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THE ECONOMICS OF CRIME

If the average citizen of Hopkinsville were to be asked to name the most serious social problems facing him, his community, or his country, his answer would very likely put crime as the first concern. Fear of crime is so widespread that politicians of all stripes are eager to be seen as "tough on crime". To be sure there is still a stubborn liberal rear guard which maintains that criminals are redeemable, that if they were properly trained for a job, or if they had the proper role models, that they would not commit crimes.

From the earliest days of the Republic to the present, the issue of crime and its punishment or prevention have concerned thinking people. In our earliest days the response to crime was to impose punishment on the criminal. Then in the 1830s, that crucial decade when so many issues which disturb us today were first raised, the American passion for redeeming the world focused its attention on the treatment of criminals. It was then that the Penitentiary replaced the Prison because it was thought that with Bible Reading, Preaching, Exhortation, Wholesome Exercise, and Worthwhile Tasks the criminal would come to repent of his errors and, having done his penance, would go out and sin no more. Alas, it was not to be, and in the 160-odd years since, crime has become a growth industry and an occupation of choice for some entrepreneurial types. This makes it useful to look at crime as an economic enterprise and by doing so perhaps learn how it affects society.

Nothing is more mind-boggling or boring than a recitation of numbers and statistics, but a few must be mentioned if we are to think about crime from an economic standpoint. The figures I am using were calculated to inform the great debate in Congress over funding the Police and promoting Mid-Night Basketball in 1994, so they are not current but are still illustrative.

About 34 million criminal acts are committed in the United States annually, or about 94,000 daily. This is from a Justice Department estimate but is considered by some to be too low since most crimes are said not to be reported. In 1992, a sample year, there was a loss of \$18 billion in cash, cars, and personal property due to robbery and theft. Not counted in this \$18 billion is the cost of trauma to the victims, medical expenses, and future disfunction of victims. Economically this \$18 billion represented transfer payments, albeit illegal, from one group of citizens to another group just as welfare payments or farm or business subsidies are transfer payments, except that the latter transfers are legal.

There is a part of the criminal economy that produces goods and services that the public wants and for which it is willing to pay. The largest part of this market is the

distribution of drugs, illegal liquor, and untaxed cigarettes and services such as prostitution and formerly gambling. Gambling is in the process of being removed from the criminal economy since it is being provided by the states through lotteries and licensed gambling boats and by the Indians through their casinos. One Indian tribe has recently put its games of chance on the Internet. Several states have sued to prevent this innovation because it competes with their own state lotteries and taxed casinos. The Indians are resisting by claiming that the gambling actually takes place on their own reservations, but I predict that wiser heads will prevail and find some way to cut the states in for some share of the revenue - perhaps by a tax on the amount wagered in each state.

Another kind of economic activities which is illegal is the so-called hidden economy, made up of people who swap out goods and services with each other without reporting the activities as taxable income. An example of such activity is a homeowner paying cash to illegal aliens for acting as nannies or other servants without paying Social Security taxes and without the recipients paying income taxes., or an auto mechanic swapping out work with a house painter.

If some attempt were made to put a dollar value on all these things, it is entirely reasonable to think that the costs of crime could reach \$500 billion or even \$1 trillion a year.

In addition to the economic value of the criminal transfer payments, criminal goods and services, and the hidden economy there are the public costs of about \$80 billion per year for police, courts, prisons, and parole systems. These are 1992 figures; the numbers have been increased by the Federal appropriations under the Community Police Law. The amount spent for private security forces and devices is probably larger than this.

Sociologists, and economists too, profess to be at a loss to explain our exploding crime rates. It seems to me that the answer is simple: the crime rate increases because crime pays. Economists postulate that man is rational and that his decisions to engage in or not to engage in an activity are based on some kind of assessment of costs and benefits. It's smart to go to college, for example, and defer entry into the labor force for four or more years because the deferred income is quickly made up.

Sociologists can describe the typical criminal as "an impulsive young man who grew up in a discordant family where one or both parents had a criminal record, discipline was erratic, and human relations were cold and unpredictable. He had a low IQ and poor verbal skills." Usually his criminal tendencies appeared early, often as early as the first or second grade, where he was aggressive and anti-social toward his peers.

