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Economic Costs of Inequality

Richard H. McAdams†

Despite its reputation, economics has much to say about the costs of inequality. Much of the early work in law and economics avoided the issue of inequality by using a normative metric—wealth maximization or Kaldor-Hicks efficiency—that gives no weight to distributional concerns.[1] But wealth maximization was never the dominant normative criteria in the larger discipline of economics, which is why economists such as Mitchell Polinsky criticized Richard Posner's wealth maximization theory for ignoring the distributional analysis of welfare economics.[2] More recently, Louis Kaplow and Steve Shavell have taken great care to explain that welfare economics evaluates states of the world by considering *any and all* effects the state has on the well-being of individuals, which obviously includes a consideration of distribution.[3]

Economics more famously identifies the *benefits* of material inequality. To the extent that inequality is meritocratic—so that those who contribute more to social welfare receive more personal income and wealth—unequal material rewards will encourage greater effort and risk-taking, including greater investment in human capital. Obviously, an issue of great dispute is exactly how meritocratic our material inequality is—a particularly salient issue in a recession focusing attention on executive

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[1] See Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J Legal Stud 103 (1979); Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norms in Common Law Adjudication*, 8 Hofstra L Rev 487 (1980).

[2] See A. Mitchell Polinsky, *Economic Analysis as a Potentially Defective Product: A Buyer's Guide to Posner's Economic Analysis of Law*, 87 Harv L Rev 1655, 1679–80 (1974). Indeed, Posner has since made some concessions about the incompleteness of wealth maximization. See Richard A. Posner, *Wealth Maximization and Tort Law: A Philosophical Inquiry*, in David G. Owen, ed, *Philosophical Foundations of Tort Law* 99–113 (Oxford 1995).

[3] See Louis Kaplow and Steven Shavell, *Fairness versus Welfare* 28–38 (Harvard 2002).

HeinOnline -- 2010 U. Chi. Legal F. 23 2010

compensation in the financial industry. But given the social productivity of meritocratic inequality, economics offers a strong reason to avoid guaranteeing complete material equality. Such a guarantee would undermine the incentives for work, investment, and risk-taking that are vital to production.

The question I address, however, is whether economics offers any instrumental reasons to value material equality. Are there economic costs of inequality that must be weighed against the benefits? One can, of course, argue for a social welfare function that intrinsically values equality. I ask, however, whether inequality imposes instrumental costs that arise even under a utilitarian social welfare function, one that gives no weight to distribution. The answer is yes; there are economic costs to inequality. Some of those costs are outside the scope of this Article. For example, increases in inequality tend to dilute the deterrent value of tort damages, as differences in wealth make it more likely that the relatively poor will be judgment proof when they injure the relatively wealthy.[4] Surprisingly, some literature suggests that inequality suppresses growth.[5] But of note for the present Article, and for reasons explained below, inequality increases crime.

Even before the present recession, this economic point was a matter of concern because the long-term trend in the United States is towards increasing inequality. Census Bureau data shows a rise in the most common summary measure of income inequality, the Gini index,[6] which rose from 0.397 in 1967 to

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[4] See Juan José Ganuza and Fernando Gómez, *Realistic Standards: Optimal Negligence with Limited Liability*, 37 J Legal Stud 577 (2008); Avraham Tabbach, *Wealth Redistribution and the Social Costs of Crime and Law Enforcement* (Nov 2008), online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1309029 (visited May 8, 2010).

[5] See, for example, Torsten Persson and Guido Tabellini, *Is Inequality Harmful for Growth?*, 84 Am Econ Rev 600 (1994); William Easterly, *Inequality Does Cause Underdevelopment: Insights from a New Instrument*, 84 J Dev Econ 755 (2007). Other evidence finds the opposite results. See, for example, Kristin Forbes, *A Reassessment of the Relationship Between Inequality and Growth*, 90 Am Econ Rev 869 (2000).

[6] The Gini index or coefficient measures the deviation between a perfectly equal distribution of income (or, alternatively, wealth) and the actual distribution. Graphically, if a horizontal axis represents the percentage of the population and the vertical axis represents the percentage of society's income, then one can represent perfect equality with a diagonal line from (0, 0) to (100, 100). Each additional percentage point of the population holds exactly one more percent of the income. In an unequal society, a Lorenz curve represents the income of each individual in society, starting with the poorest. The curve starts at the beginning of the diagonal (because 0 percent of the population must hold 0 percent of income), but falls below it because the poorest X percent of individuals have less than X percent of society's income. The Gini coefficient and Gini index are measures of the size of the difference in the diagonal and the Lorenz curve for a society. See Kuan Xu, *How Has the Literature on Gini's Index Evolved in the Past 80 Years?*, Dalhousie U Dept of Economics Working Paper 1, 4, 6–8 (Jan 2004), online at http://economics.dal.ca/RePEc/dal/wparch/howgini.pdf (visited May 8, 2010).

