

How Economists Think

Neo-Classical Economics and the Treatment of the Non-Economic

Research Report

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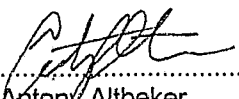
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Attestation

The following Research Report is my own, original work. It is submitted in conformance with the requirements for the M. Comm degree at the University of the Witwatersrand. and has not been submitted at any other time or place.

Signed:


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"We assume that political systems are rationally devised and rationally employed, which is to say that they are appropriate instruments for the fulfilment of desires of members of the society" (Stigler, 1988b: 210).

"[T]he name 'Auschwitz' invalidates the presuppositions ... that all that is real is rational, and all that is rational is real" (Lyotard, 1987: 162).

Chapter One

Preliminaries: Epistemology and Definitions

(1.1) Introduction

What are we to make of the studied indifference of neo-classical economics when it comes to questions of the desirability of social policies and the question of justice? Is it, as its adherents claim, possible to divorce positive and normative questions? If it is, is it true that neo-classical economics has made this distinction?

The thesis of this paper is that while neo-classicism tries to remain neutral on specific social policies, it is not value-free or apolitical. I will try to argue that at the soul of the neo-classical paradigm is a conception of justice. This conception of justice is so well disguised, and neo-classicism so seemingly empty of political implication, that none of us is truly aware of it. It is seldom openly articulated, it hides in the shadows of the rigorous formalism of the discipline, but it whispers through every equation. I will also try to show that, precisely because this 'guiding conception' is so deeply buried, that it fails its users at precisely the moment they need it most. I will try to show all this by examining the way economic theory is deployed in the analysis of real social phenomena and the way these really operate. But the focus will not be on what is argued, but on how and why it is so argued.

This paper is based on an epistemology - science of knowledge - quite different from the dominant epistemology in economics. The construal of the nature and practice of science advocated and practised by most economists depicts the scientist as a person confronted by a world which, if peered at long enough, from the right angles and using the correct spectacles, will reveal its secrets to the persistent enquirer. The scientist, constitutively and innately endowed with the capacity, if not necessarily the ability, to see, goes off into that world looking for answers to questions. Such is the depiction of the nature of scientific work in positivist and its allied modernist conceptions of knowledge.

As should be apparent, this characterisation of the work of the scientist, is also a characterisation of her relationship to the world. The scientist, if true to her convictions and intellectually integrous, will be able to discern the true nature of things. In this

construal, therefore, the scientist does not bring anything to her work other than the willingness to learn and the desire for answers. Any mistakes are a function of oversight, misrecognition or myopia. This logic of seeing and oversight reveals a particular conception of knowledge in which the work of knowledge is reduced in principle to the facts of visibility and of vision in which the object of knowledge is reduced to the condition of its existence independent of the scientist. Thus, when Knowledge becomes 'true vision', the object of knowledge is conceived as prior to, and independent of, its knowledge.

This conception of knowledge and knowing has been challenged by the so-called 'growth of knowledge' school of philosophers of science.¹ They argue that, far from the real revealing its hidden secrets to the willing observer, it is the observer's relationship to her world which determines what can and cannot be seen, and what can and cannot be known. In terms of this perspective - associated with the names of Wittgenstein, Kuhn and Feyerabend - science can only pose problems on the terrain and within the horizon of a definite theoretical structure, its problematic/paradigm, which constitutes the conditions of possibility of particular knowledges, determines the form in which all problems must be posed and solutions sought. If we return to the metaphor of sight, we might say that it is the constructions which constitute the theorist's theoretical structure which determine what is visible, and conversely, what is invisible. Any object situated within the terrain of the paradigm, ie within the theoretical field, is visible. This is meant literally - it is **not** the theorist who brings the object of knowledge to light, but the theoretical system which has already constituted that object as something which can be seen. The scientist is therefore no longer conceived as a being endowed with the quasi-divine ability to see the reality of things, rather what can be seen and is, in fact, seen is determined by the theoretical structure which precedes the work. The theorist thus 'finds' something which was always-already there, in effect she ties the problem to its conditions of possibility.

If problematics and paradigms do determine the problems, and solutions, sought by theorists, two forms of criticism of theoretical work are implicitly made permissible - either one can examine the solutions to problems developed by particular theorists, or one can scrutinize their texts in order to lift out and examine the problematic of which it is part, and which manifests itself in the formulation of problems and solutions.

Most disputes in economics take the former form. There the critic seeks to show that the solution posed by a particular writer is deficient for some or other reason, eg a

¹ The following few paragraphs draw heavily on Althusser (1970, especially p20-28).

misspecification of the problem or a solution which does not take into account some variable. The present paper takes the other path. I intend to read neo-classical texts in order to bring to the surface what Veblen called their 'guiding conceptions'. To do this, it will be necessary, very often to emphasise the phrasing of problems and solutions, rather than simply accepting the particular words chosen as transparent media for the transmission of knowledge. What I hope to show is that at its higher syntheses, neo-classicism is a conception of justice, not a description of the workings of actual economies. As such the role it can play in developing a thoroughgoing knowledge of the social is severely restricted. But I will also try to show that, precisely when the neo-classical approach is deployed in an effort to prescribe appropriate social policy, it uses the logic of the mechanics of the ideal world as if they already described the real.

Now, surprisingly, given the ease with which we speak - either in praise or contempt - of this thing called neo-classical economics, it is quite difficult to define. This is largely because neo-classicism is the language of economics. As such we require some *other* language with which to examine it. The difficulty with such a meta-language (a language within which the language of economics is an object of study), is that one must already see neo-classicism as an object to be examined, rather than the language of explanation, before one can even perceive the difficulties. If neo-classicism is the last-word, the ultimate explanation, it cannot itself be an object of study. Since its use is explanation, it cannot be explained except by itself. If, on the contrary, one is interested in the character of neo-classicism, one has already accepted that it cannot have the final word on anything - indeed one has already accepted that it is an 'it', ie that it has an independent existence and efficacy.

This is a difficulty not peculiar to economics, though it is exacerbated by neo-classicism's inordinate theoretical hegemony. In other disciplines, the relative plurality of competing approaches forces practitioners either to accept the variety of contending explanations and to recognise the heterogeneity of languages, or, as is more often the case, to translate competing languages into their own, either as special cases of their own 'general theory', or as plots by obscurantists (or more mildly, by misguided theorists) aimed at overthrowing the hallowed order of their own 'true theory'. In either case, the experience of a different perspective is, no doubt, bracing. Unfortunately, in economics, discordant voices are few and far between. Indeed those that are heard are usually demoted to the ranks of pop sociology (Veblen, Galbraith), or they are tamed (the more subjectivist side of Keynes), or their theoretical contributions are ignored while their policy proposals are cited as additional evidence for the adoption of neo-classical proposals (the Austrians).

(1.2) What is neo-classical economics?

As I have said, because neo-classicism is the language of economics, it is quite difficult to define. This means that very often disputes in economics, for all their heat, operate from a set of common premises. Thus, despite disagreement, neo-classicism is affirmed by all parties to various controversies: How, for instance, are we to understand the quest for the micro-foundations of macro-economic phenomena, framed in terms of rational agents maximising their individual utilities in an equilibrating market, except as an affirmation of neo-classical analysis as the only mode of successful economic theorising?

This paper seeks to examine elements of neo-classical economic analysis. As such it is essential that there be some discussion of what is unique to a **neo-classical** analysis, ie what is constitutive of neo-classicism. In other words what separates a neo-classical analysis from other forms of economic analysis. This brings us to having to define neo-classicism. Such a definition is crucial, for unless we know of what it consists, we will not be able to discuss its conceptions. The problem: definitions are always arbitrary. This imposes a duty on the definer to justify his choices.

We could conceivably define as 'neo-classical' any theory, the policy proposals of which affirm the superiority of free markets over state intervention. If this were the case some economists who are usually defined as Austrians, and who are noted for the virulence of their attacks on orthodoxy, are deemed neo-classicists (Hayek, Lachman), while other economists often included in the neo-classical school are excluded (Stiglitz, the New Keynesians). We may, on the other hand, define economics in such a way that there is only one way to do it - the neo-classical way. This is in fact often attempted in economics. Becker (1986) defines "the economic approach" as assuming maximising behaviour of agents, that markets exist and, with varying levels of efficiency, coordinate the activities of agents (1986: 109-110, emphasis added). This definition of economics makes the discipline neo-classical. Other approaches are simply defined as non-economic.¹

There are a number of elements which would have to go into an adequate definition of neo-classicism to cover the common core of all neo-classical projects irrespective of

¹ In the language of the previous section, we might say that Becker accepts the finality of neo-classical language, and refuses to contemplate a meta-language of economics within which neo-classicism could be discussed. Discussions of neo-classicism, because they assume some ground outside of its language, must be something other than economic. The implication, of course, is that nothing can be said in economics that is not explicable through neo-classical concepts.

the disputes between rival neo-classicists on particular scores. These elements would include a recognition that the neo-classical understanding of the economy is premised on the notion of a (i) static equilibrium achieved by (ii) voluntary exchange, with (iii) price rationing determining the choices and behaviour of (iv) economic agents who have autonomously defined preference functions, and who, when faced by (v) constraints, are understood to, respond (vi) rationally to maximise their utility/profit. Economists, on the other hand, are deemed to be (vii) positive scientists.

Each of the seven elements of the definition of neo-classicism is a source of debate between economists who would intuitively categorise as neo-classical. The difficulty, therefore, with this definition is that it is incredibly broad with a number of different approaches possible to each of its elements. For instance, take the concept of an equilibrium: Are we to include only those theorists who work with partial equilibrium models, or only those using general equilibrium models? Are preference functions to be conceived as additive, as the early marginalists (Jevons, Menger, Walras) did, or is a generalised utility function constitutive of a neo-classical approach? What about behavioural theories of the firm which argue that management maximises something other than profit? If positivism is the definitive neo-classical approach to theory, are we to exclude Walras, who some argue founded neo-classical economics, but whom others claim was not a positivist 'scientist'? What of the treatment of price-rationing: are economists doubtful of the usefulness of the Coase Theorem - which states that markets and prices can be used to internalise externalities - and who therefore posit a Pareto-improving role for other forms of rationing, automatically excluded from the school?

Clearly if we were to insist that an absolute consensus must reign on each and every element of our definition, the neo-classical school would be remarkably small. And this, perhaps, is the strength of neo-classicism: it can house diverse approaches to the subject without getting mired in debates about what to call each contesting group and without its theoretical basis being subjected to doubt. The reason for this is that the neo-classical approach is beautiful in its simplicity. Correlatively, our definition must be simple. The various elements of a definition of neo-classicism can be reduced to three simple assumptions, and it is these that embody the core of the neo-classical paradigm: (a) that individuals have utility/preference functions; (b) that when faced with constraints, agents behave rationally; and (c) that rational behaviour, combined with price rationing, leads markets to stable equilibria. The other elements I have

mentioned can either be reduced to these one of these two, or derived from them.¹

If this is the case, however, whence neo-classical disputes?

The principle sources of disagreement among neo-classicists pertain to the nature of the constraints faced by agents in the economy: determining what are the opportunity costs faced by individuals in diverse situations, the limitations of their knowledge, the role of expectations, the source and character of exogenous shocks, the determinants of supply/demand schedules, etc. provide endless sources of conflict over the nature and likelihood of a market achieving a stable equilibrium, the efficacy of policy and the optimality of existing and prospective patterns of activity and resource allocation. All of the contending explanations of the phenomena analysed, if they accept assumptions (a), (b) and (c), are neo-classical, irrespective of their conclusions or policy proposals.

This approach is then deployed to analyse, describe and explain real phenomena. In doing so, however, neo-classicism insists on its own literalism. Take, for instance, Becker (1986). He argues that economists who depict phenomena as disequilibrium states, or who use changes in tastes as a mode of explanation, are failing in their intellectual duties. He insists that at any time, observed relations are in equilibrium, and, if reality appears to be out of equilibrium, it is not really so:

"When an apparently profitable opportunity to a firm worker or household is not exploited, the economic approach does not take refuge in assertions about irrationality, contentment

¹ Becker defines the economic approach as the "unflinching use" of "the combined assumptions of maximizing behaviour [(b)], market equilibrium [(c)] and stable preferences [(a)]" (1986:110). The other theorems of economics are derived from these.

A similar, though longer, list is provided by Daniel Hausman (1984) in his discussion of general equilibrium models. He argues that the equilibrium theory is the core of neo-classicism, but that it is not to be confused with general equilibrium models which, he regards, as "applications of equilibrium theory" (Hausman, 1984: 344). His list is an archetype of these discussions.

He defines equilibrium as a state of zero excess demand and then, stressing that the following are law-like statements of equilibrium theory, ie not assumptions, he states as the fundamentals of neo-classicism:

- (i) Any individual A can only prefer x to y, y to x, or be indifferent between them.
- (ii) A's preferences are transitive.
- (iii) A maximizes his utility by choosing option x over y if he prefers x to y.
- (iv) Bundle y will be preferred to x if it contains more of one good and at least as much of all other goods as x.
- (v) The marginal utility of a good is negatively related to the quantity of that good possessed.
- (vi) The law of diminishing marginal returns in production applies.
- (vii) The production function is linearly homogenous.
- (viii) Entrepreneurs and firms maximize profits (Hausman 1984: 345).

There is an interesting omission from this list, an omission which ensures that Hausman's definition of neo-classical economics relates only to the short run. Without any explanation he has no condition that in equilibrium, profit is zero. I take this omission to derive from the incoherence of defining an equilibrium where profit is zero in the presence of imperfect competition.

with wealth already acquired, or convenient *ad hoc* shifts in values (that is, preferences). Rather it postulates the existence of costs, monetary or psychic, of taking advantages of these opportunities that eliminate their profitability - costs that may not be easily 'seen' by outsiders" (Becker, 1986: 112).

The famous Stigler and Becker (1977) paper is perhaps the best known example of this kind of work.

(1.3) Conclusion

The strategy I have adopted for this study might be termed that of 'symptomatic reading'. In essence, what I propose to do is to give an exposition of the key arguments in some of the of the neo-classical writing on aspects of politics and society in order to offer an account of the standard against which actual economies/societies are compared when neo-classicists go to work. More particularly, I will examine two neo-classical accounts of racism in society (Hutt's work on apartheid and Becker's work on the USA) and the central models of crime and criminal justice built on the neo-classical edifice. I will conclude from the analysis of the neo-classical account of racism that neo-classical economics is an economics of evaluation, and that the final term of the comparison is an expression of a conception of justice. I will then offer some (brief) comments on the intellectual desirability of making economics this sort of discipline. From the assessment of the neo-classical approach to crime and criminal justice, I will conclude that the notion of justice inherent in the neo-classical paradigm is, in this case, unable to help us to grasp and understand real issues in the application of justice, precisely because it assumes that the mechanisms that would be operative in a world which conformed to its ideals, operate in real, existing societies which are grappling with present day problems.

Chapter Two

Race, Reason and Justice in Neo-classical Economics

(2.1) Introduction: Neo-classical political economy

The Chicago-school literature on regulation and monopolies can be read as symptomatic of the neo-classical trivialisation of the role of economists to the comparison of actual practices with ideals of justice. Indeed this is a particularly fruitful place to begin an exploration of the neo-classical paradigm since it is the literature of this type (namely, public choice and rent-seeking) to which the some economic work on racism, especially Hutt's, conforms.

The two principal questions asked by the 'new political economy' are: (i) What determines the capacity of different participants in the political process to influence the course of public policy? (ii) What cost must be borne when policies are influenced to the benefit of one or other sectional influence, and who pays?

The treatment of the political sphere is undertaken along lines easily predicted by any reader of neo-classicism, in particular, the political sphere is treated as a market with its own forces driving it to equilibrium. "Whatever the governmental form, equilibrium in the political market place for legislative goods and harms is determined by the nature and composition of the politically effective coalitions and the size and nature of programs they achieve" (Stigler, 1988a: x/xi).¹ Policy is, therefore, determined by

¹ This paper is **not** about the inadequacies of the neo-classical theories of politics, however, some of the statements in the literature are so revealing as to be worth a brief digression.

