bluffing, his threats will lack credibility in future blackmail transactions.<sup>32</sup>

Coase also argues that business threats (as opposed to ordinary blackmail) are checked by a number of constraints: “by the competition of other businessmen, by the fact that the party threatened is likely to have a good idea of whether the threat has to be taken seriously, and by the adverse effects on future business of being difficult in negotiations.”<sup>33</sup> But do these Coasian constraints really distinguish business blackmail from ordinary blackmail? The point about competition is not relevant because blackmail, by definition, occurs in settings of bilateral monopoly. The point about knowledge (about whether to take a threat seriously) depends more on the bargaining skills of the parties than the precise setting in which the bargaining takes place.<sup>34</sup> And the last point (about the adverse effects on future business) is quite misleading. In the business world it often pays to develop a reputation as a hard bargainer.<sup>35</sup> In short, none of these considerations are really that helpful for distinguishing business blackmail from so-called ordinary blackmail.

Notice that Coase specifically calls attention to the presence or absence of competition as the key to understanding the law of blackmail. According to Coase, in the ordinary blackmail case “there is no competition. The victim *has* to deal with blackmailer.”<sup>36</sup> This argument, however, is utterly unhelpful for the following reason: While it is true that the victim *has* to deal with the blackmailer, it is also true that the blackmailer *has* to deal with the victim. In other words, blackmail is a textbook example

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<sup>31</sup> See Richard A. Posner, *The Cost of Accidents: A Legal and Economic Analysis*, 37 U. CHI. L. REV. 636 (1970).

<sup>32</sup> See, e.g., THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* (1960).

<sup>33</sup> COASE, *supra* note 8, at 675 (discussing the difference between blackmail and normal business demands).

<sup>34</sup> Cf. ROBERT COOTER & THOMAS UHLEN, *LAW AND ECONOMICS*, 37 n. 8 (1988).

<sup>35</sup> See, e.g., AVINASH K. DIXIT & BARRY J. NALEBUFF, *THINKING STRATEGICALLY: THE COMPETITIVE EDGE IN BUSINESS, POLITICS, AND EVERYDAY LIFE* (1993) and SCHELLING, *supra* note 32.

<sup>36</sup> COASE, *supra* note 8, at 675 (discussing the difference between blackmail and normal business demands).



of bilateral monopoly, regardless of the particular setting in which it takes place. More importantly, the closer one looks at the problem of blackmail the more one is able to appreciate that the victim's position is not as precarious as Coase portrays it in his blackmail lecture. To see why this is the case, we must put aside our moral intuitions regarding the wickedness or wrongfulness of blackmail (at least for the sake of analysis). Coase, however, is unable to take this step.

Summing up our analysis thus far, once we take a non-normative approach to the problem of blackmail, we see that blackmail is fundamentally a problem of bilateral monopoly. That is, just as the victim *has* to deal with blackmailer, the blackmailer *has* to deal with the victim. But the bilateral-monopoly nature of blackmail is not the most interesting aspect of the problem of blackmail. In our view, the most interesting aspect of blackmail is that it is not always obvious who the real victim is. Specifically, we will argue that the problem of blackmail is “reciprocal in nature” because blackmail imposes costs on the blackmailer, on the victim, and on third parties.<sup>37</sup>

### III. THE RECIPROCAL NATURE OF BLACKMAIL

The problem of blackmail is reciprocal in nature for two reasons: (1) the blackmail victim's desire to conceal certain information imposes costs on third parties, and (2) the blackmail victim is often able to avoid being blackmailed in the first place. The first point focuses on the interests of third parties who would benefit from the disclosure of information. Simply put, the blackmail victim's desire to conceal negative information about himself produces an external harm on third parties (i.e., persons who are not parties to the blackmail negotiations). As a result, any analysis of blackmail is incomplete until one considers not only the specific harm of blackmail to the “victim” but also the general harm resulting from the blackmail victim's desire to deceive third parties. In addition, the second point puts a spotlight on victim behavior. Often, the blackmail victim could have avoided the harm to himself (i.e., the risk of being blackmailed) by being more discrete about his conduct or by abstaining from it in the first instance. The problem of blackmail is thus a reciprocal one, and this compels me to put the loaded words “blackmail victim” in scare quotes or to abandon this anachronistic terminology altogether.<sup>38</sup> Talk of “blackmail victims” implies such persons should be legally or morally entitled to deceive others. Yet this is not so obvious.