HeinOnline -- 2010 U. Chi. Legal F. 24 2010

0.466 in 2008, an increase of 17 percent.[7] A more commonly cited statistic—because the change is so dramatic—concerns the income of top earners. In 2007, the income share of the top 10 percent of households reached almost 50 percent, which is the highest ever (given records back to 1913). The top 1 percent of income earners reached 23.5 percent of the total income share, which is the second highest year ever after 1928; and the top 1 percent of 1 percent (.01 percent) reached a 6 percent share, which is the highest ever.[8] But the rising inequality is not entirely limited to the elite. In 1967, the households at the eightieth percentile of income had incomes 1.66 times the income of households at the fiftieth percentile; in 2008, the ratio had risen to 1.99.[9] Similarly, in 1967, the income of households at the 80th percentile was 3.95 times the income of households at the 20th percentile, but that ratio increased to 4.84 by 2008.[10]

The recession provides an important moment to reassess the theoretical and empirical connection between inequality and crime. One reason is that recessions can affect inequality, though it turns out to be highly variable: sometimes they diminish inequality, sometimes they increase it, and sometimes they have no effect.[11] More importantly, the recession may offer an occasion

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[7] See US Census Bureau, *Selected Measures of Household Income Dispersion: 1967 to 2008* (on file with U Chi Legal F). These numbers are pre-tax. We can instead measure the Gini index *after* taxes and government transfers, when there is less inequality. The post-tax/transfer Gini index has risen from .32 in the mid-1970s to .38 in the mid-2000s, a rise of 19%. See http://stats. oecd.org/Index.aspx?&QueryId=11353&QueryType=View (visited May 8, 2010).

[8] See Emmanuel Saez, *Striking It Richer: The Evolution of Top Incomes in the United States*, 1 & Figures 1–3 (Aug 5, 2009), online at http://elsa.berkeley. edu/~saez/saez-UStopincomes-2007.pdf (visited May 8, 2010). Saez's paper updates the data reported in Thomas Piketty and Emmanuel Saez, *Income Inequality in the United States, 1913-1998*, 118 Q J Econ 1 (2003). Necessarily, the share for all other groups shrunk over the time period. See, for example, *Selected Measures of Household Income Dispersion* (cited in note 7) (reporting that the share of income earned by the third-middle-quintile declined from 17.3 percent of total income in 1967 to 14.7 percent of total income in 2008).

[9] That change constitutes a 20 percent increase in the ratio. See *Selected Measures of Household Income Dispersion* (cited in note 7).

[10] Id. That change constitutes a 22.5 percent increase in the ratio. Id. Economic literature debates the causes of this long-term trend. See, for example, Ian Dew-Becker and Robert J. Gordon, *Controversies about the Rise in American Inequality: A Survey*, National Bureau of Economics Research Working Paper 13982 (2008), online at http://papers.nber.org/papers/w13982.pdf (visited Oct 4, 2010). But one interesting fact is how the United States diverges from other nations. The United States was very similar to the income distribution in the United Kingdom and France for much of the twentieth century, but since around 1980, the United States has deviated from the other two by the rapid increase in the income share of top earners. See Piketty and Saez, 118 Q J Econ at 35–37 (cited in note 8).

[11] See, for example, George Psacharopoulos, et al, *Poverty and Income Inequality in Latin America During the 1980s*, 41 Rev Income & Wealth 245, 253 (1995) (examining

HeinOnline -- 2010 U. Chi. Legal F. 25 2010

for policy change to ameliorate inequality. The recession, the Democratic administration, and the new salience of elite executive compensation all make it possible—or more possible than it has been or apparently will be for some time—that the federal government will increase the progressivity of its income tax or take other measures to address income inequality. This Article will address one relevant point in that debate—the link between inequality and crime.

One might expect me to focus on the link between the recession's unemployment and crime.[12] While that variable is a worthy topic, I think inequality is more important. There are no advocates for unemployment as a general policy, as it does not have benefits to offset its obvious costs. By contrast, because there are benefits to meritocratic inequality, there are those who view it positively and oppose policies of redistribution. Thus, it is quite important to understand fully the economic costs as well as the benefits of this increasingly powerful dynamic of our economy. To this end, I explore the theory and evidence of two links: that material inequality causes increases in (1) street crimes of property acquisition and (2) crimes constituted by governmental corruption.

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fourteen recessions in Latin America and finding inequality rose with recessions and fell with recoveries); Gladys Lopez-Acevedo and Angel Salinas, *How Mexico's Financial Crisis Affected Income Distribution*, World Bank Policy Research Working Paper No 2406 (2000), online at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2000/08/26/000094946_00081705310276/Rendered/PDF/multi_page.pdf (visited Oct 4, 2010) (discussing why Mexico's financial crisis reduced income inequality); Tito Boeri and Andrea Brandolini, *The Age of Discontent: Italian Households at the Beginning of the Decade*, Institute for the Study of Labor Discussion Paper No 1530, 13 (2005), online at http://ftp.iza.org/dp1530.pdf (visited Oct 4, 2010) (rising inequality stabilized after major recession in 1993).

[12] There is a substantial literature on the effect of short-term and long-term unemployment on crime, tending to find that unemployment increases crime. See, for example, Steven Raphael and Rudolf Winter-Ebmer, *Identifying the Effect of Unemployment on Crime*, 44 J L & Econ 259, 276 (2001) (concluding that higher unemployment unambiguously increases property crime rates); Anna Öster and Jonas Agell, *Crime and Unemployment in Turbulent Times*, 5 J Eur Econ Assn 752, 754 (2007) (finding that there is a clear relationship between unemployment and the incidence of burglary, auto theft, and drug possession); Karin Edmark, *Unemployment and Crime: Is There a Connection?*, 107 Scand J Econ 353 (2005) (finding fairly robust evidence of a positive link between unemployment and property crime in the form of burglary and car theft in Swedish countries during the period 1988–1999); Eric D. Gould, Bruce A. Weinberg, and David B. Mustard, *Crime Rates and Local Labor Market Opportunities in the United States: 1979-1997*, 84 Rev Econ & Stat 45, 46 (2002) (finding that young, unskilled men are responsive to the opportunity costs of crime).