Since the root cause of the problem was the dysfunctional family, society's responsibility was to make the family functional. To accomplish this countless welfare

programs have been established. If the family could not be redeemed, then the school or some other agency had to serve in place of parents.

Economists are not usually comfortable with such soft concepts - they like to quantify. But a few economists who describe themselves as having hard heads and soft hearts felt that they could explain and prescribe for this situation. They felt that lowering unemployment and increasing personal incomes should reduce the crime rate.

Personal income per capita has doubled since 1960. Unemployment is currently less than 4%. The poverty rate is lower. Why hasn't crime decreased? Our incarceration rate has doubled since 1980, indicating an increase in crime instead.

Dissecting the figures on crime gives us the answer: it depends on where you live. Violent crime is mostly concentrated in inner cities. If you live anywhere but in an inner city, you are less likely to be mugged, raped, or robbed than you were in 1980.

For white, middle-class people all crime rates are down except car theft. But for anyone living in inner cities the rates of all crimes are up. The victims as well as the perpetrators of crimes are more likely to be minorities. In the inner cities the increased per capita income, reduced unemployment, and falling poverty rates do not apply.

What about the market for criminal goods and services? It is certainly growing and it is not limited to the inner city or to a social underclass.

People who once agreed that the cause of crime was a lack of money - and that the solution was more money - now admit that the problem is not money but behavior. The solution to crime is to change behavior, and economic analysis points to one way to modify behavior effectually.

If we start with the idea that criminals, even if their average IQ is low, are rational individuals who act to improve their perceived well-being, we can measure the benefits and the costs to the criminal. Obviously if the benefits outweigh the costs, it is rational behaviour on a criminal's part to be a criminal, just as it is for a white, middle-class man or woman to go to college. If the benefits are less than the cost, then it is rational not to be a criminal.

The benefits are the incomes and profits to be gained by criminal labor. What are the costs? The first cost is opportunity cost - the income lost by devoting time to criminal activities. For most criminals this cost is negligible, since the probability of making substantial incomes by legal activities is very small. The average criminal is usually young, uneducated, and unskilled.

The second and far larger cost is the time which a criminal may expect to spend behind bars if he is sent to prison. This cost might be called "expected punishment". Now this expected punishment is not the legal term established for his crime, and it is not

the actual time that a convicted criminal spends in prison. It is calculated by the probability of spending time in prison.

The rational criminal knows, first of all, that he may never be caught. It is doubtful if the chances of his being caught are 50%. Second, many of those arrested are never prosecuted. Of those prosecuted many are paroled or otherwise released. If convicted and sent to prison, he will serve only a fraction of the formal sentence.

According to the National Center for Policy Analysis, a think-tank, only 7% of all U.S. burglaries result in an arrest. Of those arrested 87% are prosecuted. Of those prosecuted 79% are convicted. Of those convicted a mere 25% go to prison; most are paroled. After multiplying these percentages to get the probability, we see that a potential burglar faces only a 1.2% chance of going to prison for each act of burglary committed. Once in prison he will stay there for about 13 months. Since he will escape confinement 98.8% of the time, the expected "cost" to the criminal is 4.8 days.

If we assume that a burglar can earn \$6.00 per hour for honest work, the opportunity cost of imprisonment is \$230.00. If we assume that the burglar's leisure time is worth \$10.00 per hour of "usable" time, or sixteen hours per day, the cost of imprisonment is \$768.00. Using these figures gives us a monetary cost to the burglar of \$998.00. The rational burglar will ask himself whether or not an act of burglary will net him goods worth more than \$998.00, or 4.8 days in jail. If it will, then crime pays.

People will commit burglaries as long as the expected benefit is greater than the price society "charges", 4.8 days imprisonment. At such a low price the rational burglar will take all the crime he can get. He would be foolish if he didn't.

The goal of the criminal justice system is thus made very clear. It is to raise the price for crime until the expected benefit is too little to tempt the potential criminal.