Return to my first point. While it is true that the behavior of the blackmailer harms the blackmail target, it is also true that the behavior of the blackmail target harms third parties.<sup>39</sup> After all, the target wants to conceal certain information, secrets, that are in the blackmailer's possession. But why should he be entitled to do so? The disclosure of this information harms the target, but at the same time, the concealment of this information likewise harms third parties. In essence, there is a parallel between the efforts

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37. COASE, *supra* note 6, at 1-2 (discussing the reciprocal nature of business firms' harm on others).

38. I shall thus refer to “victims” as “blackmail targets” in the remainder of this paper.

39. I use the terms “harm” and “cost” interchangeably; that is, when I say that one person harms another, I mean that one person imposes a cost on another.





of a seller to conceal defects in his products and the efforts of a blackmail target to conceal disreputable information about his past behavior. In both cases, the effort to conceal defects in one's products or in one's past behavior is tantamount to false advertising.<sup>40</sup> So the question is, why should he be allowed to deceive these people? Blackmail may be morally wrong, but then so is deception. Notice that I am not disputing whether the target of a blackmail threat suffers a "real harm," to use Coase's own term.<sup>41</sup> He most certainly suffers a harm, though the magnitude of the harm will vary depending on the nature of the secret he is attempting to hide. My main point is that the target's desire to conceal his secret is a form of deception, and this deception likewise produces a "real harm" on precisely those persons the target is trying to deceive. The target thus deserves no special sympathy on our part, and to call him a victim is to merely beg the question of which harm is the most serious one: the harm to the victim produced by the blackmailer, or the harm produced by the victim's desire to deceive certain third parties.

Furthermore, returning to my second point, one must also look at the blackmail target's behavior to put the problem of blackmail into proper perspective. Simply put, had the target not engaged in questionable conduct in the first place (the evidence of which he now wishes to suppress), or had he been more careful to avoid being discovered by the blackmailer, he would never find himself in the position to be blackmailed later on. One or two examples should suffice to make this point perfectly clear. A married man keeps a mistress. The mistress then attempts to blackmail the husband by threatening to disclose their little secret. Perhaps the mistress is angry because her lover has refused to divorce his wife as he promised in throes of passion or maybe because her fickle lover has taken up a new mistress. Who is the true victim here? Although I am no feminist,<sup>42</sup> I have little sympathy for the husband's predicament. Had the husband been faithful to his wife in the first place, or had he kept his word and divorced his wife, or had he not taken up a new mistress, or had he chosen a different mistress, as the case may be, his plight would have been a different one.

But what if the information to be concealed is the commission of a crime? Suppose the husband has murdered his mistress, and someone has happened to film him commit the gruesome murder. The filmmaker would now be in the position to blackmail the hapless husband. But why should anyone (save a close relative, perhaps) feel sorry for the blackmail target? As Richard Posner has noted, "the value of the information to the blackmailed person is equal to the cost of punishment that he will incur if the information is disclosed and he is punished as a result."<sup>43</sup> In a perverse way, the blackmailer is

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40. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 40 (6th ed. 2003). Posner has argued that a person in effect attempts to "sell" himself whenever he tries to persuade a potential transacting partner—an employer, a spouse, or even a casual acquaintance—that he (the seller) is an honest, loyal, and trustworthy person.

41. COASE, *supra* note 8, at 676.

42 See, e.g., Margaret Jane Radin, *Reply: Please Be Careful with Cultural Feminism*, 45 *STAN. L.REV.* 1567, 1569 (1993) (for I have no idea what the dogma of "feminism" really is).

