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Econ 321

Week 15: Crime, Lawsuits, and the Allocation of Talent

I. The Market for Crime
   A. People face an "occupational choice" between the legal and the criminal sectors of the economy. How can we analyze their decision?
   B. Punishment and other crime-related risks mean that criminals get "compensating differentials." Their income, assuming they aren't in jail or dead, will exceed income in the legal sector.
   C. The greater punishments are, the lower the quantity of crime supplied. Punishments can literally be seen as "the price of crime" that criminals (probabilistically) must pay.
      1. While many sociologists debate this point, it is hard to take seriously. The real question is not "Does punishment deter crime?" but "How *much* does punishment deter crime?" Elasticities may vary for both individuals and types of crime.
   D. What about the demand for crime? At least for crimes with victims, this seems like a strange notion. Let's explore it by thinking about the market for car thieves.
   E. The supply of car thieves depends on the expected "wage" of car thieves - how many dollars per hour do they typically earn from stealing cars? The higher the wage, the more car thieves there are. Criminal punishments shift this supply curve.
   F. What does it mean to "demand" the services of a car thief? It simply means creating opportunities for thieves to profit. By parking your car in an exposed location, you increase demand for car thieves because you make it easier for thieves to earn a buck.
   G. The higher car thieves' expected wage, the smaller the quantity of crime car owners demand. If cars were sure to be stolen, no one would drive. If the risk of theft is small, a lot of people drive.
   H. The intersection of S&D gives us the equilibrium quantity of car thieves. Higher wages are not sustainable: They would imply too many car thieves and too few cars. Lower wages, similarly, imply a lot of vulnerable cars with few thieves taking advantage of them.
   I. None of the usual welfare analysis works here because stealing cars imposes negative externalities!
   J. But we can analyze this market like any other. If people get better cars, that increases the demand for car thieves. If they get alarms, that reduces demand. Changes in the law - or other job opportunities - similarly shift supply.

II. Punishment
   A. Question: Why not eliminate all crime?

B. Answer: While there are costs of crime, there are also costs of crime **prevention**. Catching every single criminal would require enormous expenditures, even if it were possible.
C. This implies the existence of an "optimal level of crime," the minimizes the **sum** of (costs of crime + costs of crime prevention). As always, even intangible costs can in principle be quantified in dollar value. How much would you pay to halve your risk of being murdered?
D. This isn't saying that crime is good, but only that getting less crime means giving up other good things.
E. One way to estimate the value of crime reduction is to look at housing prices.
F. Are we currently at the optimal level of crime?
G. What is the most efficient way to punish criminals? If at all possible, monetary fines! Why? Fines are a transfer; jail time (and jail space) is a deadweight loss.
H. Fines may be impossible to collect, but are often more feasible than you might think. You could even execute murderers and sell their organs if you wanted to be hard-nosed.
I. When they aren't, prison (or corporal punishment) often become second-best solutions.

III. The Probability-Severity Trade-Off
A. Another trade-off that law enforcement faces is between the probability and the severity of punishment.
B. Imagine a mix of probability and severity that leaves murderers indifferent.
    1. Ex: 10 years of jail with certainty (p=1), or 30 years with a 1-in-4 (p=.25) probability.
C. Out of this set, which is the cheapest?
D. For most purposes, low-probability, high-severity. Why? It takes a lot of effort to track down and convict someone; but once you catch him, the marginal cost of "throwing the book" at the criminal is small.
E. Contrary to widespread perception, a low rate of solved crimes may not be a problem. It may be part of an optimal probability-severity trade-off.
F. Why not go all the way?
    1. Increasing costs of judicial safeguards
    2. Risk-preferring criminals?
    3. Fairness/justice

IV. Lawsuits as Private Deterrence
A. Monetary fines are actually widely used in the U.S. legal system, but they are primarily used in "civil" rather than "criminal" cases.
B. But the legal distinction is unimportant from an economic standpoint. Lawsuits are just another kind of probabilistic "punishment" which deters certain kinds of behavior.

C. By making the losing defendant pay a winning plaintiff, lawsuits create incentives for private deterrence. Without this incentive, prosecution would largely be a public good.
    1. You could get rid of state-funded criminal prosecution if convicted criminals had to pay the victim monetary fines!
D. Interesting feature of legal battles - They are a kind of tug-of-war. After both sides hire a lot of legal talent, the odds may be no different than they were if the parties represented themselves!
E. This shows the silliness of the notion that "everyone should have the best legal representation possible." If *everyone* does, what's the point?
F. How can you deter "frivolous" lawsuits? The loser-pays rule.

V. Crime, Lawsuits, and Deadweight Costs
A. Punishing criminals typically involves high deadweight costs - prison time, court time, etc.
B. An efficiency defense has to argue that the deadweight costs of deterred offenses makes this sacrifice worth it.
C. Examples of inefficient criminal laws? One of my picks:
    1. Drug prohibition
D. Similarly, lawsuits involve high deadweight costs. Perhaps the primary cost is the opportunity cost of lawyers' time.
E. An efficiency defense of lawsuits has to argue that the deadweight costs of deterred behavior makes this sacrifice worth it.
F. Examples of inefficient classes of civil cases? One of my picks:
    1. Discrimination laws

VI. Implications for the Allocation of Talent
A. Larger settlements benefit both plaintiffs' and defendants' lawyers. Bigger fines means more demand for plaintiffs' lawyers; but it also induces defendants to hire better lawyers to protect themselves.
B. Whatever bad you might say about lawyers, one thing is clear: they have a high average IQ.
C. When judges or juries make suing more lucrative, they increase the demand for lawyers. In the long-run, this siphons more high-ability people into the legal profession.
D. The U.S. lawyer/population ratio bears this out nicely during the 20th century.
E. Some lawsuits serve a useful function, but this effect on the "allocation of talent" is widely ignored.
    1. Interesting international findings on lawyer/engineer ratios and economic growth.