What, for instance, are we to make of Becker's 'influence function'. According to him, political influence is a function of:

$$I = I(p_s, p_t, n_s/n_t, x)$$

where I is the influence function, p_s and p_t are pressures by subsidy recipients and tax-payers respectively, n_s/n_t the relative number of recipients, "and x refers to the political system and other relevant considerations" (Becker, 1988a: 87, my emphasis). No doubt incumbents to office, their opponents, voters and analysts of every stripe would be delighted if "other relevant considerations" were so easily dealt with!

The only way Becker can sustain his function is by the assumption that x is fixed for the relevant range. But this use of the *ceteris paribus* assumption is, surely, more problematic than usual. How can

equilibrium in the political market place. The precise position of such an equilibrium depends on the "pressure production functions" of competing interest groups, while the identity of groups is often limited to groups of taxpayers and groups of subsidy recipients in this literature (see Becker, 1988a).

Perhaps the most interesting concept in this literature, and the one that is most important for its policy conclusions, is that of 'deadweight costs'. If policy consisted of nothing more than transfers, and these transfers were deemed desirable by an electorate characterised by groups with equal access to state power, the adoption of such policies would merely be the expression of the electorate's utility function, and, hence, would be efficient outcomes. With the introduction of deadweight costs, which are defined as costs without beneficiaries, theoretical denunciation can be achieved, even given equal access to power.

The crucial point about this literature, however, is that it attempts to account for the whys and whens of the adoption of specific policies. Almost invariably, a beneficiary group is identified. Now these theorists are not so crude as to identify the existence of a beneficiary as the *raison d'être* for the policy. No, they are far more ambitious - an explanatory theory must also account for how that beneficiary was able to get its way. Invariably it is either inequitable access to state power, or differential costs of organising political pressure for competing groups, that is cited as the origin of differential political power required to steer state policy in directions deemed desirable by particular groups.

In this regard the conception of state power is important. The state is conceived as "an organization with a comparative advantage in violence, extending over a geographic area whose boundaries are determined by its power to tax constituents" (North, 1986: 249). A state, therefore, "has one mighty resource which in pure principle is not shared by even the mightiest of its citizens: the power to coerce. The state can seize money by the only method which is permitted by the laws a civilized society, by taxation" (Stigler, 1988b: 210-211). The tone of these quotes reflects the underlying equivalence between coercion and redistribution in neo-classicism. The ultimate conclusion of these studies is that policies favouring particular groups will be adopted if either the boon accruing to the beneficiary is greater than the losses suffered by losers (who

it be argued, except as an unhelpful truism, that influence is, *ceteris paribus*, a function of the amount of pressure that particular interest groups can exert? How helpful is it to argue that changes in influence, if we discount all other factors, can be ascribed to changes in the relative pressures which different groups can apply combined with the relative size of recipients and payers?

More importantly, what does it say about the economic approach to politics when politics is reduced to a zero-sum game between tax-payers and subsidy recipients, as is implicitly the case here?

would therefore not devote as many resources to preventing the adoption of the policy as those deployed by people seeking to gain), or if the benefiting party has superior access to political power (for this conclusion see Becker 1988a).

This conception of the state, and its misuse by powerful political actors, is precisely the guiding conception behind Hutt's analysis of South Africa which I present below. The argument is that the politically powerful white working class succeeded in using the state to restrict entry into the labour market and hence facilitate the acquisition of economic rents by (overpaid) white workers. Hutt's analysis and the Chicago analyses are, therefore, homologous in structure: the state - an organization capable of disrupting the market due to its capacity to coerce results that would not be achieved on the basis of voluntary exchange - is used by (rational) rent-seekers to distort markets for their own ends.

(2.2) The economics of *The Economics of the Colour Bar*

When William Hutt wrote *The Economics of the Colour Bar* in 1964, he offered a neo-classical analysis of the structure and character of South African society. In those heady days of grand apartheid, it took a bold man indeed to argue that economic forces were operating to dissolve discriminatory social and economic practices away naturally. True, he did see an equally natural phenomenon - that "all men would be monopolists if they could" (1964: 73)¹ - to be the source of apartheid, but that other, more egalitarian, force - the market - was thought to bear with it, if allowed to operate unhindered, the death of racial discrimination. "The market is colour-blind," he declares in the title of the final chapter.

Now I do not intend to keep the reader occupied with an overly-critical exposition of what is clearly a dated text. It will little serve my purposes to belabour his constant affirmation of the superiority of "white civilization"; the peculiar blind-spot he has *viz-a-viz* the monopolized structure of ownership, whilst condemning the monopolist character of the labour market; and the persistent overvaluation of white business-owners as opponents of apartheid. What I am interested in is the conception of the rationality of the market in his text because, it seems to me, that this might be a fruitful way into our discussion of rationality in neo-classical economics.

Hutt argues a variant of theoretical economism. Traditionally economism consists in

¹ This quotation is remarkably resonant with the following from Stigler (1988b): he states as a "general hypothesis" that "every industry or occupation that has enough political power to utilize the state, will seek to control entry [into that industry or occupation]."

the argument that particular phenomena are determined by the economic relations inherent in a particular situation or period, or at a particular moment in history. That those phenomena are nothing but the translation of a particular feature of the economic force/institution from the realm of the economic into some other sphere. Now economism comes in many shapes and sizes: Marxists, using the well-known base-superstructure model, tend to argue that social relations of production determine the politico-legal-ideological superstructure; others, like Rostow (1960) argue that socio-political change is governed by the growth of output.¹

Hutt, on the other hand, argues that "the chief source of colour discrimination is ... to be found in the natural determination to defend economic privilege" (Hutt, 1964: 27). In other words racism is not the cause, but the effect, of economic inequality. It is worth pointing out this idiosyncrasy of Hutt's economism: whereas both Marxist and Rostowite economism attributes some form of **change** both to the economy and to its epiphenomenon, Hutt's economism is not about changing the economy, but about establishing distortions in an economic space which remains homogenous over time.

Hutt argues that the chief effect of income inequality, combined with unequal access to state power and the capacity to accrue rents, is the formation of racist conceptions of the world. Racism amounts to being a justification for the continuance of the economic differentiation which originated, not as an effect of a deliberate (and therefore unjust) policy, but as an effect of the coming together of two groups with different standards of living. For Hutt, apartheid's injustice consists not in the mere existence of inequality, but in the perpetuation of unequal economic opportunities through the (political) machinations of a privileged caste - the white worker - which used its privileged access to the state to erect barriers to entering the labour market before black workers.

Hutt, therefore, proclaims that racism is not a self-explanatory datum, an irreducible and irremovable feature of our social structure. He insists that it is itself an object to be examined, questioned and explained.² But, in de-naturalizing racism, Hutt exposes a peculiar vicissitude in his own use of the concept of rationality: on the one hand, colour prejudice is a "manifestation of powerful custom" (1964: 11) which is deemed "irrational" (29); while on the other, racism arises from rationality itself - the

¹ The difference between Marxists - other than particularly crude ones - and Rostowites (such as O'Dowd 1974 - first published in 1966) is that the former conceive of the economic base as constituted by a set of **relations**, while the latter view the determining base in purely quantitative terms.

² This is in stark contrast to Becker (1971) in which racism is **defined** as an exogenously formed taste. We will return to Becker a little later.

"naturalness" of the fear of competition arising from the dissolution of racial privilege is affirmed (28).

Now he has, as we have seen, insisted that the pursuit of monopoly power - rent seeking - is an inherent (ie "natural") characteristic of people, who ("naturally") prefer not to face competition.¹ This trait may, under certain conditions, result in "irrational" prejudice to buttress itself if the rent-sought becomes rent-attained by the creation of contrived scarcities. In other words, the rational pursuit of rent can result in irrational social views and unjust economic dispensations.

Hutt counterposes this conception of the emergence of irrationalities to an alternative, opposing force which serves to dissolve customs and prejudices. The market system, defined as consisting of the facilitation of the "democratic exercise of consumers' sovereignty" (1964: 176), acts to subvert and dissolve all sedimented social practices - including racism. "In a multi-racial society," he avers,

"[the market] tends, because of the consumers' colour-blindness, to dissolve customs and prejudices which have been restricting the ability of the under-privileged to contribute to, and hence to share in, the common pool of output and income. This is because business decision-makers - the 'entrepreneurs' - have an immensely powerful incentive to economise for the benefit of their customers, who collectively make up the public. Their success depends on ... discovering under-utilised resources."

He concludes therefore that "competition is essentially an equalitarian force" (Hutt, 1964: 175).²

Now the alert reader of Hutt will notice a vacillation in his location of the liberating forces of the market. He tendentiously entitles his final chapter "The market is colour-blind", but later it is the customer and entrepreneur who are deemed to be devoid of prejudice:

"The virtues of the market [depend on] the dispersed powers of substitution exercised by men in their role as consumers. In that role, a truly competitive market enables them to

¹ Elsewhere, Hutt states that "contrived scarcities arise so spontaneously in society, that it is impossible to regard their presence as 'unnatural'" (Hutt, 1934:15). Hutt, here, explicitly naturalizes the pursuit of monopoly power and rents.

² This thesis, apart from the assertion that the benefit of economizing accrues to the customer, is remarkably consonant with Karl Marx's analysis of the "revolutionizing" potential of capitalist relations of production.

In The Communist Manifesto, Marx argues that everywhere capitalism spreads, "all fixed, fast-frozen relations, with their train of ancient and venerable prejudices and opinions, are swept away ... All that is solid melts into air, all that is holy is profaned, and man is at last compelled to face, with sober senses, his real conditions of his life, and his relations with his kind" (Marx and Engels, 1986: 37).

exert the energy which enforces the neutrality of business decision-making in respect of race, colour, creed, sex, class, accent, school or income-group" (Hutt, 1964: 174/5).

This vacillation, in which the market ceases to be the source of reasoned non-racialism which is displaced onto the consumer, is a crucial move. It consists in the insistence that *qua* consumer/entrepreneur, no-one is racist. In economic theory this claim originates in the belief that the consumer is interested only in her utility, a utility which is derived from the nature of the good consumed, and not from the character of its production. This strikes one as rather incongruous given his recognition (and attempts to explain!) the existence of prejudice.

Prejudice arose as an effect of the successful (political) machinations of white workers defending their relative living standards. The claim that this prejudice should vanish when individuals enter the market as consumers, rather than as rent-seekers, sounds a little more like religious faith in a particular conception of consumer rationality, than rigorous argument. Indeed there is no argument - only assertion. Why should people, constituted as racists, drop their racism when they evaluate the utility afforded by particular products? Might they not be prepared to pay more for the privilege of avoiding commodities soiled by their proximity to the despised "race, colour, creed, sex, class, accent or income-group"? Indeed this is Becker's (1971) presumption - but more of that later.

Thus two different conceptions of rationality appear to operate in Hutt's text. There is the rationality of the agent who constitutively, *qua* economic agent, desires to accrue monopoly profits. On the other hand there is the competitive system which entices its actors to pursue least-cost techniques of production and hence leads to the eradication of irrational customs and prejudices which inflate costs by creating artificial scarcities. It would not be stretching the point to put it in these terms: the market establishes a set of rational economic relationships based on the equation of returns to factors with the value of their marginal product; these relationships are rational but rational human agents are intent on breaking the rules, an activity which can lead to the emergence and persistence of irrational economic relationships depending on irrational (in this case, racist) individuals!

Perhaps I am being unfair to Hutt. The rationality of the market is not assumed to lodge solely in the free play of its operation; rather it depends on the rationality of the colour-blind consumer underpinning that operation. There are two problems with trying to salvage the notion of rationality in this way: First, if there are rational bases for being both colour-blind (utility maximisation of the consumer) and racist (rent-seeking) even though racism is "irrational", Hutt must surely offer an account of how the individual

negotiates these competing rationalities. But, Hutt completely fails to make an attempt to do so. In any event, he would be precluded from arguing that consumers balance the relative marginal costs and benefits - psychic and otherwise - in order to determine the distribution of their resources between racist and non-racist activities because he has already said that as individuals *qua* consumers are never racist!. Secondly (and more contentiously), on what basis is Hutt permitted to assert that it is irrational to be racist? What leads him to believe this?

Indeed, it is only through a most generous and forgiving reading that Hutt himself can be seen as colour-blind. More importantly, neo-classicism, by its own self-representation, is unable to deal with questions pertaining to the rationality of preferences. It is a fundamental element of neo-classicism that tastes, social norms and institutions are exogenous. Tastes and preferences are pre-given data for the decisions, activities and allocations of resources of the members of the economy, and, *qua* economist, Hutt is incapable of making claims about the rationality of them. That is, unless he bases his judgement on something else. It is the argument of this paper that this is precisely what happens in Hutt's text: Hutt uses an implicit morality to make a normative judgement about racist social institutions, and racism itself.

In other words, Hutt bases his view of the rationality of being colour-blind on a system of ethics. This system, however, is not separate from his economics. Quite the reverse, that system, I will argue, is his system of economics.

Anyone who had followed my exposition of Hutt closely will have noticed a problem with my characterisation of him as a member of the neo-classical school. Neo-classical economics specifically disavows any claims to being able to explain the emergence of tastes, surely then, when Hutt relates the emergence of racism to the monopolisation and regulation of the labour market, he is violating the strictures of neo-classicism?

One response might be to say that other neo-classicists do the same thing: Hutt quotes Milton Friedman's *Capitalism and Freedom* as an epigraph to his book:

"The preserves of discrimination in any society are the areas that are most monopolistic in character, whereas discrimination against groups of particular colour or religion is least in those areas where there is the greatest freedom of competition."

Of course just because Friedman relates tastes to regulation also, does not make it a legitimate theoretical strategy. How then, are we to account for the existence of racism?

(2.3) The economics of *The Economics of Discrimination*

Becker's study of discrimination (1971) manages to avoid making any claims *viz-a-viz* the causes of racism.¹ Indeed that is often one of the criticism's of the text: that it assumes racism without explaining it. Becker's model allows 'tastes for discrimination' to affect the labour market (where both the employers' and employees' tastes impact on the operation of the market), as well as in the goods market (where both buyers' and sellers' racism affects decisions about resource allocation). His model of discrimination in America analyses the costs to the minority (those discriminated against) and the majority (discriminators) by building a model in which these two groups trade as if they were two distinct nations with comparative advantages in labour and capital respectively.

In essence the model posits a discrimination equilibrium price differential. In the labour market, where the equilibrium wage is x , the discriminatory employer will treat it as $x(1+d)$ while the discriminating worker will treat it as $x(1-d)$ wherever her transaction is with a potential employee or employer from a group against whom discriminatory tastes are held respectively; in the product market, the consumer will treat the equilibrium price as if it were $p(1+d)$ where the seller is from such an abhorrent group. Here d is the 'discriminatory coefficient'.

In terms of this model, discrimination exists where the individual acts "as if he were willing to pay something, either directly or in the form of reduced income, to be associated with some persons instead of others" (Becker, 1971: 14). Whether it is the worker or employer that is prejudiced, members of the group discriminated against must set their wages below the value of their marginal product, or face unemployment; if it is the consumer who is prejudiced, prices must be set below the levels that would result from a situation free of discrimination, or the seller must face reduced sales.

Throughout the text Becker refuses to take up the question of the origins of discrimination. His aim is more modest - he attempts to analyse the effects on income of any form of discrimination in the market, ie wherever non-monetary criteria enter the decision to buy, sell, hire or fire. He finds that tastes for discrimination reduce the income of both discriminator and discriminated, but that the losses incurred by those

¹ As a rider I should add that Becker does argue that in relatively more competitive industries, effective employer discrimination should be lower. The difference between Hutt's account and Becker's, is that where Hutt allows competition to change the tastes of individuals, Becker merely argues that "on average" non-discriminators do better in competitive industries than do discriminators. Indeed his conclusions are quite different to Hutt's: discriminators move to monopoly industry in Becker, in Hutt monopolists develop tastes for discrimination.

against whom the 'tastes for discrimination' exist are relatively larger than those of the discriminators - given certain assumptions (essentially matching American demographics) about the relative sizes of the groups and their relative factor endowments.