43. POSNER, *supra* note 40, at 635.



actually doing the target a favor by offering to keep quiet in return for payment.<sup>44</sup> Why? Because in the case of crime, the blackmail target has no an *ex ante* moral or legal right to keep this information hidden from the authorities or from the relatives of his victim.

Let us return now to the main question of this paper: why is ordinary or bona fide blackmail (of the mistress or murdering-husband variety) any different from business threats (threats that are merely incidental to a business relationship)? We have already seen that both types of blackmail are most likely to occur under conditions of bilateral monopoly, but Coase offers a second argument in support of the distinction between bona fide blackmail and business blackmail. According to Coase, true blackmail not only generates “fear and anxiety”—after all, all threats are by definition designed to do just that—it also “causes real harm which reduces the value of production just as with Pigou’s railway whose sparks cause fires in adjoining woods”<sup>45</sup> Furthermore, Coase contrasts the precarious position of the blackmail target with the situation of the landowner in the example of the railway sparks. If the sparks generated by passing locomotives cause a fire in the adjacent woods, the landowner of the woods can always bring a private action in tort against the railroad company to recover monetary compensation for the harmful effects produced by the sparks of the locomotives. But a person who is targeted by a blackmail threat is caught on the horns of a delicate dilemma: pay up or suffer the disclosure of his secret. In the words of Coase, “he cannot appeal to the law, since this would involve the disclosure of facts which he is anxious to avoid [disclosing].”<sup>46</sup>

Thus, for Coase the position of the blackmail target is far more precarious than the landowner’s position in the example of the railway sparks. But Coase is wrong.<sup>47</sup> Blackmail is really no different from railway sparks. From an economic perspective, the position of the landowner is no different from that of the blackmail target for two reasons. First, the landowner wants someone else, the railway company, to pay the cost of avoiding the harm caused by the railway sparks, and likewise, the blackmail target also wants to avoid having to pay the cost of concealing certain information about himself. Secondly, the landowner himself could have taken steps *ex ante* to prevent or reduce the probability of fires caused by railway sparks, just as the blackmail target could have taken steps to avoid being in the position of being blackmailed in the first place. In other words, in both cases the problem is reciprocal in nature. It does not really matter whether the harm suffered by the blackmail target is qualitatively worse than the harm suffered by the landowner; the real point is that either party could have avoided the harm.

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44. This statement is true so long as the blackmail payment does not exceed the expected cost of punishment to the target if his secret is revealed to the authorities.

45. COASE, *supra* note 8, at 675. As an aside, the sly reference to Pigou is vintage Coase. The English economist A.C. Pigou appears in one guise or another in almost all of Coase’s papers. See generally “The Problem of Social Cost” for Coase’s discussion on an example used by Pigou in his classic textbook, *The Economics of Welfare*, A.C. PIGOU, *THE ECONOMICS OF WELFARE* (Macmillan, 5th ed. 1952), to illustrate the problem of harmful effects (or “negative externalities” in the jargon of economics), see generally COASE, *supra* note 6.

46. COASE, *supra* note 8, at 675.

47. COASE, *supra* note 6, at 1-2. The irony here, as we shall see below, is that Coase himself, of all people, forgets his own insight that all harms are reciprocal in nature.



Furthermore, even if we were to consider the problem of blackmail from a normative perspective, it is not clear why the blackmail target should be entitled to conceal negative information about himself, given the reciprocal nature of blackmail.