HeinOnline -- 2010 U. Chi. Legal F. 26 2010

I. MATERIAL INEQUALITY INCREASES STREET CRIME: THEORY AND EVIDENCE

The standard economic prediction is that material inequality increases crime. The economic theory of crime views the decision to offend as a rational response to the costs and benefits of various alternative actions.[13] The decision to steal, for example, involves a choice between two different ways of generating income: one can invest time in lawful production or in appropriating the property of others. The model predicts that an individual will steal when his expected returns from illegal work exceed that of legal work.[14] Of course, sometimes one can both work lawfully and steal when the opportunity arises. But because businesses and some individuals act to protect their property from theft, as with locks, alarms, security cameras, safes, etc., much casual theft is prevented. In these cases, professional theft may succeed because one has invested the time to learn how to bypass security measures and the facts needed for a particular heist. To some extent, one chooses between the occupation of thievery and a lawful occupation.

If so, then as Isaac Ehrlich noted decades ago, those with "legitimate returns" that are "well below the median have greater differential returns from property crimes and, hence, a greater incentive to participate in such crimes, relative to those with income well above the median."[15] As Edward Glaeser put it: "[A]s inequality rises, the returns to crime increase for the poor (because rich victims [are] richer) and the opportunity costs of crime are lower (because the poor are poorer)."[16] Conversely, with significant equality, those at the bottom are more likely to prefer their lawful means of generating income to stealing from those with only slightly more wealth. The theory thus predicts a posi-

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[13] See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J Pol Econ 169, 170–74 (1968).

[14] To be more precise, if one's expected returns are net of all costs, including nonmonetary costs like guilt and shame, then one will offend if one's expected returns from offending exceed one's expected returns from not offending.

[15] See Isaac Ehrlich, *Participation in Illegitimate Activities: An Economic Analysis*, in Gary S. Becker and William M. Landes, eds, *Essays in the Economics of Crime and Punishment* 68, 87 (National Bureau of Economic Research 1974).

[16] See Edward L. Glaeser, *Inequality*, Harvard Institute of Economic Research Discussion Paper No 2078, 10 (July 2005), online at http://www.economics.harvard.edu/pub/hier/2005/HIER2078.pdf (visited Oct 4, 2010). See also Richard A. Posner, *Economic Analysis of Law* 508 (5th ed Aspen Law and Business 1998) ("The forgone income of a legitimate alternative occupation is low for someone who has little earning capacity in legitimate occupations, while the proximity of wealth increases the expected return from crime.").

HeinOnline -- 2010 U. Chi. Legal F. 27 2010

tive relationship between inequality and property crimes, such as car theft, burglary, and fraud. The theory implies a similar positive relationship for any crime motivated in part by the acquisition of material value. Thus, robbery and black market crimes such as drug trafficking should rise with inequality, as should financially-motivated murder, for example, in violent clashes with rival drug suppliers.

Consider two objections to this theory. First, one might reasonably claim that people do not constantly recalculate whether or not to steal. Individuals whose self-identity includes being honest and excludes the occupation of being a thief or a drug-dealer will not recalculate the gains from crime when their lawful opportunities decline slightly. Second, one might object to the implication that the poorest will steal from the wealthiest, as much observed crime is intra-class. The poor, for example, mostly steal from other poor in the same neighborhood.

Neither point robs the theory of its power. The first point—essentially the stickiness of consumptive and productive decisions—is fully consistent with the prediction that inequality affects those near the margin of choice between crime and no crime. Some individuals are infra-marginal, having such strong reason to choose lawful or unlawful means of generating income that they will not recalculate their decision with any frequency, given the decision costs. Even with bounded rationality and a preference to conform to one's self-identity, however, there will be individuals who find themselves on the margin, perhaps when they are young and have yet to form a strong identity as a law-abider or law-violator, when they face a dramatic contraction in their lawful opportunities, or when they encounter an unusually attractive opportunity to offend. The theory predicts that in these marginal cases, the greater the inequality, the more attractive the crime, other things constant.

To some extent, the second objection—that much crime is intra-class—is subject to the same retort. *Some* crime is inter-class; if inequality increases the returns to committing crimes against a higher class, it will increase inter-class crime and hence overall crime. Yet the second objection does suggest that we should complicate the analysis by taking account of the precautionary measures of potential crime victims. Although the poorest individuals have the most to gain by *successfully* stealing from the richest, there are reasons that the poorest might find it much harder to succeed in stealing from the richest than in stealing from, say, the middle class. Wealthier individuals will invest more in private security measures against crime—fences, dogs,

HeinOnline -- 2010 U. Chi. Legal F. 28 2010

alarms, guards, etc.—both because they have more wealth to protect and more wealth to spend on protection. Most obviously, the wealthy tend to live together in wealthy, sometimes-gated communities, making the poor who come into the neighborhood very visible. Indeed, the poorest individuals may find it too complicated or risky to travel to a neighborhood far away from their own for purposes of offending and therefore concentrate on the wealthiest people in their own or immediately bordering neighborhoods.