The prices for other crimes are similarly low. In 1990 murder cost 1.8 years, rape 60 days, and car theft 1.5 days.

Now if these prices appear low, the weighted average cost is even worse. The crimes with the longest expected imprisonment, or prices - murder, rape, robbery, assault - are the least frequently committed, comprising only 12% of all serious crime. The remaining 88% carry risk of only a few days imprisonment.

Although the cost of living as measured by every indicator since 1950 has gone up, the cost of crime to the average criminal has gone down. Between 1950 and 1974 the cost of crime to the criminal dropped from 24 days to 5.5 days. This is in spite of the enormous increase in public spending for the criminal justice system. The crime rate, as we might expect, rose 300% during this period. Criminals were certainly aware of this pricing change, and they responded to society's real incentives by producing more crimes. Obviously much of society's spending has been wasted and misdirected.

I am not aware of any work that has been done to measure the price elasticity of demand for crime, but if we look only at the figures just mentioned, we would see that a 77% decrease in the cost of crime increased the demand 300%, a price elasticity of 3.9 times.

Since 1980, when Congress passed laws creating certain minimum sentences for some types of violent crimes and states followed suit, prison time increased and the crime rate declined slightly. Once again criminals responded rationally to economic incentives.

If we were to increase the price of burglary by 3.9 times as we just calculated to be the price elasticity, then the average prison stay would go from 4.8 days to 18.7 days and the monetary cost would increase from \$998.00 to \$3892.00. This is a considerably higher hurdle rate for the expected benefit to jump, driving many burglars out of business. Presumably jewel thieves would still be operating.

If we are to reduce the supply of crime, then we must effectively raise the cost of crime to the producers, the criminals, and we must focus on those activities that are most burdensome to society: burglary, robbery, car theft, and other so-called "petty" crimes. These are far more costly to society than so-called "serious" crimes such as murder and rape, because those crimes are committed less frequently, perhaps because the price of these crimes is already high enough to somewhat discourage the criminal.

A step in this direction has been the Repeat Offender Laws, the three strikes and you're out rules, which are designed to take persistent felons out of circulation. It would be more cost effective, socially beneficial, and humane to apply the death penalty to these persistent offenders. Perhaps five strikes and you're *really* out. My feeling is that the death penalty would seldom be required because the rational criminal would quickly weigh the costs and benefits and understand that the price had become too high.

Another important step would be to decriminalize certain activities where the criminal is the only source of supply. Obviously drugs come to mind. The policing of drug distribution requires enormous expenditures of public resources, and the restricted supply of a product which a substantial part of the public desires causes drug prices and profits to be extremely high, at no benefit to society. Also the high price of drugs causes crimes to be committed to raise the money to buy them.

Some economists think that if drugs were placed under a state-controlled distribution system just as alcoholic beverages and tobacco are handled, then the economic profits would be eliminated, prices would fall, and taxes could be levied and restrictions placed on the product, which should be at least as effective as those on alcohol and tobacco. Crimes committed to finance the purchase of drugs would be greatly reduced. The lower prices would result in some increased consumption of drugs but at much less social cost than the present system.

You can see how such methods would work by examining the gambling industry. The legalization of gambling as reflected in Indian casinos, riverboat casinos, off-track betting, and state lotteries has all but eliminated the criminal element which used to control all gambling activities. Criminal interest in gambling is now marginal, since the profits which formerly went to them now go to legitimate tax-paying businesses and to the states.

Eliminating the underground economy will be more difficult. While participants are engaging in the criminal activity of tax evasion, they are not a threat to others except in the general way of affecting the incidence of taxes. It is conceivable that an across-the-board lowering of income tax rates would so reduce the benefits from the underground economy that participation would not be as tempting.

Crime is a problem everywhere that people live as a society because it will always be profitable to someone. To fight crime it is necessary to raise the price of crime to the criminal higher than the profit he can expect to make, thus enlisting his self-interest in being a law-abiding citizen. Societies always produce the level of crime which they believe appropriate, just as they produce all other goods and services. Society needs to be as rational as the criminal and assure that the costs of crime are allocated where they belong - to the criminal rather than to the innocent.

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