What should be made quite clear, and is left rather ambiguous in Becker, is that while the money incomes of both groups are reduced, it is the discriminating group's **choice** to reduce money income in order to avoid the psychic costs of working with, or buying from, people with whom they would wish to have no contact. He fails to recognise explicitly that the reduction of income of group which is the object of discrimination is caused by factors beyond its own control - a point that is perhaps important when considering the policy implications of the existence of racism.

But what, you might ask, has this to do with Hutt's analysis of South Africa? More importantly, what has this to do with my argument?

Both Hutt and Becker's arguments rest, implicitly and explicitly, on a conception of market in the absence of racism. Hutt foresees a situation where the removal of the possibility of the state's being used to discriminate to create artificial scarcities, would lead to the elimination of racism. Becker's claim that racism reduces the incomes of groups, on the other hand, can only be formulated by comparing the incomes to a (hypothetical) ideal where racism does not exist. In his discussion of employer discrimination, he hints at what such a situation would look like: "If one individual discriminates against another, his behaviour lacks '**objectivity**'". He argues further that, "in the market place, '**objective**' behaviour is based on considerations of productivity alone" (Becker, 1971: 39, emphasis added). This glimpse of the standard against which the existence of racism in the market is measured, is revealing.

In essence Becker is saying that behaviour can be '**objective**' or, presumably, '**non-objective**'. If this is the case, behaviour can also be evaluated objectively, or, at least, against objective standards. Now it is the character of this objectivity which is important: objective behaviour excludes behaviour based on criteria other than pecuniary maximisation. In this regard it is interesting that Becker should put scare quotes around the word "objective".

If the goal of using the quotation marks was to signify his disavowal of any claims to know a standard against which it is legitimate to measure the rationality of behaviour, Becker fails. The marks in fact do the opposite, they draw attention to the hypothetical nature of objective behaviour in this model. In other words the marks are symptoms of

the failure of rational actors to comply with the strictures of dispassionate and objective behaviour. The use of scare quotes also indicates the ideal character of objectivity, and hence the idealism of the state which is used by neo-classicism as a standard of measurement against which one can compare actual behaviour.

What is the significance of the idealistic character of the neo-classical touchstone? The easiest answer might be that since every judgement is necessarily a comparison, it is perfectly legitimate to hold up an ideal against which to measure reality. The difficulty with this defence is not that it is implausible -indeed I find it very convincing - but that as a defence, it raises severe problems for neo-classicism. If actual behaviour is not identical with objective behaviour, how can neo-classicism be justified as a model of real economic relations? If employers do not employ people in terms of their marginal product, but include "non-pecuniary criteria" in their decision-making, how can neo-classicism, which permits only rationing by price, possibly model actual economic behaviour?

The point: An economics which merely compares the actual to an ideal relegates itself to shouting from the side-lines about opportunity costs of 'non-objective' behaviour.

(2.4) The dual nature of rationality

In discussing Hutt's work, we noted the duality of the conception of rationality. This duality is mirrored in much of neo-classical theory: a conceivably (conceptually?) rational system is populated by rational agents, who might behave irrationally judged from a systemic point of view. Indeed Becker's work on discrimination manifests this too.

As was noted earlier, Becker makes no attempt to account for the origins of racism, preferring to treat it as an exogenously formed taste. Now, while we must acknowledge neo-classicism's reluctance to enter the debate on the formation of tastes, we are given a hint that Becker would regard discrimination as 'non-objective'. By implication this taste constitutes an obstacle to the 'objective' allocation of resources and employment of factors of production. This can only be read to affirm the irrationality of racism from the perspective of the economic system which is inherently and constitutively itself free from these obstacles. Implicitly, without these artificial hurdles constructed by fallible economic agents, the economy could go about the business of rational resource allocation efficiently, resulting in a veritable utopia of optimality. This reading is confirmed by the conclusions reached by Becker's study: racism reduces the welfare of both parties/groups, and therefore of the collective.

Despite the existence of this obstructive taste for discrimination, producers, workers and consumers remain rational. The difference is that, like any other taste, the taste for discrimination must be accommodated in the actions of the individual. Where the producer might have (were she **objectively** rational), employed people up to the point where the value of their marginal product equalled the wage, rational behaviour now entails taking account of the taste for discrimination so that further employment is contemplated only up until the value of the marginal product is equated with the wage **plus** an equilibrium differential - the discrimination coefficient. A like analysis is deployed for consumers in the goods market, and racist workers, whose decision to enter the labour market is affected by their tastes for discrimination - which causes them to treat equilibrium wages as somewhat lower than they really are if the work entails contact with people against whom they discriminate.

So far I have tried to elucidate two broadly neo-classical examinations of the causes (Hutt) and consequences (Becker and Hutt) of racism. The point I have been trying to get to is one where we will be able to examine the ethics implicit in these accounts of the phenomenon. I am about to characterize neo-classicism as a conception of justice. It is this conception of justice which is the heart of the analysis, and condemnation, of racism. Hutt, for instance, is quite clear that apartheid is an unjust system, the question I am posing is this: How is the judgement that apartheid is wrong relate to the economic analysis? It is in the conception of, and proposals for, a just society that Hutt offers us some insight into the inter-relationship of justice and rationality.

(2.5) Hutt's vision of justice

Hutt's proposals for political reform are, inevitably, a function of his vision of a just society - a society basking under the sovereignty of the consumer.¹ Here, the free play of the market, unhindered by the imposition of obstacles, restrictions and artificial limitations will ensure that a maximum product is produced and allocated optimally in terms of the natural endowments of economic agents through the process of voluntary and consensual trade. Such a society would achieve a unique equilibrium determined by 'natural scarcities' in conditions free from their opposite - 'contrived scarcities'.² This

¹ Hutt, in fact, coined the term "consumer sovereignty" and conceived it "as an expression of democratic values in achieving the social control which maximizes liberty and justice" (Persky, 1993: 183). I am indebted to Karl Mittermaier for this point.

² This paragraph is drawn from Hutt (1934: 15-16). In a footnote to that passage, Hutt defends the use of this terminology. He argues that 'contrived scarcities' is preferable to 'artificial scarcities' since these scarcities occur naturally in society - presumably because of agents' natural avarice and the pursuit of monopoly power.

equilibrium could only occur if there were no restrictions on the movement and allocation of factors in response to consumers' will. Monopolies, created and maintained only through the assertion of non-market power to shape the allocation or price of certain goods, constitute and create 'contrived scarcities'. Thus, the perfectly competitive equilibrium, in which the consumers welfare is maximised, is possible only if there are absolutely no restrictions from any non-natural, non-market source. This perfectly competitive system, he adds,

"may be taken to mean one in which institutions have been so devised that productive resources tend to be applied to production in such a way that the natural scarcities of all wanted things tend to equality. Therefore it will not pay to divert resources to different channels" (Hutt, 1934: 17)

Such a system, like the rational consumer, will optimise given resource endowments, preferences and scarcity through the rationing mechanism of prices and price adjustment.

Bearing in mind Hutt's conviction that individuals rationally pursue monopolistic power, a question to Hutt arises: "How useful is this conception of the rationality of a socio-economic system which asserts that people do not, in fact, necessarily act in accordance with its norms?"

Hutt might respond to this challenge by saying that he provides policy strictures regarding the role of the state and the nature of a constitution adequate to the task of policing a rational order. Aside from the problem of who would enact such a constitution given Hutt's stated conviction that there is an impulse to monopolism lurking in the human heart, the idea that the economy functions naturally only where the economic agent is prevented from acting in terms of her own nature brings us into direct contact with the neo-classical conception of rationality, and the relationship of this conception with the conception of the economy.

It is the fundamental thesis of this paper that Hutt's vision of a rational society is not unique to him. Quite the contrary, it is embodied in neo-classical economics in the conception of equilibrium. More importantly, neo-classicism argues that the forces acting in such a society act in all societies irrespective of their institutional/political framework - though they may be frustrated by human avarice combined with non-market power. So confident is Hutt of the natural necessity for the existence of these forces that he is not averse to elevating its necessity to the plane of gravitational forces: Criticising the term 'monopolistic competition' as self-contradictory, he asserts, "[A]ll alternative adjectives applied to the concept of competition appear equally inappropriate. We do not talk of imperfect or impure gravity ... [s]imilarly competition

must be regarded as an homogenous force" (Hutt, 1934: 15).

Thus the forces of rationality in the perfectly competitive world, operate in the same way in a world with 'contrived scarcities'. The difference is that in the latter, equilibrium is not determinate/unique because contrived scarcities can be changed over time, and the degree to which restrictions exist will differ depending on which interests determine them. This argument is developed in the work of the Chicago political economists referred to above - and it is this school which epitomises the neo-classical treatment of the concept of equilibrium.

As I have had cause to repeat, there are two forms of rationality in Hutt. However, one form of rationality (ie the rational pursuit of rents) is also deemed the origin of irrational prejudices,¹ while the second (ie the rational behaviour of economic agents *qua* consumers) is the motive force for the eradication of prejudice. The policy implications of this - and, indeed, the prescriptions Hutt offers for the creation of a society in which the sovereignty of the consumer exists and is sacred - are that, in order to prevent the emergence of irrational sentiments caused by interest groups using their political muscle to create 'contrived scarcities', the existence of 'political muscle' must be eliminated and rendered impossible. Thus the political sphere must be sealed off from those who would use it for their own sectional interests. The free operation of the market must be constitutionally guaranteed. Courts should be empowered to strike down discriminatory legislation and, through anti-trust legislation, rent-seeking monopolists should be euthanased (as Marx himself advocated be done to the exploiting classes).

In essence Hutt prescribes policies which prevent the (rational) agent from interfering with the (rational) economic system. He argues that the acceptance of the philosophy of free enterprise - "the liberalism of the nineteenth century" - the ethos of which is that it "denies the right of the state to discriminate" (1964: 178) since all laws must apply to all members of the community equally, must form the basis of the state.² The adoption of universal franchise is a necessary, but insufficient condition for the establishment of such a society. Rather, since such a society must allow the majority no rights to enrich itself at the expense of any minority and the constitution must prevent the majority

¹ Perhaps this is a tautology. I, for one, cannot conceive of a defense of the notion of a "rational prejudice". Hutt's point, however, seems to be that prejudice has a rationality that is explicable in terms of rent-seeking.

² Perhaps as a mark of its historical context, the text contains a rider: temporary discrimination can be justified if its purpose is to "remove the causes of backwardness" in the face of a "primitive and uneducated" sector of the population" (*ibid*).

extracting rents from the minority. Similarly, a "truly free enterprise society" would be one in which the artificial creation of scarcities was constitutionally forbidden, thereby allowing economic forces to operate unhindered.¹

This conception of necessary political reform is an exemplar of the conception of the Just society which orientates the neo-classical project, as well as Hutt's work. When Hutt complains that apartheid is unjust, he is insisting that the creation of a contrived scarcity for certain forms of labour (ie labour services offered by labourers with white skins), causes them to be traded at levels above those dictated by the level of their natural scarcity. This, in effect, raises the price of that labour above the level it would trade for in the absence of these politically established relative scarcities. Similarly the literature on regulation offered in Stigler (1988) is uniform in its construal of regulation as effecting transfers from some interest groups to others at levels in excess of those that would be established on the basis of voluntary exchange, undistorted by the coercive power of government, where values would be determined by price ratios unperturbed by the creation of monopoly power through the exercise of (non-market) coercion. Using the terminology of Becker (1971), we might say that political manipulation, when permitted, allows prices to reflect something other than 'objective' criteria of efficiency. The attitude towards such prices is that they represent distortions and generate costs to the welfare of at least some part of the society. More, in the case of most distortions, 'dead-weight costs' ensure that few, if any, distortions reflect simple, unambiguous transfers.

The thing to notice about Hutt's political prescriptions for a just society is that they take the form of an act of repression. It is only by preventing individuals from acting in terms of their concrete economic identities (as members of interest groups such as occupations, classes, ethnic nationalities, etc.) with specific and unique interests (and dreams of monopoly power to further those interests), that a society will be created in which the economy will be allowed to operate in its most undistorted efficiency. In other words, individuals must be stripped of their concrete individuality to prevent their being

¹ The neo-classical approach to the state is founded, primarily, on a high degree of suspicion of its power, and of the motives of those who would use the state. This creates something of a problem: How did so dangerous an institution arise. Interestingly, the origins of the state are not, necessarily, viewed as having so mercenary a motive as is imputed onto the occupants of real, existing states. Robert Nozick, for instance, argues that the origin of the state - an institution almost inherently antithetical to the just, unhindered and rational allocation of resources - need not be deemed to be either irrational or immoral. He argues that the development of a single, nonopolistic "protective association" protecting all members of a geographic region can be explained in terms of the rational, self-interested and, most importantly, **voluntary** decisions of individuals. He argues, essentially, that such protective associations are necessary (to protect individuals from unjust expropriations by others) and that it would be irrational and counter-productive for competition to reign in this sector. See Nozick (1974: Part One, especially chapter 5).

obstacles to the establishment of rational/efficient economic relationships. The question that must immediately be confronted is how/why a concrete individual (naturally avaricious) would deny herself the possibility of acquiring economic rents on the basis of an argument of economic efficiency?¹

We are, when we examine this question, entering a (definitively) political terrain for we are asking what makes one system good and another not, ie why one form of society is to be chosen over others. But this realm has numerous obvious as well as hidden pitfalls and traps.

As is widely recognised, there are an infinite number of conceptions of the good society present in the world. There are religious fundamentalists, anarchists, liberals and Marxists. There are feminists, racists, and psychotics. The effect of this plurality is that in contemporary secular society in which any number of world-views coexist, every particular, determinate conception of the Good is always experienced as contingent and arbitrary.² These conceptions are often (always?) incompatible with each other with the effect that they cannot be unified in terms of some common Good.

Neo-classicism, recognising this, provides no answer to the question "What is the good society?" because it insists that our particular, contingent tastes, ideologies and attitudes are related to our concrete economic interests and our preference for acquiring rents. In the face of this, neo-classicism affirms the primacy of Justice - understood as justice in exchange - over the Good (since, in any event, the Good cannot be identified). Justice is identified with a situation in which resources are exchanged on the basis of the value of their marginal productivity such that neither contractee is asked to give up something for nothing. Such exchange must be voluntary.

By this token Justice is an ethical principle which is to be installed irrespective of the 'rational' consideration of individual (contingent) economic interest. The ethical subjects who would construct a society in terms of the principle of commutative justice - ie the people who would follow Hutt's prescriptions - must act as if they did not know their own particular interests. Thus the ethical subject is constituted in the abstract, ie abstracted from herself. Thus, in Zizek's words, "the subject is irreducibly *split* into the

¹ Hutt, to his credit, never claims that white workers have been deprived of any income that they might have earned had markets been allowed to function normally. His point is that social costs have been incurred - by black workers and white business.

² The following draws heavily on Zizek's discussion of Rawls's *Theory of Justice* (Zizek: 1991).