Initially, even if this objection meant that inequality does not increase crime, it would still point to another cost of inequality: an increase in costs of crime *prevention*. Because the increase in inequality increases the returns from successful crime, the rich invest more in preventing crimes from being successful. Even if the net result were no more crime, there would still be more dead weight losses from investments in crime prevention. Installing bars on the windows might prevent burglary, but the homeowner loses the costs of the bars (including aesthetic and fire safety losses), while the frustrated burglar gains nothing. Similarly, not buying expensive art or stereo equipment may successfully prevent the burglary of those objects, but the homeowner loses the value of enjoying those goods, while the potential burglar again gains nothing.[17]

Yet, to return to the main point, the ability of the rich to invest in crime prevention does not void the basic theoretical claim that inequality increases inter-class crime. First, because economic segregation is imperfect, increasing inequality will tend to increase inequality within neighborhoods and especially between bordering neighborhoods. As the economic gap between the richest and poorest individuals within a geographic area increases, the returns from crime increase. Second, assume it takes a certain amount of wealth and human capital to be the kind of burglar or scam artist who can successfully prey on the richest individuals or sell them black market goods. Assume the necessary investments put these crimes out of reach of the poorest segments. Nonetheless, for moderate-wealthy individuals who can afford to make these investments, their returns to crime will increase as the gap between themselves and the richest individuals

[17] Of course, the person selling window security bars gains from selling them. But the seller, in the long run, could gain from selling something else—for example, window curtains—that did not produce dead weight losses. In any event, the second example is clearer because the seller of art or stereo equipment also loses from the potential buyer's fear of crime.

HeinOnline -- 2010 U. Chi. Legal F. 29 2010

increases. Recall, for example, the Census data recounted above showing an increase in the ratio between the income of households in the eightieth and fiftieth percentiles.[18]

In addition to Ehrlich's initial theory, there are at least two more economic reasons one might expect inequality to increase crime. First, inequality may dilute the deterrent effect of criminal sanctions.[19] The dominant punishment in many wealthy nations, at least for serious crimes, is prison, yet the deterrent effect of prison depends on the perceived difference between life in prison and life out of prison. In a wealthy nation, prison may work well as a deterrent of the citizen of average wealth because the perceived difference is so great. But in a nation with substantial inequality that forgoes torture and inhumane treatment of prisoners, the poorest citizen may live almost as badly outside of prison as he would inside prison, or at least the gap, and hence the deterrent, is much smaller. In economic terms, the costs of prison are lower for the poor. Inequality therefore negatively affects the deterrent efficiency of prison; more inequality means there are more people for whom prison threatens a lower cost.[20] Of course, inequality creates a class of wealthier citizens who are especially deterred by the threat of prison, but because the relatively poor have the greatest incentive to offend (for the reasons Ehrlich gave), the loss of deterrence for them outweighs the gain in deterrence of the rich.[21]

Another possibility is that inequality adversely affects the level of policing. According to economic theory and empiricism, more policing raises the probability of detecting crime and therefore decrease crime.[22] But the provision of a public good like policing requires collective political action that is most likely when the actors are homogeneous in their demand for the good. When

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[18] See *Selected Measures of Household Income Dispersion* (cited in note 7).

[19] Earling Eide, *Economics of Criminal Behavior*, in Boudewijn Bouckaert and Gerrit De Geest, eds, *Encyclopedia of Law and Economics, Vol V: The Economics of Crime and Litigation* 345, 361 (Edward Elgar 2000).

[20] The point may be made more general by including the analysis of fines. Others have observed that the effectiveness of criminal fines, like tort damages, depends on the level of inequality, with increased inequality diluting the effectiveness of fines, as more people become judgment proof. See Ganuza and Gómez, 37 J Legal Stud at 581 (cited in note 4); Tabbach, *Wealth Redistribution* at 13–17 (cited in note 4).

[21] Nonetheless, the next Part argues that inequality makes the rich more likely to commit crimes of bribery. If so, then the increased deterrent effect of prison noted in the text may push back against the tendency to commit crimes of political corruption.

[22] See, for example, Steven D. Levitt, *Understanding Why Crime Fell in the 1990s: Four Factors That Explain the Decline and Six That Do Not*, 18 J Econ Persp 163, 171 (2004); Steven D. Levitt, *Using Electoral Cycles In Police Hiring To Estimate The Effects Of Police On Crime: Reply*, 92 Am Econ Rev 1244, 1245–49 (2002).

HeinOnline -- 2010 U. Chi. Legal F. 30 2010

citizens are instead heterogeneous, differing in the type and quantity of public goods they value, the cost of their political organization is higher and the government will provide less of such goods. Thus, it will be easier to organize political support for paying taxes to fund police if everyone agrees on the priorities the police should have. But, as Glaeser explains, income inequality makes this less likely:

> [T]he rich might want a legal system focused on protecting property while the poor might be more concerned with preventing interpersonal violence in disadvantaged areas. Because these groups disagree, there is less willingness to invest in a common legal system than there would be if the population shared a common set of legal needs.[23]

Of course, the rich and poor may segregate themselves into separate political communities, each of which is homogeneous. But there are economies of scale to policing and other municipal services, which is why modern societies have many large cities with the rich and poor sharing a common police force. Thus, other things equal, rising inequality within a city should decrease police funding. As an anecdotal illustration, Glaeser notes that New York City has 28,000 police officers, while Bogota, Columbia, with a similar population but far more inequality, has only 12,000 officers.[24]

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[23] Glaeser, *Inequality* at 11 (cited in note 16).