Ironically, it was Ronald Coase himself who first recognized the reciprocal nature of the problem of harmful effects. For Coase, the problem of railway sparks was just one instance of a more general problem, the “problem of harmful effects” (Coase, 1960, pp. 1-2). A railroad locomotive emits sparks the faster it runs; sparks in turn increase the risk of fire; and the resulting fires may destroy nearby crops, threaten homes, and endanger the life and limb of landowners. Before Coase, the legal issue was always one of “causation.”<sup>48</sup> Since the law of ancient Rome, legal liability for harmful effects turned on the following principle: a party who causes or produces harm is responsible or legally liable for the resulting damages caused by his actions. Consider, once again, the problem of the railway sparks: it seems to be “perfectly obvious” that the locomotive engine is the cause of the sparks.<sup>49</sup> On this view of causation, the railway company should thus be liable in tort to the landowners. But in reality, the issue of causation is not, in fact, “perfectly obvious.” One could just as well argue that the landowners are just as responsible for the fires as the railway company. Since the fleeting railway sparks can travel but a short distance, there would be no fires had the landowners simply planted their crops farther away from the railroad line and taken care to remove all inflammable debris from the fixed path of the locomotive.<sup>50</sup> However the case of the railway sparks is decided, someone will suffer harmful effects. A cost will be imposed on either the landowner or the railway: If the railway company has the legal right to generate sparks, then landowners will be harmed because they will have to take costly precautions to avoid the harm; If the landowners have the legal right to be compensated for fires caused by railway sparks, the railway company will be harmed, since it will now have to take costly precautions to avoid legal liability.

Notice, then, that the problem of blackmail is analytically no different than the problem of railway sparks. The question is not, who harmed whom? It is not one of causation either. From a purely social-welfare perspective, the main question is, who can avoid the harm at the lowest cost? A related (but no less important) question is, who decides who the lowest-cost avoider is? Markets, courts, or legislatures? Summing up my

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<sup>48</sup> See generally BARRY NICHOLAS, INTRODUCTION TO ROMAN LAW 268-72 (Oxford: Clarendon Press 1975) (1962), provides a concise overview of the history of the concept of causation in Roman law; OLIVER WENDELL HOLMES, JR, THE COMMON LAW, (1991) (1881), one of the best expositions of the evolution of causation.

<sup>49</sup> I have borrowed this phrase from one of my students.

<sup>50</sup> Of course, one may be tempted to ask, why should the landowners have to take such costly and time-consuming precautions? The problem with this question, however, is that it presupposes that the landowners are the victims of the railway company’s locomotives. Yet one could just as well ask, why should the railroad company have to run fewer trains or install costly anti-spark equipment on all its locomotives? To call the landowner the “victim” in this situation disregards the reciprocal nature of the railway sparks problem. The sparks would not have posed a problem had the landowner planted his crops farther away from the railroad line or had he planted fire-resistant crops. In truth, it is not at all clear who the real victim is because both parties could have taken steps to avoid the harm but neither wants to pay the cost of doing so.



analysis thus far, blackmail will occur in situations of bilateral monopoly, and the harmful effects of blackmail (blackmail harms) are reciprocal in nature. So, what is to be done? Next, I shall propose the creation of blackmail markets.

#### IV. BLACKMAIL MARKETS

Since blackmail is inevitable in bilateral-monopoly settings, and since the problem of blackmail is essentially reciprocal in nature, where does this leave us? I suggest a bold but simple solution: the creation of blackmail markets, or markets in legal rights to secrets. That is, instead of merely legalizing blackmail, why not allocate the legal rights to secrets to the finders of such secrets and allow these legal rights to be openly traded? In other words, why not let the legal right to disclose any given secret, and the corresponding legal right to conceal a secret, to be decided by markets instead of courts or legislatures?

Before proceeding, notice I say “blackmail markets” (plural) instead of a “market in blackmail” (singular) because I envision a wide variety of different blackmail markets depending on the type of information to be disclosed or concealed. For example, there might be a market for information regarding celebrities and other public figures, a market for information regarding cheating spouses, a market for information regarding unethical business practices, etc. Other commentators have proposed legalizing blackmail<sup>51</sup>. My proposal, in contrast, would not only make blackmail agreements legally enforceable (just as non-disclosure agreements are enforceable in business transactions and in litigation), it would also create a market in legal rights to information and thus allow blackmail markets to prosper and flourish. Although my proposal may sound a trifle mad, it is the lesser of two evils.