'pathological' subject made of 'blood and flesh' and the ethical subject [who is] a kind of symbolic fiction" (Zizek, 1991: 71). In Rawls the ethical subject is allowed the space to operate only by virtue of the drawing of a hypothetical 'veil of ignorance' preventing the subject from knowing her own (particularistic) interests at the moment at which the just society is instituted.¹

The idea that the establishment of a Just society requires only the repression of certain traits of the *homo oeconomicus* is symptomatic of the notion in neo-classicism that the real economies are driven by forces common to all, and that the ideal society, constitutively characterised by an optimising economy, would be one in which those forces, which are construed to be always-already there, are allowed to function in an unobstructed manner. This argument, it seems to me, is metaphysical in its presumption, since it presupposes the existence of certain forces in all economies: those forces driving markets to equilibrium. This conception is metaphysical precisely because it takes the form of an unverifiable presupposition - that economies are driven towards equilibrium. The assumption is unverifiable because, as epitomised by the arguments of Becker (1986: *supra*), the theorist, when faced by phenomena in an apparent state of disequilibrium, must assume that she has missed something - an opportunity cost of a material or psychic nature - the recognition of which would confirm the rationality of the *status quo*. The failure to make such an assumption would entail dropping the assumption of maximising behaviour. Thus the presuppositions of the theoretical framework (stable preferences, maximising behaviour and market equilibrium) establish a predeterminate form of enquiry, and a predetermined format for solutions.

Our final task at this stage, however, is not to focus on the metaphysics of neo-classicism, to which we will return in the final chapter. Rather I wish to comment on how the conception of the just society influences the task economists perform, and how they perform it.

(2.6) The role of the economist in an unjust world

I have shown, I think, that both Hutt and the regulation theorists from Chicago, assume some standard against which they measure the effects of racist (or other monopolist-like) practices. That standard is of a society constituted in terms of the principle of

¹ I am aware that in Rawls 'Justice' refers to the distribution of goods, not to 'justice in exchange'. I feel however that the treatment offered above would stand without references to Rawls. In effect I have merely constituted Hutt's ethical subject, who contemplates the justice of economic exchange, for Rawls' ethical subject, who had contemplated the justice of outcomes.

justice which states that no-person should be permitted to use state power to generate monopoly power and, therefore, accrue rents. In essence the state against which the comparison of actual societies is performed is one in which the Biblical injunction "Thou shalt not steal" has been raised to the level where it is the basis of all economic relationships.

This society, I think I have shown, is one in which individuals are permitted to act only insofar as they do not acquire market power in excess of the level established by natural scarcities or objective criteria of productivity. In effect the Just society is constituted when the free play of market forces is enshrined and distortions are eliminated.

Given this standard of judgement, the role of the economist is relegated to that of the winger: it is her task to find who pays for any given policy or any for any given non-objective social phenomenon. This is hardly a novel point - in fact George Stigler is well aware of it.

In a series of lectures in 1981 (Stigler: 1982), Stigler argued that the role of the economist in society is really that of a moralist, condemning and praising as required. But, he insisted, economists knew that it was futile to reprimand human beings for their actions since their actions are always governed by their pursuit of maximum utility. Thus the economist castigates social institutions. He argues that the basis for the economist's critique of social policy in spite of his not being a fully trained moralist is his being "a well-trained political arithmetician ... [H]e simply points out to society that what it seeks, it seeks inefficiently" (Stigler 1982: 8).¹ Most interestingly, however, is his agreement with the following statement from Adam Smith:

"To hurt in any degree the interest of any one order of citizens, for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all the different orders of his subjects" (Quoted, Stigler, 1982: 11).

What Stigler seems to be arguing is that the economist, *qua* economist, is endowed with a particular task - to complain when self-seeking individuals acquire the capacity to distort the market and achieve results in conflict with those that would be achieved

¹ He remarks that "An economist is a person who, reading of the confinement of Edmond Dantes in a cell, laments the lost alternative product" (Stigler, 1982: 7).

through the market.¹ In other words, the economist's goal is to ensure that social policies most closely accord with the model of the just society and that, as a consequence, all outcomes are achieved through voluntary exchange - "the ethical attractiveness of voluntary exchange plays at least some part in our attitudes," he admits later (1982: 22).

Now this is all very well, but modelling the role of the economist along the lines here envisaged - the economist being little more than a social accountant or "political arithmetician" - has severe consequences for the science. In particular it renders ridiculous the claim that neo-classicism describes the economy. In fact it does little more than describe a particular mode in which the economy fails - real life economies are not constructed in such a way that the allocation of resources corresponds with the ideals of commutative justice. To have a theory that says nothing else - as important as being able to say this much might be - emasculates the theorist.

More particularly, conceiving economic theory in these terms, leaves the economist unable to deal with anything other than the sub-optimality of the economy, and this sub-optimality is always conceived in static terms. All that can ever be said with neo-classical theory is that at a given moment in time resources are not allowed to move freely and this leads to output levels below those achievable. Nothing about the evolution of economic systems can be said for the reason that economics cannot see the economy in evolutionary term. The economist is doomed to ask only questions about the allocation of resources in the here-and-now, she cannot ask questions about dynamics because economists evaluate the real against an hypothetical ideal, they do not investigate the nature of economic evolution. Change is always exogenous, because change is not about the creation of scarcity or the relationship between natural scarcities.

¹ Later in the book, in an admittedly light-hearted vein, he justifies the role of the economist in the pursuit of optimality by arguing that "[T]he United States has perhaps the equivalent of 5000 full-time research economist, costing - with ancillary services - perhaps \$250 million per year. If the various special interest policies cost the nation \$40 billion per year - a wild estimate but one that is not easily refuted! - then we earn our keep if we reduce these exactions of consumers by about one half of one percent" (Stigler, 1982b: 62).

Chapter Three

Economics, Crime and the Goals of Justice

(3.1) Introduction

The argument of the previous chapter sought to show, through a symptomatic reading of the economic literature on racism and regulation, that embedded deep within the edifice of neo-classical economics lies a conception of a world in which resources are allocated with seamless efficiency. It sought to show further that this world is one in which returns to economic agents are based solely on the 'objective' criteria of productivity. Of necessity, such a world would have to be one in which non-market power was absent or unobtainable; where interest groups could not contrive to shape the pattern of resource allocation artificially through deploying state power in their own interests; where the distribution of resources was a result of initial endowments and the of voluntary, consensual exchange. Such a world, by permitting the maximal attainment of the utility of individuals would also maximise the welfare of society as a whole.

Precisely because it would be impossible in such a world to deploy non-market power to induce and enforce involuntary and coerced transfers, social relations would be founded on, and reflect, a pure form of justice. The state, and, as importantly, its occupants, would not, and could not, structure social and economic relations to the benefit of any group and at the expense of any other. Thus, the defining feature of the state - its coercive power - could not be used to advance the particular interests of even the largest majorities at the expense of even the smallest minorities.

The existence of this foundational view of the Just society has important implications for the work of the economist. In essence, as Stigler puts it, the economist becomes a "political arithmetician" seeking to show that the manner in which society pursues a particular goal is either unjust (in that it imposes hidden or overt costs on someone or some group) or inefficient (in that it reduces overall welfare). The economist, therefore, uses this vision of the ideal society as the basis of a measure of the failure of real, existing societies to achieve the maximization of utility and the ideals of justice.

Now it is clear from the above argument that much economic literature poses the issue of injustice in terms of non-consensual/coerced transfers utilising the non-market power of the state, and seeks to understand politics as the contestation for the right to deploy state power in one's own interests. The conception of the state, and politics, has,

therefore, a view of its being the locus of potential or actual injustice. Sound social policy, therefore, restricts the utility of the state for unjust and inefficient purposes, sealing the state off from those who would wish to use it to promote their own interests.

That said, economists would not be the last to recognise that the state is not the only source of all conceivable injustice. While the state may be the sole possessor of the right to the **legitimate** use of force, it is by no means the only agent with access to power unrelated to its endowment of non-coercive economic resources.¹

Dealing with issues of justice, therefore, is not simply a matter of eliminating the misuse of state power. The Just Society also requires the elimination of other forms of unjust transfers and extractions. Almost ironically, it is the use of state power that economists turn to give effect to this imperative. But, in order to do this, economists turn to a second aspect of the conception of the state and of state power.

A long tradition of theory focusing on "market failures" describes a positive, desirable and utility-promoting role for the state. In particular, in the context of goods deemed to be non-exclusionary, public goods, a role for the state is described, promoted and supported. In this context, the state is not conceived as primarily coercive, but as the embodiment of the legitimate interests of the social whole - providing those goods and services which, in the absence of intervention, would be under-provided. The very fact that the state has command over the legitimate use of coercion is a necessary element of its capacity to provide these goods and services because, in the absence of the power to tax (and, therefore, to effect non-consensual transfers) or to enforce compliance with regulatory requirements, the free-riding of the rational utility maximizers that make up its citizenry would ensure that the state would lack the resources to give effect to its legitimate and desirable objective regarding the provision of non-exclusionary, public goods. In the case of such goods, economic theory asserts, the proper objective of the state is the maximisation of social welfare which requires that the good in question be provided up to the point where its marginal costs (including both the costs of production and the direct and indirect costs associated with raising the necessary taxation) are equal to its marginal benefits (including the utility directly provided to users as well as its contribution to the welfare through reducing costs of production, lowered transactions costs, etc.) and that such a point would be at a level

¹ This rather infelicitous phrase - "non-coercive economic resources" - results from the recognition that the power to coerce can be, and is, an economic resource. At the very least, the same physical resources which can be used to create wealth through labour, can also be used to extract wealth through crime. Thus, the idea of non-coercive economic resources is intended to signify those resources which are not or cannot be used to extract wealth coercively. Thus, the very forces vital to the creation of wealth and income, can be used for the forceful seizure of resources, wealth or income.

greater than zero.

In terms of this understanding of the role of the state, law enforcement is said to be a non-exclusionary public good which must be provided in such a way so as to maximise social welfare. In this chapter, we will look at the model of criminal justice presented by theorists working within the parameters of the neo-classical paradigm. In doing so, we will endeavour to understand the relationship between the conception of a just society (in which forced transfers are absent), and the conception of the relationship between state institutions providing law enforcement services and the reduction of private injustice. Surprisingly, we will see that the theory of law enforcement and criminal justice has some peculiarities. In particular, the absence of an economic theory of the nature of crime, and the lack of a sound consideration of the full and heterogeneous (and even, contradictory) objectives of the criminal justice system, are striking and important gaps, revealing a tendency of the theory to be blinded by the apparent obviousness of the problems of crime, criminality, law enforcement and criminal justice.

(3.2) The neo-classical model of crime and criminal justice

In the first chapter, it was argued that a workable definition of the paradigmatic approach of neo-classical economics to any question could be reduced to the description of three irreducible, fundamental assumptions, viz: (a) that economic agents have utility/preference functions; (b) that, when faced with constraints, agents behave rationally; and (c) that rational behaviour, combined with price rationing, leads markets to stable equilibria. These three assumptions are manifestly present in neo-classical models of the determinants of the levels of crime in society. This assertion is borne out by Ehrlich who argues that the "market model" of crime is based on five key assumptions:

First, offenders, potential victims, buyers of illegal goods and services, and law enforcement authorities all behave in accordance with the rules of optimizing behaviour. Second, [potential offenders] generally form expectations about relative legitimate and illegitimate opportunities, including the severity and certainty of punishment, based on available information. Third, there is a stable distribution of preferences for crime, as well as for safety from crime, in the population. Fourth, since crime is an external diseconomy by definition, and public law enforcement is a prime example of a non-exclusionary public good, the objective of law enforcement is generally presumed to be the maximisation of social welfare. Fifth, aggregation conditions concerning the behaviour of all relevant parties assure well-defined equilibria. These assumptions lead to an equilibrium model of crime" (Ehrlich, 1996: 44-45).

Now the first, third and fifth assumptions correspond identically with the three basic prerequisites I have proposed as measures of the commensurability of the model with,

and as manifestations of, the approach of neo-classical economics. The second reflects one aspect of the construal of rational behaviour generally deployed in neo-classical work (which could, therefore, be deemed to be a logical implication of the first assumption rather than being an independent assumption at all). The fourth assumption deals with the nature of the services provided by the institutions of criminal justice and the corresponding assumption about the goals and preferences of the relevant service providers. We will return below to the question of the manner in which law enforcement institutions must approach the maximisation of social welfare, suffice it to say here that the model asserts that the goal of law enforcement is the minimisation of the social costs of crime, including the costs of enforcement. That said, Ehrlich notes that "the specification of the relevant social welfare function ... involves normative as well as positive considerations" (*op cit*, 50), thus recognising Becker's point that:

"The general criterion of social loss is shown to incorporate as special cases, valid under special assumptions, the criteria of vengeance, deterrence, compensation and rehabilitation" (Becker, 1968: 170).

It is an oft-stated and inviolable assumption of the theoretical edifice constructed to examine these issues that offenders and potential offenders **choose** to commit or not to commit crime. Further, these choices are shaped and made in the light of the perceived and real¹ relative costs and benefits of the results of different legal and illegal activities. Similarly, the social response to crime and criminality - criminal justice policy, the criminal justice system, and criminal justice service providers - are also deemed to be rational responses to the existence of crime. This system, in the economic models of crime, rationally pursues the imputed goal of reducing the net social loss resulting from crime.

The economic models of crime which will be presented below are, therefore, homologous with the theoretical structure of neo-classical economics. Agents and institutions have preferences and choose rationally; choices are constrained, and activities rationed, by monetary prices and non-monetary costs; and the resulting forces tend toward an equilibrium. The effect, is the development of a model which is, as one

¹ Naturally, decisions are made in terms of the subjective expectations of risk, return and punishment. It is common, however, in economics to assume that subjective expectations are related in some way to the objective realities about which the expectations are generated. Dilulio (1996) is at great pains to argue, for instance, that the rising fear of crime and criminals, as well as the growing unhappiness with the criminal justice system in the USA, far from being media- and politician-induced hysteria, is a perfectly rational recognition of the reality of the growing ineffectiveness of the system. Whether he is correct or not about the reduction of effectiveness is not as important as his assertion and belief that the public response is rational and founded in reality.

advocate of the model comments,

"a principal-agent model of crime: criminals are rational, self-interested agents whose behaviour is best understood as an optimal response to the incentives set by government (or principal) via expenditures on law enforcement and corrections" (Dilulio, 1996: 3).

Indeed, we need to go further than Dilulio because government's policy choices amount to optimal responses to the supply of offenses schedule. The result is a stable equilibrium between two (contending) categories of agent - the potential offender population, and the criminal justice system representing society.¹

(3.3) Modelling crime and law enforcement

Beginning with Becker's seminal paper (Becker: 1968), economists have developed and refined a model of the crime levels based on the determinants of the demand and supply of offenses based on the above assumptions. These models reflect the essential assumption that levels of crime and law enforcement are simultaneously and mutually determined if the supply of offenses and costs of law enforcement schedules are properly specified. Using this approach, models have been defined for crime in general² or in relation to particular forms of crime.³ The present paper concentrates on the more general models since the argument and structure of the more specific models is essentially identical. Whether general or specific, however, economic models of crime generally all owe their basic framework to Becker.

Becker's original article was drafted with explicitly normative intentions. Based on an economist's specification of the determinants of crime focussing on the role, purpose and objectives of law enforcement, Becker sought, in his own words,

"to answer normative ... questions, namely, how many resources and how much punishment *should* be used to enforce different kinds of legislation? Put equivalently, although more strangely, how many offenses *should* be permitted and how many offenses *should* go unpunished?" (Becker, 1968: 170, emphasis in the original).

¹ Although I have seen no-one describe it as such, it seems to me that the proper analogy is not with supply and demand curves, but with the reaction curves of competing oligopolists. Indeed, the equilibrium point seems to be better described as a Nash equilibrium rather than as a market equilibrium. That said, given the manner in which the model is constructed, there is no material difference between the deployment of either of these metaphors.

² See Becker (1968), Eide (1994), Ehrlich (1973, 1981, 1996), Harris (1970), Pyle (1983), Stigler (1970) and Wolpin (1978).

³ For example, Ehrlich (1975, 1977a, 1977b) posits a model of the supply of murders, Pyle (1983: 26-28) describes a model of optimal tax evasion proposed by Allingham and Sandmo.