[24] Id at 10. A final reason for the inequality-crime link is the possibility of relative preferences. See Richard H. McAdams, *Relative Preferences*, 102 Yale L J 1, 3 (1992) (explaining how individuals seek relative status and income and exploring the relevance of this competition for law); Francisco Alpizar, Fredrik Carlsson, and Olof Johansson-Stenman, *How Much Do We Care about Absolute Versus Relative Income and Consumption?*, J Econ Behav & Org 405, 411–14 (2005) (demonstrating that most individuals are concerned with both relative income and relative consumption of particular goods); Olof Johansson-Stenman, Fredrik Carlsson and Dinky Daruvala, *Measuring Future Grandparents' Preferences for Equality and Relative Standing*, 112 Econ J 362, 364–78 (2005) (arguing that an individual's personal utility partially depends on relative income). Individuals may care intrinsically about how their income or consumption compares to others. But the exact nature of the preference determines whether the link between inequality and crime is positive or negative. For example, suppose individuals desire the higher ranks. In a society with very little inequality, a single successful theft might improve one's relative rank very substantially, where the same theft in a very unequal society would change one's rank very little. Thus, inequality decreases the incentive for theft. By contrast, suppose individuals desire to avoid falling too far behind the mean. Adam Smith, for example, defined poverty as falling so far below the standard of living as to incur shame. See McAdams, 102 Yale L J at 11–12, citing Adam Smith, *The Theory of Moral Sentiments* 112–13, David D. Rafael and Alexander L. Macfie, eds (Clarendon Press 1976). If so, then everyone can satisfy this preference in a society with very low inequality, but greater levels of inequality create new incentives to acquire property, which includes acquiring property by theft.

HeinOnline -- 2010 U. Chi. Legal F. 31 2010

To my knowledge, no one has tested Glaeser's claim.[25] The studies tend to control for the level of policing rather than measuring an effect of inequality on police. The theory is suggestive, however, given Steven Levitt's finding that the United States underinvests in police compared to prisons.[26] The crime-reducing returns to investing an extra dollar in public policing significantly exceed the crime-reducing returns to investing an extra dollar in prisons. Perhaps the explanation is that the wealthy can employ their own private police but cannot run their own private prison system; they therefore prefer public money go to prisons while spending privately on security.[27]

In any event, the empirical evidence generally supports the claim of the first two theories that inequality increases crime. In an early economic study, Erhlich examined crime levels among the states in 1940, 1950, and 1960 and found that "[c]rimes against property (robbery, burglary, larceny, and auto theft) . . . vary positively with the percentage of families below one-half of the median income."[28] After Ehrlich's 1973 study, sociologists and economists explored the issue using different data and different statistical methods. Hsieh and Pugh conducted a meta-analysis of the literature in 1993 and found a significant link between income inequality and violent crime.[29] In 2004, Rodrigo

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[25] There is evidence of a different but parallel point. A recent paper finds that, independent of absolute poverty, income inequality is associated with higher infant mortality. See Tilman Tacke and Robert J. Waldmann, *Income Distribution, Infant Mortality, and Health Care Expenditure*, Centre for Economics and International Studies Tor Vergata Research Paper Series, Vol 7, Issue 3, No 146 (2009), online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1434514 (visited Oct 4, 2010). The authors explain the finding by the fact that, holding social wealth constant, public expenditures on health care fall as inequality rises. The reason could be that the inequalities create heterogeneity in the demand for health care and insurance, which lowers the willingness to spend tax dollars to provide these goods.

[26] See Steven D. Levitt, *Understanding Why Crime Fell in the 1990s: Four Factors that Explain the Decline and Seven that Do Not*, 18 J Econ Persp 163, 176–79 (2004) (concluding that "a dollar spent on prisons yields an estimated crime reduction that is 20 percent less than a dollar spent on police.").

[27] See David A. Sklansky, *The Private Police*, 46 UCLA L Rev 1165, 1171–82 (1999). Or the rich may use their political power to divert public police to their own neighborhoods and refuse to fund additional police who would be effective at reducing crime in poor neighborhoods.

[28] Ehrlich, *Participation in Illegitimate Activities* at 94 (cited in note 15). See also Belton M. Fleisher, *The Effect of Income on Delinquency*, 56 Am Econ Rev 118 (1966) (studying whether low income is a cause of juvenile delinquency).

[29] Ching-Chi Hsieh and M.D. Pugh, *Poverty, Income Inequality, and Violent Crime: A Meta-Analysis of Recent Aggregate Data Studies*, 18 Crim Just Rev 182, 198 (1993) (applying meta-analysis to thirty-four aggregate data studies reporting seventy-six zero-order correlation coefficients for all measures of violent crime with either poverty or income inequality, of which all but two, or 97 percent, were positive and, of those, nearly 80 percent were of at least moderate strength, meaning greater than 0.25).

HeinOnline -- 2010 U. Chi. Legal F. 32 2010

Reis Soares reviewed and summarized the literature, finding it more mixed.[30] Many studies found a positive relationship between inequality and crime, many found no significant relationship, and virtually no study found a negative relationship.[31]

In more recent years, the issue has attracted increasing attention, and the newer wave of studies tends to confirm that inequality causes crime. Some of these studies introduce interesting methodological refinements. Soares, for example, noted that prior studies relied overwhelmingly on reported crime, even though

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[30] See Rodrigo Reis Soares, *Development, Crime, and Punishment: Accounting for the International Differences in Crime Rates*, 73 J Dev Econ 155 (2004).

