

ECONOMICS OF CRIME

The effects of crime act upon the economy in two primary ways. Microeconomics deals with the effect on individuals and businesses. Macroeconomics deals with the effect on the local community, national, and international economies. Individuals and businesses can easily understand the effect of crime in their everyday activities. However, most individuals and businesses have difficulty understanding the effect of crime on the community, national, and international levels.

Cost Reality

The cost of crime on the economy in the U.S., in Nigeria and in most nations of the world is now at a staggering height. The outlook does not look any better. There is no real compensation for emotional and social harms done to members of a society by criminal acts. The average citizen would be shocked to know the actual costs. There are no consolidated figures as to the total cost of crime. However, if all the various costs were compiled into a consolidated figure, then they would surely be enormous. The cost of crime involves all of the following elements:

- i. Law enforcement:** This encompasses the cost of training and maintaining a police department and all of its support staff, equipment, buildings, etc.
- ii. Crime prevention:** This involves all the community programmes that try to help prevent crime. Common programs include Crime Stoppers, school programmes, and various other programmes sponsored by local community tax monies.
- iii. Drug prevention and rehabilitation:** This involves both public and private financing. Both government and private organizations offer programs to prevent and rehabilitate drug and alcoholic offenders. This costs money to both the taxpayers and the patients.
- iv. Incarceration:** It costs the taxpayers a lot of money to house, supervise, train, feed, clothe, and provide medical care for inmates in a jail or detention centre.
- v. Courts:** Operating and maintaining the court system costs the taxpayers many tax dollars. It involves judges, court reporters, clerks, buildings, etc.
- vi. Prosecutors:** The costs of employing prosecutors and their staffs, buildings, and all of the associated costs of operating and maintaining them are enormous, especially in large metropolitan areas.
- vii. Public defenders:** Many defendants are not able to afford defence lawyers; therefore, the taxpayers must foot the bill. This bill includes costs of defence lawyers, their staff, and all the costs of operating and maintaining them.
- viii. Hospitalization:** A significant cost to society as a whole is health care costs. Medical costs for criminals, victims, and those involved in the justice system are a significant item. With the increase in AIDS and other diseases, this cost has become even more of an attention getter.
- ix. Businesses:** Businesses suffer losses when customers or employees steal from them. They have to raise prices or lay off employees because of thefts.

- x. **Insurance companies:** Individuals and businesses that have insurance file claims for losses that they suffer from crime. This, in turn, causes insurance companies to raise premiums to individuals and businesses.

The cost of crime can be very high. Some people say that some types of crime do not cost society, i.e., illegal gambling and prostitution. However, you can see that it does cost society. Let us take an example of a simple case. A bookmaker takes bets from his bettors. It is illegal in his area. The bettors are not forced to place bets. They place wagers because they want to “place their money where their mouth is.” Most bettors are middle-class workers. The bookmaker pays off the winners and collects from the losers. When law enforcement makes an arrest after considerable investigation, they must put the bookmaker in jail. The bookmaker usually posts bond or bail and is out after a short period. The bookmaker claims poverty and must retain a public defender. The case goes to trial and the bookmaker is found guilty. He is sentenced to 60 days in the county jail.

The cost to society in terms of money in this example is high. First, the bettors who placed the bets should not have placed bets, since they were using their hard-earned money that should have been used to pay their living expenses. It costs money to the taxpayers to pay the salaries of the investigators and their supporting staff to look into the bookmaker. In addition, it costs taxpayers money to try the bookmaker in court. The judges and their staff have to draw salaries and pay for their expenses. It costs taxpayers even more money to house the bookmaker in jail. The taxpayer has to pay for food and medical costs while the bookmaker is in jail. Also, jailers and correction officers must be paid, along with their benefits, to guard the bookmaker while he is in jail. It costs taxpayers for the detention facilities. The public defender must be paid from public funds. One can see that it costs society in dollar terms even though there is no violence. This example can apply to other “victimless” crimes, i.e., traffic violations, prostitution, and other misdemeanours.

Microeconomics

This segment of economics deals with individuals and businesses. The primary effect is the direct loss of money or property by the victim. In most cases, the dollar amount of money or property can be determined after the commission of the crime. In other cases, this may not be true. There are a few crimes where the reputation of the victim is damaged. The victim usually suffers a loss. Any person or business can become a victim. The cost to the victim can be enormous, or there can be no economic loss. The costs to the local community and the nation can be enormous when considering the total costs. The following examples of crimes show how victims can suffer a loss.