This approach, explicitly normative and prescriptive, also impacts on the way in which the model is constructed and specified.¹ Precisely because the model focuses on what the state should attempt to achieve through law enforcement policies, the model focuses on the relationship between law enforcement and levels of crime. Summarising the conclusions of the model, Becker argues that:

"The optimal amount of enforcement is shown to depend on, among other things, the cost of catching and convicting offenders, the nature of the punishments - for example, whether they are fines or prison terms - and the response to offenders to changes in enforcement" (*ibid*).

Thus the mutual determination of the supply of offenses function (which is founded on the response of offenders to changes in enforcement) and the level of enforcement (which is premised on the costs of achieving changes in the amount of crime committed by offenders), determines the level of crime in society and creates the possibility of minimising social losses resulting from crime, and, therefore, establishes the optimal level of law enforcement.

Thus the approach of the model, by its very nature, reflects the assumption that levels of law enforcement determine the extent of crime, *ceteris paribus*. Indeed, unwilling to claim sole credit for this approach, Becker argues that:

"all the diverse [ie criminological, sociological, psychological, biological, etc] theories [of the causes of crime] agree ... that when other variables are held constant, an increase in a person's probability of conviction or punishment if convicted would generally decrease, perhaps substantially, perhaps negligibly, the number of offenses he commits" (1968:176).

The assumption that other things are equal is, of course, a potential problem empirically. Indeed, taken literally, it renders the model empty since it is just as feasible to argue that, *ceteris paribus*, the weather or the seasons or the level of unemployment or levels of inequality or changes in anything else, will determine levels of crime.² For this reason, attempts have been made to test the assumption that law enforcement does, in fact, determine levels of crime. Such tests often focus on the deterrent effect of punishment and, quite often, of the deterrent effect of capital punishment.³

¹ Stigler (1970) also seeks to answer normative questions, hoping to "construct a theory of rational enforcement". Stigler's rather less formalistic theory, in his own words, "owes much to Gary Becker's major article" (Stigler, 1970: 526) and will not, therefore, be discussed on its own.

² This error might be termed the fallacy of misplaced causality.

³ This literature, particularly the work of Ehrlich (1975 and 1977a) attempts to use econometric techniques to estimate the number of murders deterred by capital punishment. Although Ehrlich finds a positive number of deterred murders for each execution in both time series and cross-sectional studies of US data, his conclusions have been challenged. Without attempting to engage with

For the purposes of this paper, however, we will accept as plausible and persuasive the argument that the probability and severity of punishment does determine the level of offenses, *ceteris paribus*. The models premised on this do, in fact, provide interesting insight and useful, policy-oriented conclusions. That said, we should not forget the difficulties inherent in the assumption underpinning this approach, some of which we will return to below after looking at the model itself.

(3.4) The model itself

The most appropriate starting point in an explication of the market model is with the supply of offenses which, as has been described, is premised on a relationship between levels of crime and levels of law enforcement. Such enforcement increases the expected costs (reduces expected returns) to crime - amounting to the conception of public expenditure on law enforcement as a "tax" on crime" (Ehrlich, 1996: 50) - and becomes the basis for the hypothesis that the number of offenses committed by an individual is determined by the probability of apprehension and conviction (p), the expected sanction (f) - which is measured in monetary terms - and a vector of all other relevant demographic variables (u) which includes tastes/distastes for crime as well as the possible rewards available to the individual from legitimate activities (Becker, 1968: 177). It is further proposed that, *ceteris paribus*, increases in p or f will reduce the number of offenses committed by an individual.¹

This rather "straight forward" (Pyle, 1983: 10) application of choice theory can be stated as an application of basic time-allocation models.² An individual is confronted by a simple utility maximisation problem and the allocation of time to legitimate activities or

this sometimes very technical literature, it does seem likely to me that there is some deterrent effect of capital punishment. That said, as Ehrlich notes, the presence of a deterrent effect does not imply that capital punishment should, necessarily, be practised. Such a decision must be made in the light of numerous other social goals and attitudes..

¹ More specific models, such as the models forming the basis of empirical work on the deterrent effect of capital punishment must, of necessity, break p down further. Ehrlich (1975, 1977a) separates the enforcement variables into the probability of arrest (p_a), the probability of conviction ($p_{c/a}$), and the probability of execution ($p_{e/c}$). The specification of each variable facilitates the prediction of the magnitudes of their relative effects on the level of murder, as well as creating the possibility of measuring the independent effect of capital punishment.

² This presentation of the motivation of the individual potential offender is based on the virtually identical expositions in Pyle (1983: 9-14) and Eide (1994: 49-53). While these expositions are helpful and clear in relation to the motivation of the individual offender, they are not faithful to Becker's model. In particular, they fail to depict the model as an equilibrium model and focus solely on the individual decision to commit crime. This substantially reduces the analytic usefulness and uniqueness of the neo-classical approach.

the commission of crime is determined by expected utility:

$$EU_c = pU(W_0 - L) + (1-p)U(W_0 + R) \quad (1)$$

where p is the subjective possibility of capture and conviction; W_0 is the exogenously given or certain wealth of the individual; L is the loss (monetary and psychic) resulting from conviction; and R is the potential gain from the crime. On the assumption of rationality, a crime will be committed where $EU_c > U(W_0)$.

The model establishes that whether the individual will, in fact, commit a crime will depend on (i) her attitude towards risk and (ii) the sizes of L , R and p . The former will determine the shape of the utility curve of wealth (which affects the extent to which an individual is prepared to trade off increased risk - as illegitimate income is, by definition, inherently risky - against increased rewards), while the latter will determine whether the crime offers a return sufficient to induce taking the risk.

Based on this simple model of the rational (potential) offender, the model allows one to draw some conclusions about the effects of changes of the values of the variables. If L or p is raised, the number of crimes committed by an individual will fall, and the extent of that fall will depend on the marginal utility of wealth - and, therefore, on attitudes to risk. Becker also shows that if the elasticity of crimes with respect to changes in p is larger than the elasticity of crimes with respect to changes in L , then offenders must be risk preferrers. He goes on to show that optimal social policy will allocate law enforcement resources such that the elasticity of offense with respect to certainty (p) exceeds the elasticity with respect to severity (f), and that, therefore, optimal social policy sets incentives such that the marginal offender is a risk preferrer. We can also state that an increase to the exogenously given wealth, or the expected income from employment in legal activities, of the individual will not have a predictable effect on the commission of crime by that individual since such is determined by her opportunity set and her attitude to risk.

Becker assumes that the "market supply" of offenses is based on the aggregation of individual supply curves and is, therefore, determined by the average values of each individual's p , f and u . Thus:

$$O = O(p, f, u) \quad (2).$$

This function is assumed to have the same characteristics as the individual supply of offenses schedule.

Thus, the construction of a supply of offenses schedule is premised on the relationship between the expected rewards of crime and legal activities and their respective expected costs. Rationality demands that crimes are committed if, and only if, the maximisation of expected utility is furthered by their commission. Becker concludes that:

"This approach taken here follows the economists' usual analysis of choice and assumes that a person commits an offense if the expected utility to him exceeds the utility he could get by using his time and other resources at other activities. Some persons become 'criminals', therefore, not because their basic motivations differ from other persons, but because their benefits and costs differ" (Becker, 1968: 176).

Becker assumes that certain activities are prohibited because they cause harm to participants (such as the harm caused to drug users, etc) or to third parties (victims of property crimes or crimes against the person). He further assumes that the amount of harm generated by crime is directly related to the level of activity. From a macro point of view, however, a great deal of criminality amounts to a (non-consensual) transfer from one agent to another. Thus the damage caused to society is not simply the sum of the harm caused by crime, but must be moderated by the gain to offenders. Thus:

$$D(O) = H(O) - G(O) \quad (3),$$

where D is the damage to society as a whole, H is the harm done to victims and G is the gain to offenders. He further assumes that the marginal harm to victims and gain to offenders is always positive, but that the harm caused by each additional offenses increases while the gain achieved by each additional offense decreases. Further, because crime causes external diseconomies, its harm to victims must exceed its gains to offenders, ie $H > G$. These assumptions combine to ensure that the damage to society from the marginal crime is always positive and that it increases as the level of crime increases.¹

The damage caused by crime is not, however, the only cost to society. Becker recognises that there are costs associated with the process of law enforcement as well

¹ "Since criminals cannot collect as earnings all the damage they impose on victims (for example, the value of life and property destroyed, the real cost of insurance and protection against victimization, and the value of the resources used to commit offenses), the net social damage from crime is expected to be positive in connection with 'simple' theft and fraud, as well as serious felonies" (Ehrlich, 1981: 310).

We should note, however, that the make-up of "the real cost of insurance and the protection against victimization" includes some transfers. They are not, therefore, social losses in the strict sense of the word.

as individual and collective crime prevention.¹

Law enforcement expenditure is made up by the direct cost of policing, the courts and the institutions of punishment/rehabilitation. Public expenditure on these will determine the probability of apprehension and punishment, as well as the quantity of punishment. Thus p and f are determined by public expenditure, in terms of a production function, by the level of resources in the police and prosecution and correctional services. Thus Becker proposes a cost function where costs are determined by p (the probability of conviction), O and a (which measures arrests and other forms of activity). It is assumed that the marginal costs of increases in any of the three determinants is positive and increases as their levels rise.

There are also costs accrued by society associated with the punishment of individual offenders. These costs are partly determined by the nature of the punishment regime since the total costs, and their distribution between the convict and society, of various forms of punishment differ widely. For instance, fines impose almost no, or very small, social costs and only a monetary cost to the convict (plus whatever effects on her reputation, etc), while prison sentences are costly to prisoners (in terms of opportunities foregone as well as the monetary equivalent of the loss of freedoms) and impose some fairly onerous costs to society (in order to maintain and support the prisoner). Presumably, summary executions, torture and slaps on the wrist also vary in the size and distribution of costs.

Becker proceeds from the premise that all the costs of punishment can be monetized.² Given differential earning opportunities and marginal utilities of wealth, punishments of the same absolute size will have different values to different individuals. However, irrespective of the absolute value attached to a given punishment by a particular individual, increases in punishments will increase her costs. As punishments impose costs on the offender and on society, Becker proposes that the social cost is directly related to the size of the punishment. Thus:

¹ Becker's discussion on the optimal expenditure of individuals in self-protection is not of real importance to our discussion. Suffice it to say that optimal private expenditure is determined by the potential perceived harm each individual believes she may suffer from crime; the cost of reducing her chance of victimization and/or increasing the probability of arrest for offenses against her; the private expenditures of others (since criminals can substitute between offenders); and the expenditure of public law enforcement bodies (since increases in public expenditures should reduce the prospect of crime, while increases in private expenditure may reduce crime and, therefore, social expenditure). For more on this, see Becker (1968: 200-201). Not unexpectedly, Becker concludes that optimal private expenditure on crime prevention will be where the marginal gains and losses are equal.

² See Pyle (1983: 23) for a discussion of the implications of costs not being monetizable.

$$F = bf \quad (4),$$

where F is social cost and b is a constant relating the social cost to the individual convicts cost, f . It is assumed that b is very close to zero for fines (which are simple transfers), but is positive for all other forms of punishment. Indeed, b can be quite large, particularly for parole and juvenile care.

Having defined the determinants of the supply of crime, as well as its costs and the costs of reducing it, Becker is in a position to deploy equilibrium analysis to determine the optimal probability of apprehension, severity of punishment and incidence of crime. Because of the costs of preventing crime through law enforcement, Becker argues that optimal social policy will not aim to eliminate all crime, but rather to minimise the *per capita* costs of crime (including the costs of law enforcement and punishment). Thus, the objective function is to minimize the social loss function, L_s :

$$L_s = D(O) + C(p, O) + bpfO \quad (5),$$

where the marginal contribution of each determinant to L_s is positive. C , b and f are directly subject to social control, once these are chosen, so too are the levels of p , O , D , via the C , D and O functions.

For analytic convenience, Becker assumes that p is directly determined.¹ We also assume that b is set exogenously. This means that only p and f are decision variables available to minimise L_s . Through simple differentiation the optimality conditions are derived and these can be re-written in the following form if we assume that the elasticity of offenses with respect to both f and p is not equal to zero:

$$D' + C' = -bpf(1-1/\epsilon_f) \quad (6), \text{ and}$$

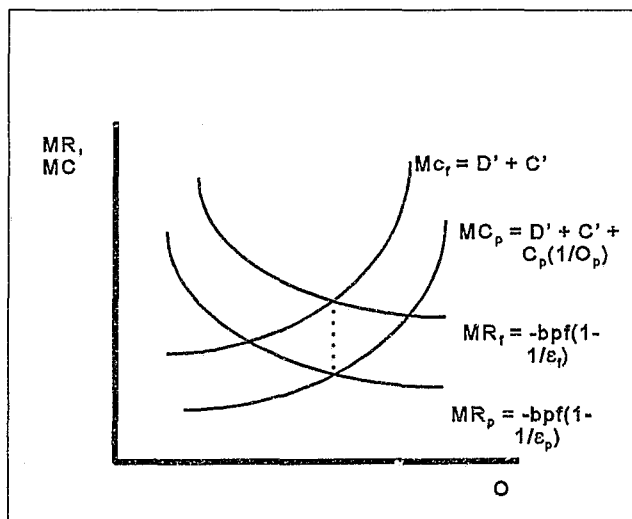
$$D' + C' + C_p(1/O_p) = -bpf(1-1/\epsilon_p) \quad (7),$$

where $\epsilon_f = -(f/O)O_f$ and $\epsilon_p = -(p/O)O_p$ and are the elasticities of crime with respect to changes in punishment and the certainty of apprehension respectively.

Now, the left-hand side of (7) and (8) is the marginal cost of increases in crime attendant on reductions to f and p respectively. Because of the various assumptions made, these curves must slope upward. Also, because reductions in p result in lower

¹ We will discuss the implications of this later.

expenditure on law enforcement (at any given f), the marginal cost of increases to crime resulting from the lowering of p is lower than the cost of increasing crime by lowering f . Similarly, the right-hand side of the equations reflect that marginal social gains (ie marginal revenue) associated with declines in crime attendant on increases to f and p respectively. Because of our assumptions, these slopes must be negative. As one would expect, social losses are minimised where the marginal costs and revenues are equated. This can be captured in the following figure.



Because the marginal cost of a change in O resulting from a change in p is less than the marginal cost associated with an equal change in O resulting from a change in f , at equilibrium the marginal revenue associated with a change in O resulting from a change in p must be smaller than the marginal revenue associated with a change in O resulting from a change in f . This, however, will only occur if $\epsilon_p > \epsilon_f$. This will occur only where offenders prefer risk. Hence Becker's famous conclusion that optimal social policy ensures that "crime does not pay" because the marginal criminal, being a risk preferrer, will have a lower average income from crime than she would do from riskless activities.

Having set out the model thus far, the broad approach must be familiar. From this point, Becker is able to derive conclusions based on standard comparative statics. He looks at the optimal response to changes in the perceived damage associated with crime (where p and f will both rise in response to an upward shift of the damage function). One implication of this is that where crime in general is made up of a variety

of types of crime, it is rational to ensure that those crimes causing the most damage should have the highest values for p and f . Where the costs of law enforcement increase, the optimal level of offenses will too.¹ A further result of the model is that an improvement in police technology in capture/conviction will, at equilibrium, unambiguously reduce penalty severity (Wolpin, 1978: 821-2).

We have spent a good deal of time developing Becker's model and, before proceeding, it would be well to take stock. The model is, in essence, one of a self-equilibrating market for the determination of the optimal level of crime based on an exogenously determined supply schedule which includes arguments subject to policy choice. Choices are made by individuals and institutions on the basis of the expected and real costs/prices that prevail. True, potential criminals face uncertain prices, but the level of their activity is rationed by the expected costs they will bear. Institutions, on the other hand, rationally pursuing the maximisation of social welfare, have their activities constrained by the costs/prices that will be borne by society.