[31] See id at Table 1, which categorizes the following fourteen studies: Ralph C. Allen, *Socioeconomic Conditions and Property Crime: A Comprehensive Review and Test of the Professional Literature*, 55 Am J Econ & Soc 293, 300–03 (1996) (using a time series of United States national data and finding no significant effect of inequality on crime); William C. Bailey, *Poverty, Inequality, and City Homicide Rates*, 22 Criminol 531, 535–43 (1984) (using a cross-section analysis of United States city data and finding no significant effect on murder); Peter M. Blau and Judith R. Blau, *The Cost of Inequality: Metropolitan Structure and Violent Crime*, 47 Am Soc Rev 114, 120–26 (1982) (using cross-section analysis of Standard Metropolitan Statistical Area (SMSA) and finding a positive effect on murder and assault and no significant effect on rape or robbery); Leo Carroll and Pamela Irving Jackson, *Inequality, Opportunity, and Crime Rates in Central Cities*, 21 Criminol 178, 181–91 (1983) (using cross-section analysis of United States cities data and finding a positive effect of inequality on burglary, robbery, and crime against the person); Sheldon Danzinger and David Wheeler, *The Economics of Crime: Punishment or Income Redistribution*, 33 Rev Soc Econ 113, 120–26 (1975) (using United States national data for time series and finding a positive effect on robbery and no significant effect on burglary or assault; using cross-section analysis of SMSA and finding a positive effect on burglary, assault, and robbery); Paul Eberts and Kent Schwirian, *Metropolitan Crime Rates and Relative Deprivation*, 5 Criminologica 43, 48–51 (1968) (using cross-section analysis of SMSA data and finding positive effect on total crime); Pablo Fajnzylber, Daniel Lederman, and Norman Loayza, *Determinants of Crime Rates in Latin America and the World: An Empirical Assessment* at 18–29 (World Bank Latin America and Caribbean Studies 1998) (using cross-country panel data and finding a positive effect on homicide and robbery); Richard Fowles and Mary Merva, *Wage Inequality and Criminal Activity: An Extreme Bounds Analysis for the United States, 1975-90*, 34 Criminol 163, 166–78 (1996) (using panel date for SMSA and finding a positive effect on aggravated assault, murder, and larceny; no significant effect on car theft, robbery, or burglary; and a negative effect on rape); David Jacobs, *Inequality and Economic Crime*, 66 Sociol & Soc Res 12, 12–22 (1981) (using cross-section analysis of SMSA data and finding a positive relationship on burglary, grand larceny, and robbery); Morgan Kelly, *Inequality and Crime*, 82 Rev Econ & Stat 530, 531–33 (2000) (using cross-section analysis of United States county data and finding a strong and robust effect on violent crime, but no significant effect on property crime); Steven F. Messner, *Poverty, Inequality, and the Urban Homicide Rate*, 20 Criminol 103, 106–11 (1982) (using a cross-section analysis of SMSA data and finding no significant effect on murder); E. Britt Patterson, *Poverty, Income Inequality, and Community Crime Rates*, 29 Criminol 755, 764–69 (1991) (using cross-section analysis on United States neighborhood data and finding no significant effect on burglary or violent crime); Steven Stack, *Income Inequality and Property Crime: A Cross-National Analysis of Relative Deprivation Theory*, 22 Criminol 229, 237–48 (1984) (using cross-section analysis across nations and finding a negative effect on property crime); Kirk R. Williams, *Economic Sources of Homicide: Reestimating the Effects of Poverty and Inequality*, 49 Am Soc Rev 283, 285–88 (1984) (using a cross-section analysis of SMSA data and finding no significant effect on homicide).

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there is significant underreporting of crime. Soares found that underreporting systematically distorted the analysis of the link between inequality and crime and therefore examined the connection in two new ways: first, using victimization surveys and, second, using a statistical adjustment to reported crime. In the two cross-section analyses of international data, he found a significant and positive relationship: inequality increases thefts, burglaries, and contact crimes such as robbery and assault. The effect is robust across specifications and quite large: one specification implies "that reducing inequality from the level of a country like Colombia to levels comparable to Argentina, Australia, or United Kingdom, would reduce thefts by 50%, and contact crimes by 85%."[32] Matz Dahlbert and Magnus Gustavsson offered a different innovation: separating the effects of transitory changes in income from permanent changes. Using Swedish panel data from 1974 to 2000, they found that, while an increase in inequality of transitory income had no effect on crime, an increase in the inequality of permanent income significantly increased total crime.[33]

Other studies seek to separate the effects of inequality on the poorest from the more general effect. François Bourguignon, Jairo Nuñez, and Fabio Sanchez[34] used panel data from seven Colombian cities over twenty years to isolate the effect inequality has on a particular group—those living in households where per capita income was below 80 percent of the mean. Though variations in inequality affecting those above this group did not affect crime rates, variations in inequality affecting this group did to a significant degree.[35] Similarly, Anna Nilsson used individual-level panel data to examine the effect of income inequality on crime in Sweden from 1973 to 2000.[36] She found a significant positive effect between the proportion of the population with income below 10 percent of the median and the incidence of property crime. Specifically, a "one-percentage point increase in the proportion of the population with an income below 10 percent of the median income would increase . . . the burglary rate [by] 5.9

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[32] Soares, 73 J Dev Econ at 178 (cited in note 30).