- i. **Arson:** This is the criminal act of deliberately setting fire to a property. This crime can affect both the victim and the insurance company. If the victim has no casualty insurance coverage, then the business or individual will undoubtedly be put out of business or home if the owners do not have the capital to rebuild. If the victim has insurance, then the insurance company

has to pay the claim. If the casualty is caused by the victim in order to collect insurance, then the insurance company can refuse to pay and the victim will normally suffer the loss. In either case, one or the other, or both, will realize a loss of property or money.

- ii. Bankruptcy Fraud:** This crime affects the creditors of a business. They ship goods to a customer with the expectations of receiving payment on agreed terms. The customer diverts the goods elsewhere and does not make the payment. The creditor suffers a loss of not only the cost of the merchandise but also the gross profits. For small businesses, this can be devastating. They are usually not able to recover the losses. For larger businesses, they pass the loss, which could take weeks, months, or even years to recover, on to other customers by raising their prices.
- iii. Forgery and Uttering:** This crime usually involves writing bad cheques or cashing stolen cheques. The amount of the loss is the amount of the cheque(s) involved. This crime also involves the criminal submitting false or forged documents to obtain a financial gain.
- iv. Larceny:** Larceny is also called theft. It involves the criminal taking of property from a victim. The value of the property is the economic loss incurred by the victim.
- v. Identity Theft:** This crime involves using the identity of the victim to obtain financial gain. The criminal uses the victim's Social Security number or driver's license number to obtain credit. The criminal uses credit to obtain goods and services. The goods and services are not paid by the criminal. The creditors try to get the victim to pay the bills. Even though the victim does not have to pay the bills, it ruins the credit standing of the victim. In this case, the creditors suffer the economic loss.
- vi. Loan Sharking:** This involves a situation where a borrower is required to pay interest at a very high rate. Usually, the interest is so high that the borrower can never get the principal reduced. As a result, the loan shark may use violence against the borrower, which in turn results in the borrower getting further behind on his payments because of additional bills, e.g., medical expenses. In the case of organized crime, the borrower may be forced to commit some other act, usually economic, which will either repay the lender or help the lender to get some economic advantage.
- vii. Credit Card Fraud:** Most stolen credit cards are stolen before they reach the intended customer, although many credit card numbers are stolen by store cashiers or other store employees. In some cases, credit cards are counterfeited, sometimes using legitimate numbers. Stolen credit cards are used to purchase merchandise that is fenced to an illegitimate vendor. The vendor in turn sells the merchandise for cash. The cardholder is not liable for the purchases if he reports the theft to the credit card company within 30 days. This requires the cardholder to review his statements every month. After he discovers that his card is stolen, he is still out some money, usually \$50 after the credit card company is notified. One organized crime group ships the goods overseas for resale. Credit card companies report that they lose multiple millions of dollars through credit card fraud. This is the primary reason for them charging high interest rates of 14 to 18%, or even higher in some states.

- viii. Mail-Order Operations:** This crime occurs when a customer sends money to a mail-order house for the purchase of merchandise and the mail-order house does not send the merchandise, but pockets the money. This is called a “boiler room” operation. Some states have required licensing of telemarketers. This has not prevented or deterred these operations, but it has made it somewhat easier to track down corrupt telemarketers by law enforcement.
- ix. Medicare/Medicaid Fraud:** This crime involves health professionals obtaining Medicare/Medicaid numbers from patients. The health professionals submit false claims to the government for goods and services not provided to the patient. This is fraud against the government. This can apply to the National Health Insurance Scheme in Nigeria.
- x. Repair Fraud:** This crime involves various types of repairmen who either do not fix the item needing repair or charge for services not performed. The victim suffers a loss by the amount charged by the repairman.
- xi. Skimming/Embezzlement:** Skimming involves the diversion of business receipts from the business, in effect stealing from the business and the government. The owner of the business is usually trying to hide money from either the tax collector or a partner. Embezzlement is the stealing of money from the employer. The economic loss is the amount of funds diverted or stolen.
- xii. Stock Manipulation:** Stock manipulation is the transfer of stock between related entities or people in order to increase the market value. When the value is high, normally far above the market value, the stock is sold to other investors. Later, the value of the stock or bonds drops to the actual market values. The investor later suffers a loss measured by the cost less the amount realized when sold.
- xiii. Swindlers:** The perpetrators of this crime are often referred to as con men. The word *con* is short for confidence. The criminal gains the confidence of a victim. When the con man has a victim’s confidence, then he or she will take money or property from the victim and disappear. The economic loss is determined by the amount of money or property lost by the victim.
- xiv. Narcotics:** The use of narcotics by consumers has devastating effects at both the micro- and macroeconomic levels. This section deals with the microeconomic level. First, narcotic use diverts consumers’ funds to narcotics, instead of for everyday living expenses. The narcotic user becomes addicted, which drives the user to want to buy more and more. After a time, the narcotic user will use all his resources to purchase the illegal substance. Crack cocaine is one narcotic that will do this in a relatively short time. There is no such thing as a casual drug user. The narcotic user will eventually do anything to get funds to purchase more narcotics. The user’s performance on his job drops and absenteeism increases. Eventually, the user will lose his job. In some instances, he will steal from his employer and may get caught. Narcotics users would rather pay for narcotics than for their living expenses. When they lose their jobs, they resort to borrowing and stealing from others. The street pusher, who sells the narcotics to the consumer, is usually a user himself. If not, the pusher is trying to make money in order to get out of his economically depressed state. Street pushers have been