Equilibration in the model is automatic since, although changes to f and p require deliberate, conscious choice, supplemented by changes to the resourcing of the institutions of criminal justice, these decisions are merely reflections of the preferences of the authorities. Thus, so long as the authorities adopt the appropriate decision-rule based on public interest, in seeking to maximize social welfare by minimizing the losses from crime, including the costs of law enforcement and crime control, they will respond automatically to changes in the parameters of the model. Thus, if all actors in the market, including the authorities, rationally pursue the maximisation of their respective utilities, the equilibration is automatic and predictable. As Ehrlich puts it:

"[The] pattern of [the public response to changes in levels of crime] helps guarantee, of course, the stability of equilibrium in the general market of offenses" (Ehrlich, 1981: 311).

Now, on the face of it, a self-adjusting equilibrium model of crime seems to push the envelop of plausibility. While the notion of a supply of offenses function seems plausible, even if the identification of determinants will be as varied as the number of opinions sought, the idea that the response of law enforcement agencies will be predictable is somewhat surprising. It is important to remember, in this regard, that changes to p and f require a number of steps. At the very least, government must recognise that the resourcing of law enforcement must increase if either or both of p and f must rise. Then the requisite resources must be raised through taxation. Finally, the various independent (and competitive) institutions in the criminal justice system

¹ For these results and more, see Becker (1968: 185-190).

must agree with the required changes and must implement the necessary steps. On purely practical grounds, the likelihood that adjustment will be speedy seems negligible.¹ Depending on the specification of the supply of offenses function, any delay could create feed-back loops fuelling criminality and requiring greater, and yet more difficult, adjustment in criminal justice. Of course, this is hardly fatal to the model itself since the path from one equilibrium to another need not be smooth. Neo-classical models in which the movement from one equilibrium to another traces an oscillating path are perfectly feasible. Such models, however, may predict that a new equilibrium will not be attained under some circumstances when the parameters of the forces create explosive paths. Interestingly, however, the nature of the path between equilibrium points is never discussed in the literature on crime.²

The model exhibits all the elements one would expect from an economic model of crime and crime control: individuals and other agents are rational (ie they have stable preferences, and make choices in order to maximise their utility); there is price rationing in that individuals' and agents' decisions and actions are governed by the price they must pay; and the resulting equilibrium is self-correcting. We have, therefore, a fully specified market model conforming to our definition of the assumptions of the neo-classical paradigm.

That said, there are a number of very interesting and revealing assumptions buried in the soft whisper of the equations. We will explore these issues more fully below. That discussion should be preceded by a (brief) account of a very similar model of crime proposed by Ehrlich. This model, following Becker's pioneering work, exhibits all the basic assumptions of its progenitor.

The notion of equilibrium in the market for offenses is not, therefore, unique to Becker's

¹ A further objection might be made at this point, namely that the utility schedules of public authorities are seldom identical with the social welfare function. Indeed, it is often wondered whether this is even possible. However, ensuring that the incentive structure ensures that the preferences of the authorities (agents) match those of the public (principals) is not an issue that can be pursued here.

² Indeed, if pressed to deploy the language and approach of the neo-classical model, I would hypothesise that something akin to this happened in SA in the early 1990's. For a variety of reasons, not least the traumatic processes of rebellion and repression culminating in the collapse of one form of social control without its replacement by another, the supply of offenses function shifted in SA as a result of a strong shift in tastes for, and willingness to commit, crime. The inability of the criminal justice system to respond coherently and effectively to the new parameters of the supply of offenses schedule, fuelled perceptions of impunity, further shifting the supply curve, creating greater and greater pressure on the very system which was unable to adjust in the first place. The extent to which this process is explosive or leads to a stable, if higher, equilibrium level of crime is, of course, a vital question for our society. It is not one I will attempt to address here.

model. On the contrary, the existence of equilibrating forces in this 'market' is, if anything, even more strongly asserted in the models developed by Isaac Ehrlich which are even more faithful to the spirit of neo-classicism.

(3.5) Ehrlich's model

Ehrlich's basic model of the individual decision to participate in crime was proposed in 1973. While based entirely on the conception of individual rational decision-making, the structure of his model is different to Becker's in that he proposes a more elaborate specification of the choices facing the individual. In essence, the individual faces a choice of how to allocate her time between licit and illicit income-generating activities. She will allocate of her available time¹ between illicit and licit activities on the basis of the returns she expects as well as the possible risks. In doing this, she will calculate her expected returns from illegal activity in full awareness of the potential for capture and punishment. Thus, the probability and severity of punishment enters, once again, as a direct determinant of the level of crime.

One clear advantage of the model is that expected returns from legitimate activities is a direct argument, as opposed to being captured, along with all other relevant variables, in a catch-all variable. The model also allows for predictions about the conditions under which specializing in crime or in legitimate activities will occur for individuals with different attitudes to risk. Indeed, Ehrlich argues that the model

"can be used to explain why many offenders, even those convicted and punished, tend to repeat their crimes. Given the offender's opportunities and preferences, it may be optimal for him to commit several offenses in any given period. Moreover, even if there is no systematic variations in preferences for crime from one period to another (these may in fact intensify), an offender is likely to repeat his illegitimate activity if the opportunities available to him remain unchanged. Indeed legitimate earning opportunities of offenders may become much more scarce relative to their illegitimate opportunities because of the criminal record effect and the effect of long imprisonment terms on legitimate skills and employment opportunities. Recidivism is thus not necessarily a result of an offender's myopia, erratic behaviour, or lack of self-control, but may be a result of choice dictated by opportunities" (Ehrlich, 1973: 529).

The essential model of the decision to commit crimes, as well as its conclusions are very similar to those of Becker. However, the model is framed in terms of state-preference theory where different states are imagined and actions are chosen in terms of the expected returns given the probability distribution of end-states. Thus, three basic states are imagined where: (i) no crime is committed and all income is from

¹ See Eide (1994: 57-65) for a discussion of the differences between models in which the amount of time allocated to leisure is fixed and models where such time is allowed to vary.

legitimate activities; (ii) a crime is committed but the offender is caught; and (iii) a crime is committed, but the offender gets away with it. Given the prospective returns, as well as the probabilities of capture if a crime is committed, the individual rationally allocates her time to legitimate and illegitimate activity in order to maximise her total expected utility.¹

Ehrlich's theory predicts that an increase to the probability of apprehension will reduce the time spent on illegal activities, as may increases to the punishment schedule (which relates punishment to the amount of crime committed). The precise effect of changes to the level of punishment will, however, be affected by individual attitudes to risk, with risk preferrers actually increasing their commission of crime (Ehrlich, 1973: 530).

But while there is little difference between the articulations of the motivation of the individual offender in the works of Becker and Ehrlich. The latter's work, particularly his 1981 and 1996 articles, exhibits a greater attention to the edifice of equilibrium analysis. The implications of this heightened awareness of the extent to which the economic model, as articulated by Becker and Ehrlich, is a model of the market for goods and services (and not a model merely of the motivation of the individual offender), is revealed by his insistence that, in evaluating rehabilitation programmes, the extent to which such programmes reduce offender recidivism is not an appropriate measure of their effect on crime. Precisely because the level of offenses depends the forces determining the position of the equilibrium, changes to the motivation/tastes of individuals are relatively insignificant. Only policies which either shift the supply curve, or move the equilibrium level of offenses downward will have an impact on crime levels. Programmes successfully targeting the motivation of a few individuals who happen to be captured, are just as likely to create market opportunities for other potential offenders (by increasing the average return to crime through the creation of 'profitable' gaps in its supply) as to reduce the level of crime. He argues that:

"if the flow of offenses of a specific type reflects, by and large, not the capricious outcome of biological or social idiosyncrasies, but the equilibrating interplay of systematic 'supply and demand' forces, then the effectiveness of individual control programmes must be evaluated not by their anticipated effect on the supply of offenders, but on their ultimate

¹ This exposition has somewhat simplified the argument. For Ehrlich, the prospective returns to legitimate and illegitimate activities are themselves functions of the amount of time allocated to them. He assumes that, in both instances, returns increase at decreasing rates as time spent on them increases. He further assumes that, if caught, the punishment apportioned to the offender will be positively related to time spent on illegal activity, and that the size of punishment increases as time spent on illegal activities increases. Interestingly, Ehrlich assumes that the probability of capture is unaffected by time spent on illegal activities, reasoning that, while increasing the amount of time spent on crime could make the offender more likely to be caught simply by virtue of the greater amount of time spent in risky activities, it may also make her more skilful and less prone to errors.

effect on the equilibrium volume of offenses" (Ehrlich, 1981: 307).

Simplifying the determination of the individual's supply of offenses to a positive function of the difference between the the income from illegal and legal activities (d), minus the weighted cost of punishment, he describes the individual supply of offenses as a function, $s(\pi)$, where $\pi = d - pf$. Now, assuming that each individual has a basic minimum, critical entry-level π below which the commission of crime will not be considered, and assuming that there is even a moderate distribution of individuals with critical π close to the existing expected rate of return from crime, the aggregate supply of offenses function will be elastic. Indeed, the more condensed the distribution of critical values, the more elastic the aggregate supply of offenses schedule (Ehrlich, 1981: 309). In this context, π reflects tastes for crime. Thus the aggregate supply of offenses is determined by the average returns to offenses, the shape of the distribution of returns to legitimate activities, and the distribution of tastes for crime (Ehrlich, 1996: 47).

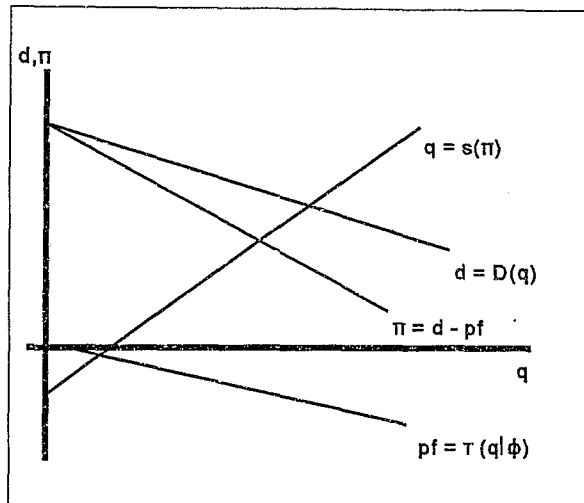
Having derived a supply of offenses curve, Ehrlich proceeds to describe a derived demand for offenses. This seemingly paradoxical notion captures two distinct notions. The first is that many crimes (including the possession/enjoyment of illegal goods and services, as well as most property crimes) are directly, and willfully demanded. The second element of the demand for offenses is **derived** from the private demand for safety. Combining these elements, a negatively sloped demand curve $d = D(q)$ is derived with $D'(q) \leq 0$.¹

In the context of this model, the role of public law enforcement is, once again, assumed to be the minimization of losses from crime. These costs include (i) the cost of crime (less the gains to offenders); (ii) the direct costs of law enforcement; and (iii) the social costs of the punishment of individual offenders. These losses must be minimized subject to the responsiveness to changes of q to changes in the relevant law enforcement choice variables and the production function determining the costs of those policy choices. In general, both p and f will be adjusted upwards in response to changes in social parameters (ϕ) resulting in increases to q .

¹ The negative slope of the demand curve is guaranteed by three assumptions: (i) the demand for loot will decrease as the level of stolen property rises and, therefore, as the number of crimes (q) rises; (ii) self-protection and target hardening by potential will lower the average return per crime and the level of self protection will be positively related to q , thus, as q rises, so too will self-protection and the return to each crime will fall. Finally, the third assumption is that criminals, being rational, will target the easiest or most rewarding potential targets first. Thus, as q increases, the 'value' of the marginal potential victim to the criminal will decline as the direct costs of each crime rises.

These three assumptions guarantee that the return to crime is a decreasing function of the crime rate itself.

This market for offenses can be captured diagrammatically.



In terms of this model, the market is in equilibrium when the quantity of crime:

"is such that neither criminals (looking at the net expected return from crime), private individuals (looking at their risks and costs of victimization), nor government (looking at the relevant social welfare function) find it necessary to adjust their behaviour and alter the prevailing net return or price associated with crime" (Ehrlich, 1996: 51).

Having defined the model, a number of theorists have attempted to assess actual criminal justice policy in relation to the predictions of the model. In essence, these tests revolve around determining whether the relative values elasticities of offenses with respect to changes in the probability (ε_p) and severity of punishment (ε_f) matched the predictions of the model. It will be recalled here that rational law enforcement must, in terms of the model have $\varepsilon_p > \varepsilon_f$.

Beginning with Becker, theorists have, in fact, found that criminal justice policy is, in fact rational. Becker finds, for instance, that model sentencing trends are "at least broadly consistent with the implications of optimality analysis" (Becker, 1968: 190). Ehrlich, even more ambitiously, finds that all the models' predictions, including those of the models dealing solely with murder, are confirmed by the relative magnitudes of the relevant variables, arguing that both his time-series and cross-sectional analyses obtain "remarkable consistency with theoretical predictions" (1977a: 778).

(3.6) The model and the nature of crime

Both Becker's original model, and Ehrlich's more refined and better articulated version of it, are partial equilibrium models in the market for offenses. The actors in the market are potential offenders (who decide whether or not to commit crimes), potential victims (who can render themselves more or less vulnerable to victimisation on the basis of expenditure on self-protection), and the public law enforcement authorities (who, by setting the values of the key enforcement parameters, shape the respective choices of both potential offenders and potential victims).

As was remarked earlier, the role of the state in the market for offenses is premised on the argument that:

"Since criminal activities by definition create external diseconomies, and since private self-protection or private enforcement of criminal laws are themselves associated with various externalities and [law enforcement has] some properties of a non-exclusionary public good, there is a generally recognised incentive for public intervention in the market for offenses" (Ehrlich, 1981: 310).

Because of the nature of the good provided by the law enforcement authorities, it is assumed that state intervention is deemed to be aimed at minimising the social losses associated with crime.

But here, an interesting problem arises. Precisely because the models developed by Becker and Ehrlich are intended to be general, they lack a definition of crime. Becker states explicitly that:

"the analysis is intended to be sufficiently general to cover all violations, not just felonies - like murder, robbery, and assault, which receive so much newspaper coverage - but also tax evasion, the so-called white-collar crimes and other violations" (Becker, 1968: 170).

Similarly, with the exception of his work on the relationship between murder rates and capital punishment, Ehrlich's interventions are also intended to be general. He argues for instance that:

"In spite of the diversity of activities defined as illegal, all such activities share some common properties which form the subject matter of our analytical and empirical investigation" (Ehrlich, 1973: 523).

The fact of the models' generality is important insofar as it reflects the presumption of the economist that activities are determined (or time is allocated) on the basis of the expected return from different activities. Illegal activities, insofar as they are enforced, are subjected to a public tax, reducing their expected returns. Thus the economist

approaches the question of crime - intentionally understood as all crime - from the perspective that an optimal level of enforcement will minimise the social losses associated with crime.

But let us examine this issue a little. Ehrlich acknowledges that crime consists of those diverse activities "**defined**" as illegal (quoted above), while Becker argues that what is criminal is usually determined by "a belief that other members of society are harmed" by the outlawed activity (Becker, 1968: 172).¹ The recognition of the contingent and socially-determined nature of crime can hardly be avoided in any discussion of crime. That said, the fact that the identification and definition of criminal activity is a social, even a political, process must be read against the approach neo-classicism has adopted towards social regulation, as discussed in the previous chapter.

It will be recalled, that neo-classicism regards the state, and the contest over the definition of state policy, with a high level of cynicism and a certain measure of trepidation (or, less pejoratively, it might be said that neo-classicism depicts a degree of sanguinity in its contemplation of the role of the state in society). The state, defined as a body possessing the right to the legitimate use of coercion, is perceived as a site of struggle between contending interest groups intent of deploying state power to their own advantage. Thus, neo-classical economists, concerned to ensure that social policy is optimal, compare the results of actual or prospective policies against an hypothetical ideal. The economist, *qua* "political arithmetician", seeks to protect society from the manipulation of state power.