[33] See Matz Dahlberg and Magnus Gustavsson, *Inequality and Crime: Separating the Effects of Permanent and Transitory Income*, 70 Oxford Bull Econ & Stat 129, 141–48 (2008).

[34] François Bourguignon, Jairo Nuñez, and Fabio Sanchez, *A Structural Model of Crime and Inequality in Colombia*, 1 J Eur Econ Assoc 440 (2003).

[35] Id at 445–48.

[36] Anna Nilsson, *Income Inequality and Crime: The Case of Sweden*, Institute for Labour Market Policy Evaluation Working Paper No 2004:6 (May 4, 2004), online at http://www.ifau.se/upload/pdf/se/2004/wp04-06.pdf (visited Oct 4, 2010).

HeinOnline -- 2010 U. Chi. Legal F. 34 2010

percent, the number of auto thefts [by] 22.1 and the robbery rate [by] 9.1 percent, everything else held constant."[37]

Perhaps the most econometrically sophisticated study is the one Pablo Fajnzylber, Daniel Lederman, and Norman Loayza published in the *Journal of Law and Economics* in 2002.[38] They reported on panel data consisting of five-year averages for homicides in thirty-nine countries during 1965–95 and for robberies in thirty-seven countries during 1970–94.[39] Across and within countries, they studied the correlation between inequality as defined by various measures and crime, measured by robbery and homicide, while controlling for other influences on the crime rate and various forms of measurement error. They concluded that "[c]rime rates and inequality are positively correlated (within each country and, particularly, between countries), and it appears that this correlation reflects causation from inequality to crime rates, even controlling for other crime determinants."[40] Specifically, they found that if the Gini index "falls permanently by the within-country standard deviation in the sample (about 2.4 percentage points), the intentional homicide rate will decrease by 3.7 percent in the short run and 20 percent in the long run."[41] They also found that "a decline of 1 within-country standard deviation in the Gini coefficient (about 2.1 percent) leads to a

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[37] Id at 30. For similar results involving Canada and South Africa, see Martin Daly, Margo Wilson, and Shawn Vasdev, *Income Inequality and Homicide Rates in Canada and the United States*, 43 Canadian J Criminol 219, 224–31 (2001) (finding that provincial and municipal income inequality and homicide rates move in the same direction even though greater inequality occurs in wealthier areas); Gabriel Demombynes and Berk Ozler, *Crime and Local Inequality in South Africa*, in Haroon Bhorat and Ravi Kanbur, eds, *Poverty and Policy in Post-Apartheid South Africa* 288–320 (Human Sciences Research Council Press 2006) (controlling for police expenditures, unemployment, and inequality within a given police precinct, burglary rates, but not other crimes, are 20 percent higher in jurisdictions that are the wealthiest among their neighbors).

[38] See Pablo Fajnzylber, Daniel Lederman, and Norman Loayza, *Inequality and Violent Crime*, 45 J Law & Econ 1 (2002).

[39] A related but smaller literature links crime to wages by showing that declining wages for the least skilled workers increases crime. See Gould, Weinberg, and Mustard, 84 Rev Econ & Stat at 49–57 (cited in note 12); Jeff Grogger, *Market Wages and Youth Crime*, 16 J Labor Econ 756, 768–87 (1998); Richard B. Freeman, *Why Do So Many Young American Men Commit Crimes and What Might We Do about It?*, 10 J Econ Persp 25, 30–33 (1996).

[40] See Fajinzylber, Lederman, and Loayza, 45 J Law & Econ at 26 (cited in note 38). This result is robust to changes in the crime rate when it is used as the dependent variable (whether homicide or robbery), the sample of countries and periods, alternative measures of income inequality, the set of additional variables explaining crime rates (control variables), and the method of econometric estimation. Id at 25.

[41] Id at 17. The standard deviation is a statistical measure of variability or spread of a variable. It is equal to the square root of the variance, which is the average distance between the set of variables and their mean.

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6.5 percent decline of the robbery rate in the short run and a 23.2 percent decline in the long run."[42]

The recent studies are not, however, entirely consistent. Eric Neumayer, for example, criticized the study by Fajnzylber, Lederman, and Loayza, claiming that the effects of inequality on violent crime disappear when a larger sample of countries (fifty-nine instead of thirty-nine or thirty-seven) is used and there is a control for country fixed effects.[43] Yet the overall results favor the inequality-crime link. Several new studies focus specifically on the regional variation of crime and inequality in the United States and find a strong positive relationship.[44] To illustrate the possible magnitude of the effects, consider the findings of Ayse Imrohoroglu, Antonio Merlo, and Peter Rupert.[45] Their primary goal was not to explore the relationship between inequality and crime but to answer a question vexing economists: what explains the recent drop in crime in the United States? Much of the drop was in property crime—burglary, larceny, robbery, and motor vehicle theft—which fell from a rate of 5.6 per one hundred inhabitants in 1980 to 4.65 in 1996.[46] These researchers found three primary causes of the decline: a greater probability of apprehension, a stronger economy, and the aging of the population (a relative decline in twenty- to twenty-eight-year-old males).[47] In addition, they found a major influence on crime working *against* the decline: the "marked increase" in income inequality during this time period (from a standard deviation of 0.397 to

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[42] Id at 18. See also Pablo Fajnzylber, Daniel Lederman and Norman Loayza, *Crime and Victimization: An Economic Perspective*, 1 Economica 219, 244–48 (2001).