found to be as young as 12 years old. In recent years, criminal organizations like to have kids do their drug pushing because they do not serve time in jails or correctional centres. Also, they have an easy market for drugs because they can sell to elementary, middle, and high school students. The drug kingpins reap the major profits from drug trafficking. They usually do not use or possess any drugs. They control and direct the shipments and distribution of drugs. A major part of the profits goes to the drug kingpins. This, in effect, causes the wealth of a community to become concentrated from the many to the few. In small communities, this can be readily evident by observing who the wealthy people are in the community and by their occupations or business ventures. In metropolitan areas, this is not so evident because of the intermingling of wealthy people from both legal and illegal business ventures.

Macroeconomics

Macroeconomics deals economic realities that affect the local community (city or county), regional, national, and international levels. Academia is interested in the economic aspects of crime. Law enforcement is also interested. Large metropolitan police departments monitor crime areas in order to move resources to combat it. Various federal agencies have economic or statistical units. These units keep track of various types of crimes.

i. Organized Crime

Organized criminal organizations operate at both the micro- and macroeconomic levels. Legally speaking, organized crime is defined as three or more individuals. Actually, they range from a handful to thousands of members. These individuals usually operate as a group. Their main goal is financial gain. In some organizations, power is another goal. Organized crime provides the biggest threat to local communities and the nation.

Manufacturing and mining operations are the only major industries that do not appear to be heavily infiltrated. A major concern with organized crime involvement in legitimate industries is that threats and intimidation may be used to limit competition and obtain excessive profits. The measurable result of such activities is higher prices. Taxes are not paid on much of the income generated by organized crime; implicitly, this results in higher taxes being imposed on the incomes of other citizens to make up for this loss in tax revenues. Based on the lower-level estimate of organized crime income (\$29.5 billion) and the assumption that taxes are not paid on 60% of this criminal income, it is estimated that personal taxes on other citizens were \$6.5 billion higher than would be the case if all organized crime income were taxed.

- **Local Industries:** In the local community, organized crime operates many businesses, legal and illegal. Organized crime likes to operate illegal activities in communities as follows: Prostitution, Gambling, Narcotics trafficking, Trafficking in stolen goods, Auto theft and repairs, Extortion, Illegal liquor making or distribution, Trafficking in tobacco.

Local businesses that organized crime likes to operate in the legal arena are: Construction, Waste removal, Garment industry, Food processing, distribution, and retailing, Hotels, Bars,

Banking, Business and personal services, Legalized gambling, Liquor retailing and wholesaling, Entertainment, Motor vehicle sales and repairs, Real estate, Other cash-oriented businesses. It likes to operate these businesses for three reasons. First, it can launder its illegal profits through a legitimate business. Second, it can skim profits by various methods. Last, if organized crime can obtain a monopoly in the area, then it can get higher prices for its products and services. This results in greater profits.

- **International**

Macroeconomics deals not only with national economic policies, but also with the international economic arena. This section deals with the international impact of organized crime. International organized crime is almost solely involved in narcotics trafficking; however, this is changing. Basic narcotics substances are produced in one country and exported to another country where they are sold for huge profits. A lot of the huge profits are returned to the country where the narcotic substances are produced. These profits are used not only to acquire wealth, but also to acquire power, which can be almost as great as the government itself.

Rational Choice Theory

This is a theory that explains the way criminals want to behave in the society as regards to whether he is rational or irrational. It is a basic theory that explains a part of the economics of crimes. According to this theory, a criminal is not irrational but rather ecologically rational, outfitted with evolutionary conserved decision modules adapted for survival in the human ancestral environment (Winden and Ash, 2009).