From a blackmailer’s perspective, blackmail is just a rent. He is engaged in classic rent-seeking behavior since the blackmail payment is simply a wealth transfer from the target to the blackmailer. This aspect of blackmail (i.e., blackmail as rent-seeking) supports the traditional economic objection to blackmail, although it does not explain the distinction between ordinary blackmail and business blackmail. As Coase puts it, blackmail transactions at the very least involve “the employment of resources which leave the value of production unchanged.”<sup>52</sup> Worse yet, one could argue that blackmail not only leaves the value of production unchanged, it also decreases it by diverting scarce resources into rearranging existing wealth rather than producing new sources of wealth<sup>53</sup>. All this is true as far as it goes. But now, consider blackmail from the perspective of the blackmail target, or from the perspective of the target’s victims.<sup>54</sup> From their vantage point, blackmail is not just a rent; it is a tax on the target’s secret. Indirectly, blackmail is also a tax on the target’s behavior. The target could have avoided the blackmail tax either

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<sup>51</sup> See e.g., BLOCK, *supra* note 5, at 1182-83.

<sup>52</sup> COASE, *supra* note 8, at 655.

<sup>53</sup> See e.g., BUCHANAN ET AL, *supra* note 28.

<sup>54</sup> That is, those third parties, such as the target’s spouse, employer, business partner, etc., who would benefit from the full disclosure of the target’s secret.



by abstaining from the conduct he now wishes to conceal, or by being more careful and discreet when he engaged in such conduct in the first place.<sup>55</sup>

When blackmail is seen as a tax and not just as a rent, it becomes an efficient, though perhaps unorthodox, method for allocating the legal rights to the target's secret. If the target values his secret more than the people whom he is trying to deceive, then he will pay the blackmail tax. Of course, my analogy is an imperfect one, because the target and the target's victims are not engaged in a true competitive auction. But this is true of any transaction under conditions of bilateral monopoly. Now, I do not wish to be misunderstood; I am not saying that blackmail is a wonderful thing. In a perfect world, there would be no blackmail, but there is no perfect world.<sup>56</sup> I am thus simply saying that legalizing blackmail agreements and creating markets in blackmail are the lesser of two evils. Let me explain.

Blackmail is evil, but so is the concealment of secrets. In Coasian terms, blackmail harms those who wish to conceal their secrets, but the concealment of secrets, in turn, harms those who would benefit from full disclosure.<sup>57</sup> The question is, which is the greater harm? If the latter, then legal institutions should strive to create incentives for the full disclosure of secrets and other information about oneself. In this sense, one can draw an analogy to existing legal institutions, such as the law of warranties, norms against false advertising, and even SEC disclosure requirements. But at the same time, a legal rule that promotes full-disclosure should work as a default rule. If one values certain information about oneself, which is in the possession of a third party, then one should be permitted, though not required, to purchase the rights to such information. Of course, I recognize that blackmail markets will create incentives for would-be blackmailers to engage in non-productive rent-seeking behavior. My point is that blackmail markets would also create incentives for would-be blackmail targets to change their behavior to avoid being blackmailed. This change in behavior by would-be targets produces large benefits to third parties, the target's own victims, who would have been harmed by the concealment of the information.

If we assume that the blackmail target's secret is just as valuable to the target as it is to the target's victims, and if we further assume that transaction costs are zero or close to zero, then it does not matter what the legal rule is. The party who values the secret more will purchase the rights to that information. But once we make the more realistic assumption of positive transaction costs, then all bets are off, for it is no longer clear that the legal rule should continue to favor the blackmail target. If the person or persons whom the target wishes to deceive value the secret information more than the target does, then the rights to that information should, in theory, be assigned to the blackmailer's victims rather than to the target. The problem, however, is that the target, in the absence of blackmail, will succeed in keeping his secret concealed. As a result, one could argue

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<sup>55</sup> POSNER, *supra* note 40 ("blackmail operates as a tax . . . on whatever behavior makes the blackmailer's victim willing to pay blackmail").

<sup>56</sup> See, e.g., COASE *supra* note 6, at 15-19, 42-44.

<sup>57</sup> *Id.*



that the would-be blackmailer is acting as a proxy for the target's victims and that we should thus allow him to potentially extract a rent from the target in order to provide would-be targets with an incentive to change their behavior.