The recognition that regulation, prescription and the definition of criminality are all matters of political contestation is an important premise of neo-classical political economy. So too is the premise that such contestation will be governed by the interests of the parties, their costs of producing political pressure and the resources that those who stand to lose from particular policies will be able to muster. It seems therefore, somewhat unsatisfying for the model of the determination of crime and levels of law enforcement to have ignored these matters. A similarly unfortunate omission, in this regard, is the failure to consider the which crimes will be enforced.²

¹ Stated even more explicitly, Posner recognises that a nation's crime rate is partly determined by "the scope of the nation's criminal laws - how much conduct is made illegal" (Posner, 1995: 3).

² Institutions of the criminal justice system are endowed with a peculiarly large degree of discretion relative to other state institutions. The police, prosecutors and judges in any system are empowered to use their professional judgement in a vast slew of areas. From decisions regarding which crimes are priorities, to those regarding which victims, offenders and convicts require special attention, a great deal of power to shape the outcomes of the interaction between the supply of

The absence of a consideration of these matters is by no means fatal to the model. If one wished to do so, one could reconsider the nature of social loss to reflect harm caused to victims (which could, conceivably be close to zero) and costs of enforcement, and include an argument for costs of compliance. To the extent that costs of compliance were positive, optimal levels of enforcement (both the probability and severity of punishment) would be lower relative to the previous definition of social loss. Thus the importance of the omission of the insight that not all activities defined as criminal actually reduce social welfare is not in its being impossible to correct, but in what it reveals about the rather common-sense notion of "crime" considered by the model.

In terms of the model, the damage generated by a crime is defined as the harm to the victim less the gain to the offender. Crucially, the logical and mathematical coherence of the model depends on an assumption that the harm to the victim exceeds the gain to the victim. The absence of such an assumption, for instance, would make nonsense of the idea that laws are enforced in order to improve social welfare. If non-compliance with a certain law, rule or regulation raised aggregate social welfare, its violation should, in fact, be encouraged. Thus, the absence of a recognition that there might be circumstances under which complying with the law imposes costs on the agent abiding with the law in excess of the costs to the potential victim, reflects a particular conception of crime. If bread is stolen from a bakery to feed a starving family, does the damage to society exceed zero? If two consenting men engage in illegal but consensual sexual activity, what victim suffers harm in excess of the offenders' gains? If a mature, informed adult voluntarily consumes unlawful psychotropic narcotics or purchases the services of a prostitute or adopts religious beliefs in opposition to law of the day, is the net effect on society negative?

So what then are the crimes that the model seeks to analyse?

Clearly, the models are concerned with crimes which create harm to victims. Indeed,

offenses schedule(s) and the nature of the equilibrium achieved in the market.

The practical relevance of this point is thoroughly, and fascinatingly described by Fogelson (1977) who, in contesting the idea that "the police enforce the law, keep the peace and serve the public", describes how changes to US policing affected which laws were enforced, whose peace was kept and which public was served. The more general point that criminal justice is an arena of public policy in which discretion plays a major role is, however, so common in criminological literature that it is almost unnecessary to reference it. Perhaps the most common reference on these issues, however, is Reiner (1985).

I do not intend to deal further with this matter, but the absence from the model of a recognition of the importance of the distribution (between crimes, areas and offenders), as well as the level, of law enforcement is a gap which should be closed.

the oft stated assumption that **by definition** crime creates negative externalities, which is the economic basis for a rational role for state intervention, is premised on this notion. Presumably, therefore, those crimes sometimes described as victimless - eg drug use and prostitution - must either be conceived as having victims (even if the identity of these victims is not immediately apparent), or as harming society as a whole. One might, for instance, argue that what is usually defined as criminal will include "the sale of those commodities that society believes reprehensible, [like] prostitution and narcotics" (Rottenberg, 1968: 80).¹

The problem is that using such an approach in a normative theory of law enforcement aimed at identifying its optimal level, will contradict the analytical insights of neo-classical political economy. If it is true - as it surely is - that contesting interest groups will attempt to use state power to their own advantage and that in doing so they will not always (perhaps even, seldom) advance the interests of all members of society,² then accepting the socially defined code of laws and behaviour robs the neo-classical approach of the ground from which it would otherwise analyse public policy. Ironically, precisely when the notion of an ideal/just society would be most fruitful, the economic approach to crime naively accepts as criminal what is already criminal.

Now a defender of the neo-classical approach will argue that this criticism misses the mark. Indeed, she might even claim that such criticism wilfully obscures a simple, analytically helpful model. She may argue that the deployment of the market-model as a framework for the analysis of criminality is not intended to also assist in, or reflect the insights of, analysis of the way the (social) definition of criminality proceeds, nor the insights about the contending interests which clash over the definition of criminality.

Such a response would not be inappropriate. The criticism does not challenge the insights or conclusions of the market model. Nor does it reject its premises or logic. What it does do, however, is ask just how analytically useful the model is. Does the assumption and conclusion that, *ceteris paribus*, an increase to the probability or severity of punishment reduce the occurrence of crime take analysis of law enforcement policy forward? How valuable is the conclusion that the relative cheapness of fines relative to imprisonment makes them more desirable?

¹ Rottenberg includes two other classes intended to encompass the whole of criminality: "(1) they may destroy part of the capital stock of society, as murder and arson; [and] they may involve coercive transfer payments, as theft" (*ibid*).

² Recall the insights into the generation of policies which transfer wealth/income from one group to another, as well as the existence of "deadweight costs".

Thus the model provides no insight into an economic theory of what should be enforced. It takes the existing content of the social definition of crime, and looks at the nature of optimal enforcement. But, even within these narrow limits, the model has a number of deficiencies.

(3.7) Deficiencies of the model

The neo-classical model of crime posits a central role for the state in the market for offenses. The state must do so because, given the non-exclusionary public good nature of law enforcement, criminal justice will not be provided by private economic agents acting spontaneously and voluntarily. Further, the nature of social regulation, and the definition of the nature of crime, is quite different from the consensual definition of appropriate behaviour attendant on the act of contract. In defining what is criminal, the state, for practical purposes and irrespective of the extent to which the populace participates in the drafting of legislation, acts unilaterally. Thus, unlike in a voluntary contract, the will of the state/society must be enforced on those who will not comply. Thus, when we have prescribed behaviour fixed unilaterally (ie law or regulation), rather than by individual agreement (ie contract), the enforcement of those laws must be carried out by the state (see Stigler, 1970: 526).

Now, because individual potential offenders when reviewing their options are assumed to assess the expected returns of criminal and non-criminal activities, the approach of law enforcement, in terms of the model, is to raise the costs of illegal activities - to "tax" that behaviour. This approach, stated simplistically, amounts to an application of the basic assumption of the theory of rational action - if you raise costs or lower rewards, a good will be purchased and consumed, and an activity will be performed, less (making the appropriate assumptions regarding the relative price and wealth effects). It also based on the conclusions of the literature on market failure which asserts that externalities can be internalised through appropriate taxes.

Unfortunately, the conclusions of the theory of market failure regarding the role of taxation in the internalization of externalities are not wholly applicable to all issues of crime and criminality.¹

Raising the costs of many types of (black market) crimes may not, in fact, be an effective deterrent. To see why, consider a non-consensual crime like burglary. The

¹ The following few paragraphs rely heavily on the argument of Caulkins, *et al.* (1997: 13).

potential benefit to the aspirant offender is unaffected by changes to either the possibility or severity of punishment, while increased enforcement will increase her potential costs. Thus, more policing, or longer sentences, might well deter some potential offenders by pushing the expected value of the crime below zero.¹

But the benefits of selling drugs and other illicit goods (such as illegal weapons) are different. The benefits are not independent of the expected costs of capture. As those expected costs rise, so does the mark-up on the drug price in order to compensate dealers. Thus, increased enforcement not only increases the expected costs (monetary and non-monetary) to dealers, but also raises the monetary reward from dealing. Increased enforcement, far from reducing crime, may simply select for dealers who attach a high value to money and a low value to the potential costs of capture.

Thus, the extent to which raising the price of crime will actually reduce criminality is somewhat contentious. We may, in fact, go even further than this: The raising of the potential income to be derived from illegal activities, precisely because they are illegal, can attract economic agents who would otherwise be employed elsewhere. By increasing competition, the raised value of future illicitly acquired income streams, can also increase competition, leading to product innovation and aggressive attempts at market capture.²

The implications of this line of argument, of course, is not that the model is irrecoverably flawed. It is quite feasible, for instance, to define an expected reward schedule to include an argument for the effects of law enforcement on the price of the illicit goods and services produced, distributed or consumed in the course of illegal activities. The fact is, however, that the models do not approach this issue in this way - leading one to the conclusion that the approach adopted is simplistic, potentially dangerously so, if policy choices are to be made on the basis of its conclusions.

A further significant problem with the approach is its inadequate treatment of the mechanics of the criminal justice system. This leads to a fairly mechanical view of how changes to the values of law enforcement parameters can, and will, be effected in

¹ Even this may not be strictly true. Increased enforcement may increase the sale price of stolen goods in recognition of the increased risk run by the various criminals involved in the theft, hiding and distribution of stolen goods.

² Something like this appears to have happened in the US where various competitors, with different products have competed for market share and profits. This has led, ironically, to a 75% decline in real terms of the price of a gram of pure cocaine in the US between 1977 and 1992 (Rydell and Everingham, 1994: 4/5). As the authors remark, the effect of competition on cocaine prices is greeted somewhat more mutely than is the same effect on the prices of computers.

response to autonomous changes in the crime rate. Indeed, the early models of crime wholly ignored the issue of the legal regime and an attempt was made by Harris (1970) to put this right.

The outputs of any production process, including the production of convictions, depends on the level of resources, their quality and the technology of production. The quality of resources (including the quantity of human capital embedded in personnel) and the technology of production are not considered in Becker's model. The exclusion of the latter is interesting because the technology of production, in this case, includes the legal regime in terms of which law enforcement authorities produce their results. This legal regime is, like the resourcing of the police and courts, also subject to policy choices by law enforcement authorities. The permissibility of evidence obtained through torture, otherwise unlawful searches, etc. is not an altogether exogenous variable.

Recognising this, Harris attempted to modify Becker's model by building in the endogenous determination of the legal rights of suspects. He does this by formulating a function for the social cost of wrongful convictions. This cost is directly related to p , O , and f . It is negatively related to α , which reflects the legal safe-guards of suspects. He then makes the level of crime a function of p , f , u and α with O positively related to α reflecting the idea that increased protection encourages crime.

By building the social cost of wrongful convictions into the determination of the optimal level of crime, Harris shows that α is also subject to policy choice. He also shows that the addition of α to the model raises the optimal level of crime for all levels of α , and lowers the optimal levels of p and f , and concludes that;

"If the perceived social loss arising from unjust punishment rises, greater legal safe-guards and lower levels of apprehension and punishment will be called for. Alternatively, increased costs from crimes calls for increased apprehension and punishment and relaxed legal safeguards. If the costs of apprehension rise, harsher punishment and relaxed legal safeguards are required. However, in the latter two cases, the increases in punishment and the relaxation of legal safeguards will be less than they would be in the absence of the function" (Harris, 1970: 169).¹

However, even this attempt is more revealing of the misunderstanding of the nature of the criminal justice policy process in a democracy than it is helpful in the analysis of crime and its determination.

¹ Ehrlich and Brower (1987) seek to construct a quantified index of the development of the safe-guards of suspects and their effect on the productivity of the criminal justice system. Although they admit that their results are "highly tentative" (1987: 105/6), they find a negative relationship between legal safe-guards and police arrest rates.

Embedded in the fundamental nature of any democracy, a series of countervailing powers operate to ensure that the exercise of state power, particularly in the arena of criminal justice, is constrained and controlled. The criminal justice system, far from being subject to the direct control of any one authority seeking solely to control crime and minimise social losses attendant on it, is designed to ensure that rules and procedures exist to protect the innocent from unjustified arrest, prosecution and punishment. The rules and procedures governing changes to these "due process" rules and procedures are designed to make it quite difficult to effect changes to the rights of the suspect. Since as even Ehrlich recognises in one article, these due process provisions constitute the "major efficiency parameter" of the criminal justice system (Ehrlich and Brower, 1987: 100), it is far from clear that changes to either f or p can be effected rapidly and smoothly in response to changes in the parameters of the supply of offenses schedule. It appears, therefore, that the simplistic notion that the authorities pursue the maximisation of social welfare through the minimisation of the costs of crime by making appropriate policy choices, misperceives the manner in which the structure of the criminal justice system renders the determination and implementation of policy difficult.

Again, one might question the extent to which this criticism penetrates to the heart of the model of crime proposed by neo-classical economics. It might well be possible to incorporate and endogenise changes to the legal framework governing the criminal justice system in order to predict the nature and speed of changes. Such an attempt, however, will have to come to grips with the difficulties of predicting policy responses of a judiciary which is, in all democracies, independent of the authorities precisely in order to prevent the manipulation of the rights of citizens to further the goals of public policy.¹ Once again, therefore, the neo-classical model of the determination of the levels of crime flatters to deceive.²

¹ This is not to imply that changes to criminal justice policy choice parameters are impossible to make, or that the difficulty of making changes must, necessarily, be greater for increasing p rather than decreasing it. Wolpin (1978: 821) finds that the conviction rate in England and Wales jumped in 1908 when a policy change permitted the imposition of probationary sentences on convicts was implemented. In the course of plea bargaining, suspects agreed to plead guilty (and raise p) in return for a promise of probation (lower f).

A further difficulty with the assumption that the optimal response of the law enforcement authorities to changes in crime rates can be effected through simple policy choices relates to the interaction between changes to the probability and severity of punishment: It is well recognized that policy-directed changes to the severity of punishment can have perverse results on the conviction rate. Prosecutors, judges and juries appear, for instance, to adopt a more cautious attitude in the pursuit of convictions when the stakes are raised.

² This criticism of the approach of the model to the determination of law enforcement policy parameters reflects its bias towards a model of criminality in which public policy is adopted and implemented relatively unproblematically by a willing, strong and competent state. This attitude, implicit

(3.8) Conclusion

We have come a long way in this chapter. I have described the basic premises and conclusions of the approach of neo-classical economic theory to the simultaneous determination of levels of crime and optimal levels of law enforcement. That approach, in essence, is that a market for offenses, is construed as consisting of a supply of offenses schedule and a derived demand curve reflecting the optimal response of public law enforcement authorities to crime, based on the costs of crime and the costs of law enforcement. The intersection of the two curves defines an optimal level of crime and law enforcement where the combined costs of both are minimised.

The model, essentially identical to all other partial equilibrium models, posits the equilibrium as stable and self-enforcing so long as all agents rationally pursue the maximisation of their respective utility schedules. In the case of the authorities, this schedule is defined as the maximisation of social welfare through the minimisation of *all costs of crime and law enforcement, while criminals, potential criminals and potential victims seek to maximise their utility in light of the risks posed by crime.*

I have also tried to show that the approach of the neo-classical model is deficient in a number of respects. In particular, precisely because the model is so broad, its conclusions, while plausible, are also quite thin and unsatisfying. The model suffers from a lack of clarity about the heterogeneity of crime, and unsuccessfully attempts to impose a level of uniformity on all types of crime in all situations. It also fails to come to grips with the diverse, indeed conflicting, nature of the objectives of the criminal justice system, as well as imputing an unfounded degree of policy management coherence and capacity onto the system as a whole.

But, as was pointed out in the text, these criticisms of the model do not seem all that

also in the assumption that public law enforcement is the key determinant of levels of crime, is not, necessarily congruent with the experience of crime through history. In fact, the majority of states in the world are probably quite incapable of designing and/or executing "rational" law enforcement policies. In this context, a theory which seeks to describe a rational policy, falls short of adequate description.