Becker's Rational Choice model, where an individual's decision to commit a crime is based on the costs and benefits (1968). In this model, all potential criminals have a benefit of crime (b), includes both the financial and any expected psychological benefits of crime. An individual committing crime faces costs from law-enforcement activities. The severity of the punishment including fines and jail time is one part of the total cost, and the other part is the probability of getting caught. Therefore, the costs will equal the probability of punishment (p) times the cost of punishment (c). Thus, the net expected returns from crime equal: $b - pc$. Standard differentiation tells us that the number of criminals rises as b rises, and falls as p or c rises. Therefore, the individual decision to commit a crime is conditional upon the following stipulation: $(b - pc) > 0$.

Isaac Ehrlich analyses the effects of income levels and distribution on crime in 1973. He argues that payoffs to crime, especially property crime, depend primarily on the opportunities provided by potential victims of crime, as measured by the median income of the families in a given community. He also considers the effect of unemployment on crime rates. He views the unemployment rate in a community as a complementary indicator of income opportunities available in the legal labour market. In his empirical research and study, he finds that unemployment rates are less important determinants of crime than income levels and

distribution. These variables are a measure of opportunity cost (o) which could be added to Becker's model

$$= b - (pc + o).$$

Based on the assumption that the individual preferences are constant, rational choice theory can be used to predict how changes in the probability and severity of sanctions and in various socio-economic factors may affect the amount of crime.

However, there are some limitations to the rational choice theory. They include:

- It is based on guess that individuals i.e. criminals are all rational
- Critics of this theory also ask as to whether potential offenders indeed have sufficient information to calculate the outcomes of their acting.

Behaviour of Criminals

Economic models of criminal behaviour have focused on sanction effects (e.g. deterrence issue) and the relationship between work and crime. In the main context, these models have not directly addressed the role of education in offending. It could be argued that unemployment is the conduit through which other factors influence the crime rate. For example, poor educational attainment may be highly correlated with the incidence of crime.

The economic model of crime is a standard model of decision making where individuals choose between criminal activity and legal activity on the basis of the expected utility from those acts. It is assumed that participation in criminal activity is the result of an optimizing individual responding to incentives. Among the factors that influence an individual's decision to engage in criminal activities are:

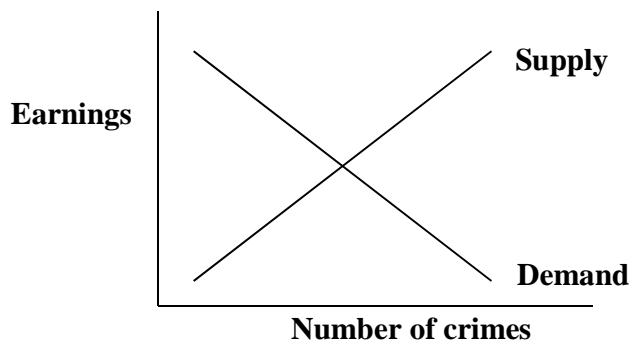
- the expected gains from crime relative to earnings from legal work;
- the chance (risk) of being caught and convicted;
- the extent of punishment and;
- the opportunities in legal activities

The Demand and Supply of Crime

Just like economics, crime can be formed into a graph of supply and demand of crime. The demand for crime is downward sloping, identical to the demand for economics.

The demand side, or the marginal benefit, of crime is the relationship of the number of crimes and total earnings. Crimes such as drugs and gambling are considered to be normal goods, rather than inferior so as the price increases, consumers will buy less and vice versa.

The supply side of crime is upward sloping and is the same concept of marginal cost. This will be the negatives of committing a crime. These include the opportunity costs of components of the criminal system such as legal fees, a legitimate job, and prison time. These are factors that must be considered when determining whether to commit a crime.



If demand for crimes were to increase, the quantity of crimes would increase and the earnings would increase. If demand for crimes were to decrease, the opposite would occur; the quantity and the earnings would both decrease.

If supply for crimes were to increase, the quantity of crimes would increase and the earnings would decrease. If supply for crimes were to decrease, the quantity of crimes would decrease and the earnings would increase.

The motivation behind most early applications of Becker's model was to examine the impact of legitimate labour market experiences (e.g., unemployment) and sanctions on criminal behaviour.

Broadly speaking, the empirical findings are that:

- poor legitimate labour market opportunities of potential criminals, such as low wages and high rates of unemployment, increases the supply of criminal activities and
- sanctions deter crime