For what it is worth, however, Coase makes one last-ditch argument in his 1988 lecture in support of the law of blackmail. According to Coase, the main difference between business (legal) blackmail and ordinary (criminal) blackmail is the lack of finality in ordinary blackmail negotiations: “[b]usiness negotiations . . . either lead to a breakdown of the negotiations or they lead to a contract. There is, at any rate, an end. But in the ordinary blackmail case there is no end. The victim, once he succumbs to the blackmailer, remains in his grip for an indefinite period.”<sup>58</sup> I do not dispute the veracity or the logic of Coase’s argument. There is, however, a delightful irony in it. Although Coase makes this argument about the lack of finality in order to support the legal status quo (i.e., the continued criminalization of ordinary blackmail, his argument, ironically), shows why there should be markets in blackmail. That is, the reason why the target, even if he succumbs to the blackmailer’s demands, “remains in his grip for an indefinite period” is precisely because blackmail markets are illegal!<sup>59</sup> If blackmail agreements were legally enforceable, the target could get on with his life.<sup>60</sup> This is no wild speculation on my part. Consider, for example, how commonplace non-disclosure agreements are in business transactions and in litigation.

But perhaps the greatest irony—the irony of ironies—is that one can defend the creation of blackmail markets on Coasian grounds. One of Coase’s greatest contributions to the economic analysis of law, in addition to the idea of reciprocal harms, is the idea that legal rights can be traded on markets just like other goods and services.<sup>61</sup> Now, because markets are not costless (i.e., transaction costs are positive), the legal system should define and assign rights in such a way as to maximize the value of production. How? By making sure that legal rights are well-defined and by assigning those rights to those to whom they are most valuable, thus eliminating the need for any transactions. In the case of blackmail, the interests of would-be blackmail targets, who benefit from the concealment of their secrets, might be outweighed by the interests of those who would benefit from the disclosure of secrets.

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58. See, e.g., Coase, *supra* note 8, at 675.

59. *Id.*

60. Also, I cannot resist pointing out another glaring irony in Coase’s last argument. In a word, the lack of finality in “the ordinary blackmail case” actually works in favor of the blackmail target and against the blackmailer! As Richard Posner has noted, a blackmailer, “lacking a transferable property right in the target’s secret [because blackmail is illegal], cannot make a credible promise not to repeat his demands for money after the target yields to his first demand.” POSNER, *supra* note 40, at 664. As a result, the blackmailer’s inherent inability to make a credible threat actually makes it easier for the target to call the would-be blackmailer’s bluff, as I explained earlier in my game-theoretic analysis of blackmail.

61. See generally Coase, *supra* note 8 (a legal right, or what Calabresi and Melamed refer to as an “entitlement,” is simply the right to perform a certain action or to prevent others from performing a certain action) (construing Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: Another View of the Cathedral*, 85 Harv. L. Rev. 1089 (1972)).



## V. CONCLUSION

We have now come full circle. We began, with Coase, by noting the distinction under the law of blackmail between “the ordinary blackmail case” and “blackmail incidental to a business relation.”<sup>62</sup> The former constitutes a crime, while the latter is perfectly legal. Although Coase is correct to note the pervasive nature of blackmail in the business world, his purported distinction between criminal blackmail and business blackmail is fundamentally flawed for two reasons. First, blackmail is part and parcel of the process of exchange, especially in bilateral monopoly settings, and secondly, the problem of blackmail is reciprocal in nature. That is, a potential blackmail target can always avoid being blackmailed by altering his behavior *ex ante*; in addition, although blackmail harms those who wish to conceal their secrets, the keeping of secrets also harms those who would benefit from their disclosure. We therefore propose the creation of blackmail markets or markets in legal rights to secret information. Specifically, legal rights to secrets should be allocated to the finders of such secrets, and these finders should be allowed to sell the legal rights to such secrets. Although the creation of blackmail markets would no doubt reward blackmailers for digging up dirt on their targets, such markets would also create incentives for avoiding being blackmailed in the first place and for the full disclosure of secrets.

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62. Coase, *supra* note 8, at 675.