Once again, however, this criticism need not be seen as central to the claims of the model. One might argue, after all, that the weakness of the state does not necessarily mean that crimes and socially proscribed behaviour is unpunished. Diego Gambetta, for instance, argues that the rise of the mafia in Sicily can be directly linked to the weakness of the newly unified Italian state in the 19th century. Arguing that the defining feature of mafia activity is the provision of private protection, ensuring that its clients' interests are protected and enforced, Gambetta argues that the development of the mafia is the direct result of the inability of the Italian state to enforce contractual relations (see Gambetta, 1994: Section One). Thus, instead of having a public enforcement agency, private agencies may develop. An alternative to this strategy might be that in the context of a weak state, p and/or f might be assumed to be zero. Thus, although unconsidered by the designers of the model, these matters can be handled within the framework of the model.

compelling. Indeed, the model seems to survive these criticisms by being able to adapt and expand in order to accommodate criticisms and concerns. But perhaps it is this very adaptability which is a manifestation of a deeper malaise.

The model, precisely because of its generality, is unable to develop insight into many issues facing criminal justice. No-one would doubt that, *ceteris paribus*, an increase in the likelihood or degree of punishment will reduce the rate of crime. No-one could contest that the implementation of fines as the punishment of choice is rational where the aim of criminal justice is to minimise social costs arising from criminality. That said, these conclusions hardly seem to justify the effort and energy put into the development of the model itself.

Let us be clear about what is being asserted here.

The neo-classical approach to crime and law enforcement is explicitly and self-consciously, normative. In violation of some of the more prescriptive rules of positivist science, the economist uses her models to develop a conception of a 'rational' level of law enforcement. Thus, in contrast to the work done in developing analyses of racism and regulation, analysis of law enforcement seeks to define what should be done, and not merely to describe the costs and benefits of existing approaches.

In attempting to do this, the model posits certain goals of criminal justice policy, as well as a certain presumed logic of the determinants of the costs, benefits, risks and levels of crime. In doing this, the model has been shown to have at its core a poorly considered and incomplete conception of the nature of the problem it is seeking to address. The implications of this will be taken up in the next chapter.

Chapter Four

Consolidation and Conclusion

(4.1) The aims of this study

This study set out to explore the manner in which the neo-classical economics is deployed in the study of non-economic phenomena. In doing so, the intention was to examine how the premises and logic of the neo-classical paradigm shapes the way in which problems are posed, and solutions are sought and, in so doing, to see what might be learnt about how economists think.

Neo-classical economics, the theoretical and intellectual centre of the discipline of economics, presents itself, primarily, as a mode of approaching economic and non-economic phenomena. That approach, I have argued, is founded on three irreducible and fundamental assumptions: (i) that economic agents have utility functions defined by their preferences; (ii) that, when faced with constraints in the attainment of utility, agents act rationally; and (iii) that rational behaviour, combined with stable preferences and price rationing, leads to stable equilibria in which no agent or individual has any incentive to adjust their respective allocations of time, energy and resources.

This study has attempted to examine how this approach, when used to analyse real world phenomena, affects the methods and the results of theorists. In so doing we have explored two quite different realms. On the one hand, we have explored the neo-classical approach to racism, on the other, we have looked at the models used to investigate issues of crime and law enforcement. These two issues are, on the face of it, quite different. There is no obvious reason why these two topics should be juxtaposed in an exploration of the neo-classical paradigm. Indeed, and more fundamentally, the aims of the theorists who constructed the various models examined were quite different. While Hutt sought to explain the origin of racism in the attainment and utilisation of state power by the white working class in SA, Becker sought to describe the effects and costs of racism in the USA by modelling discrimination as trade between two nations with different relative advantages and strong mutual antipathy. Becker and Ehrlich, although presenting empirical results confirming the predictions of the model, seek, on the other hand, to advance a more normative project: how much law enforcement *should* there be? How much crime *should* exist?

These two approaches, one primarily positive, the other primarily normative, would appear to be mismatched when examined in the context of a single study of the neo-classical framework. And, to some extent, this is so. Nonetheless, I will try to show, in this final chapter that the results of these twin explorations are compatible and mutually reinforcing. Before doing so, let us revisit the results of our studies.

(4.2) What have we found?

While the approaches of Hutt and Becker to the question of racism and discrimination were by no means identical, they exhibited some interesting and revealing commonalities.

Hutt, in arguing that racism arises from the development of ideological justifications for an unequal distribution of both income and opportunity, demonstrated a conviction that this state of affairs was somehow unnatural. He argued that the existence of racism in SA was a manifestation and result of the seizure of state power by the white working class, and the commitment of the state's coercive powers to the creation of a contrived scarcity for white labour. The contriving of this artificial scarcity required as an unavoidable precondition the distortion of economic relations founded on principles of free trade and consensual contract. Thus, Hutt's argument rests full-square on a conception of an ideal society in which the unhindered free play of market forces is allowed to operate, and in which state power could not be appropriated to the interests of any interest group at the expense of any other. Such a society, built on the foundations of the unfettered sovereignty of the consumer, would be both just and economically efficient.

Becker too evinced this reliance on a conceptualisation of an ideal society. This conceptualisation was, however, a little harder to find because Becker was not overtly interested in condemning racism. Evincing the neo-classicist discomfort with discussing the origins of tastes and preferences, Becker argued that discrimination, as a particular taste of groups of people, affected the manner in which resources were allocated between goods and services. In making this case, however, Becker sought to compare, even if only implicitly, the effects of racism on the level, and distribution, of wealth in society. In order to do this, he asserted that the results of economic interactions governed, even if only in part, by tastes for discrimination, could be compared to an hypothetical situation in which all economic (ie resource-related) decisions were made on the basis of 'objective' criteria - ie those of pecuniary maximisation alone. Once again, therefore, an ideal economy, founded on 'objective' and rational decision-making, was used as a yard-stick to assess the effects of racism

in the economy.

Thus in both the cases of Hutt and Becker, an hypothetical ideal, founded on economic relations undistorted by the actions, backed by coercive authority, of the state, or by 'non-objective' criteria in decision-making, found its way into the heart of the neo-classical analysis of racism and discrimination.

Turning to the neo-classical approach to crime and law enforcement, on the other hand, we found some seemingly important differences with the conclusions we reached about the models of discrimination.

The economic models of crime and law enforcement which we have examined depict all the characteristics of typical neo-classical reasoning. In line with the neo-classicist's dictum that the economist must assume that an equilibrium exists, or is in the process of being achieved, the models assert the existence of equilibrating forces in the market for offenses. Indeed, even where there is apparent disequilibrium, the economist is enjoined to assume that there are hidden costs or benefits the perception of which would confirm the rationality of the actions of the relevant economic agents. Here, the model assumes that the market for offenses, like all other markets, is populated by rational actors seeking to maximise their respective welfares, and that, in so doing, provided that all else remains constant, a stable equilibrium will be achieved. It was apparent, however, when we examined this model, that the extent to which it could be said that its presumptions 'fit' the nature of crime, criminality and law enforcement is open to some significant doubts. Indeed, it became clear that, in pursuing the grail of an equilibrium model, a number of significant, and troubling simplifications on reality were made. For instance, it was assumed that law enforcement policy management could rapidly effect the appropriate changes when, in reality, criminal justice systems in democracies do not work in this way. It was also assumed that all crimes generated costs to victims in excess of the benefits to perpetrators, and that offenders were unable to internalise raised costs as law enforcement policy raised the expected costs, and lowered the expected rewards, of crime.

These simplifications, I believe, result from the modellers preconceived idea that an equilibrium model of crime and law enforcement is both an appropriate theoretical strategy for analysis, and a reasonable description of the forces operative in the market for offenses. The fact that their empirical studies (and Becker's, for one, is very simplistic, even naïve) confirm the predictions of the model serves, in their minds to validate the presuppositions of the model.

But even if this is the case, it is certainly worth thinking about the place of the notion of equilibrium in the structure of neo-classical theory.

(4.3) The place of equilibrium in neo-classical thought

Becker was quoted in the first chapter arguing that:

"When an apparently profitable opportunity to a firm worker or household is not exploited, the economic approach does not take refuge in assertions about irrationality, contentment with wealth already acquired, or convenient *ad hoc* shifts in values (that is, preferences). Rather it postulates the existence of costs, monetary or psychic, of taking advantages of these opportunities that eliminate their profitability - costs that may not be easily 'seen' by outsiders" (Becker, 1986: 112).

Thus, the economist assumes the existence of an equilibrium even when one is not immediately apparent.

It should be clear, however, that this approach falls victim to the distinction drawn by Boland (1992) between explaining and explaining away. "Explaining away," Boland argues, "takes the truth of one's explanation for granted; thus whatever one may think reality is can be seen to be mere appearance" (1992: 3) - a problem that is very manifest in the neo-classical approach to law enforcement policy. This criticism of neo-classicism, however, was advanced as long ago as the turn of the century by Veblen (see Veblen 1899a, 1899b and 1900).¹

Veblen argued that economics was guided by certain preconceptions which established the orientation of its enquiries, and, in particular, determined the types of questions it asked and the answers it provided. In particular, he argued that at its "higher syntheses", economics validates its knowledge on a metaphysics of normality. This metaphysics posits as a feature of the material facts of the world, a beneficial tendency - that the natural order if allowed to run free will tend towards the highest welfare of the race. This law is construed as not being immutable or unerring, rather human beings wilfully or accidentally, can and do, contradict it - with the result that those with access to the truth of the matter (economists, for example) must set themselves the task of restoring the optimality, rationality and naturalness of the economic order. The precise character of this particular metaphysical presupposition of economics, he argues, slowly evolved in the writings of the early economists, nevertheless it manifests itself as a particular 'point of view' in economics.

¹ As an interesting historical footnote, it was in these articles that Veblen coined the term "neo-classical economics" to distinguish it from classical economics.

For instance, in discussing Adam Smith, Veblen argues that the conception that there is a "wholesome trend in the natural course of things" (1899b: 396-399), and that though these natural relations are not inevitable, if left to themselves the economy has an innate recuperative power. This, he argues, reflects a teleological metaphysics inherent in the paradigm. In essence Veblen accuses economics of illegitimately imputing a quasi-conscious intent to the economy. This course of argument he insists is unscientific since the economist is oriented towards viewing economic relations through her own preconceptions.¹ Veblen insists that those studies in economics which are based on the purely competitive markets populated by untainted human agents - the basic building-blocks of all economic theory - "are a feat of scientific imagination and are not intended as an expression of fact intended to provide abstract laws". He argues that this model has been accepted because it is insightful and has shaped enquiries into fact, but that it is not, itself, a description of the facts (1899b: 423). The problem is that this deductive model is then (mis-)used to characterise situations in terms of their adequacy in relation to the model of the natural economic relation - but this judgement is based on a conception of normality founded on an intellectual fiction.

This argument is supported by historical studies of the development of neo-classicism. It has been argued that when Walras developed his mathematical treatment of economics, which we have subsequently inherited in neo-classicism, he did so with the express purpose of presenting an ideal social order based on the principle of justice in exchange. His 'model' was, therefore, not a model of the real world, but of a "realistic utopia" (Jaffe, 1980: 530; see also Jaffe (1977)). His model amounted to an exposition of a society which, while not violating realistic assumptions about the world (principally it assumed scarcity while determining the distribution/endowment of those resources to be beyond the range of the model), maximized social welfare within the limits determined by the distribution of initial endowments. It is the argument of this paper that the use made of the neo-classical framework to explain real phenomena is constrained by these 'utopian' aspects of the original conception.²

¹ In relation to Smith, this argument is confirmed by Evensky (1993) who argues that Smith's fundamental aim as a moral philosopher was to demonstrate the divinity of the construction of the world and of economic relations. He argues that the concept of the 'invisible hand' is intended to reflect the idea that the order we observe is the "handiwork of a great designer" (Evensky, 1993: 199).

² If the reader is offended by the notion that Walras's scheme was normative, rather than a positive description of the workings of the real economy, then my only consolation is that she is not alone. Walker (1984), characterizing Jaffe's interpretation of Walras's project as an "allegation" (1984: 445), tries to defend Walras from the charge. Ultimately his defense rests on a rather tenuous distinction: between a "scientist" who honestly pursues objective truth (446) even though subtly and "unconsciously influenced by his normative views" (467); and "someone" who tries to show how ideas about social justice can be distilled into rules of proper conduct (446).

Ironically this distinction is tenuous only in the neo-classical paradigm for it is there that the

The examination of the approach of neo-classicism to non-economic phenomena has demonstrated that lurking behind the apparent value-neutrality of neo-classical economics is a conception of an ideal economic space, undistorted by the intrusive and undesirable actions of fallible man and state. This ideal, however, is not left merely as a point of comparison. In fact the presumed logic of its mechanism is understood to operate in all economies through time and space irrespective of the distortions created. Indeed, the metaphor of 'distortion' is appropriate, because the actions of individual, avaricious economic agents, as well as those well-intentioned policies of government, do not create a new economic fabric shaping and colouring individual and institutional choice. These actions merely affect the choices, the underlying logic of which is invariant across time and space.

But compelling as the logic of the neo-classical model of the ideal economy is, we must be cautious when using it as a description of reality. It seems to me that the basic theses of the logic of the ideal posited by neo-classical economics reflects a conception of the workings of economic relations that, far from being real, invariant characteristic of the world across time and space, has been a feature of real economies for only a small part of human history. True, that logic has generated the fastest and most extended period of economic growth in human history, but that is hardly a reason to believe that it has existed throughout history in a distorted and dysfunctional manner. It seems to me that the equation of income to the factors of production with their marginal contributions to the value of production is both historically and spatially more the exception than the rule. Historically, the most important aspect determining the distribution of resources and income has been the extraction and transfer of rents and quasi-rents. From oligopolistic market structures, to feudal social organisation to social welfarism, the common theme in the distribution of income has been transfers (largely effected through coercion), not returns to productivity, or, as Becker would say, 'objective' criteria.

In an entertaining review of Posner's *Economic Analysis of the Law*, Arthur Leff discusses the use made by certain neo-classical economists, including Posner, of the notion of inefficiency as a critique of social phenomena. Posner, he says, depicts American society as one which regulates itself in a rather bizarre fashion. On the one hand it has created one grand system - the market - which is virtually flawless as a mechanism for the maximisation of human happiness. On the other, it has created

ultimate source of motivation is deemed unimportant: from the perspective of the neo-classicist, motive is irrelevant.

For an account of how the normative model became, under Pareto a hypothesis about actual economic relationships, see Mittermaier (1986).

another system - the law - which is wholly pernicious to that aim. An anthropologist, he remarks caustically, would be fascinated. A bad anthropologist would cluck and depart. A real anthropologist would stick around and try to find what it is that she was missing. She would be particularly careful not to stand back and scoff at this perceived irrationality. The point is that "nothing can be considered inefficiently achieved until one discovers what the aim of that activity was" (Leff, 1974: 463/4).

The essence of the preceding point is that the neo-classical tendency to impute objectives onto economic agents - be it the pursuit of the maximization of welfare without consideration of race or the minimization of the social costs of crime - can be, and is, dangerous - for it sets the economist up as a "political arithmetician" comparing reality with what she believes people really want and with what the world really should look like.

Perhaps it will be said that the conclusion that neo-classicism contains a vision of the ideal is neither novel, nor surprising. After all, economists know that the model of perfect competition is a simplified ideal-type. They know that reality is far more complex than can be captured in the equations of modellers and theorists. They know that when they assess social policy, it is against a model which has never, and probably can never, exist full-blown in the real world. Recognising the nature of the approach does not in any way minimise the insights that can be gained from neo-classical models. However, in the rush to develop models which generate equilibrium solutions, economists should also understand that that approach, while being efficient and productive, leaves them open to the critique that they impute an ameliorative trend onto human affairs which is simply not there in reality.

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