[43] See Eric Neumayer, *Inequality and Violent Crime: Evidence from Data on Robbery and Violent Theft*, 42 J Peace Res 101 (2005). See also Jesse Brush, *Does Income Inequality Lead to More Crime? A Comparison of Cross-Sectional and Time-Series Analyses of United States Counties*, 96 Econ Letters 264, 265 (2007) (criticizing studies that control for too few variables); George Saridakis, *Violent Crime in the United States of America: A Time-Series Analysis Between 1960–2000*, 18 Eur J Law & Econ 203, 208–16 (2004) (finding no long term effect of any economic variables on violent crime and a short-run effect of inequality only on murder, though that effect is substantial).

[44] See Edward L. Glaeser, Matthew G. Resseger, and Kristina Tobio, *Urban Inequality*, National Bureau of Economic Research Working Paper No 14419 (2008), online at http://www.nber.org/papers/w14419.pdf (visited Oct 4, 2010) (finding a strong positive relationship between inequality in American municipalities and the municipal murder rate, with various controls); Choe Jongmook, *Income Inequality and Crime in the United States*, 101 Econ Letters 31 (2008) (examining variation in inequality and crime among American states, controlling for fixed effects, and finding a strong effect of inequality on burglary and robbery).

[45] Ayse Imrohoroglu, Antonio Merlo, and Peter Rupert, *What Accounts for the Decline in Crime?*, 45 Intl Econ Rev 707 (2004).

[46] Id at 707.

[47] Id at 709.

HeinOnline -- 2010 U. Chi. Legal F. 36 2010

0.476).[48] Thus, the crime drop would have been much larger had there not been this rise in inequality. Specifically, "[b]y holding inequality constant at its 1980 level we could have observed a 55 percent drop in property crime [by 1996] as opposed to a 17 percent drop."[49]

In sum, though the empirical connection between inequality and crime is not fully resolved and requires more study, there is significant evidence that it is real and substantial.[50] An economic cost of inequality is greater street crime.

II. MATERIAL INEQUALITY INCREASES CORRUPTION: THEORY AND EVIDENCE

In a democratic society, economic theory predicts that material inequality will increase crimes of corruption. One reason runs parallel to the above discussion of street crime, but the effect works on the rich rather than the poor. If everyone had the same material wealth, it would be difficult for any one person to "buy" government officials or agencies. By contrast, inequality facilitates bribery.

The point is most easily understood by focusing on two individuals. Suppose *A* and *B* each wish to influence a court case, municipal legislation, or a zoning board decision in inconsistent ways. Each considers offering a bribe to *C*, the relevant judge, legislator, or zoning board member. Relative income matters in two ways. First, focus on the relative incomes of the potential briber and bribee. The maximum size of the bribe an individual is willing to offer depends on, among other things, the individual's income. If *A* and *B* have the same income as *C*, then the maximum bribe either will offer will be lower and less tempting than if either *A* or *B* has much greater wealth than *C*. Being less tempting, a given risk of criminal sanctions is more likely to deter the offer from being accepted and therefore more likely to deter the offer from ever being made. Second, consider the relative incomes of the two potential bribers. If *A* and *B* have the

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[48] Id at 717–18.

[49] Imrohoroglu, Merlo, and Rupert, 45 Intl Econ Rev at 724 (cited in note 45). See also Francois Bourguignon, *Crime as a Social Cost of Poverty and Inequality: A Review Focusing on Developing Countries*, in Shahid Yusuf, Simon Evenett, and Weiping Wu, eds, *Facets of Globalization* 171–91 (World Bank 2001).

[50] See Gary LaFree, *A Summary and Review of Cross-National Comparative Studies of Homicide*, in M. Dwayne Smith and Margaret A. Zahn, eds, *Homicide: A Sourcebook of Social Research* 125–45 (Sage Publications 1999) (reporting that a positive link between inequality and homicide is one of the most robust findings of cross-national crime research).

HeinOnline -- 2010 U. Chi. Legal F. 37 2010

same income as each other, then it is possible neither can offer a bribe so large that the other cannot match it. There is a greater chance, therefore, that they will fear that their bribe will prove ineffective or that they can just as productively seek to settle the dispute with the other party.

By contrast, inequality increases the productivity of bribery. First, inequality makes it more likely that one of the private citizens, *A* or *B*, has sufficient resources, relative to *C*, to make a bribe tempting to *C*. Second, if *A* and *B* have highly unequal wealth, then the wealthier can bribe *C* without having to worry that the other can nullify the effect of the bribe by matching it. That wealthier individual may find it cheaper to bribe the government official than to settle the dispute with the other citizen.

The economists Edward Glaeser, Jose Scheinkman, and Andrei Shleifer made this point regarding the judiciary: "If one person is sufficiently richer than another, and courts are corruptible, then the legal system will favor the rich, not the just."[51] Thus, where inequality causes the poor to commit more property-related crime, inequality causes the rich to commit more crimes of corruption because, the relatively richer they are, the more productive their bribes are likely to be. Political influence should operate as a "luxury" good in that we expect an individual to use a greater percentage of his income on such a good the more wealth he has *relative* to others in society.[52]

Much economic theory focuses on a different reason to expect inequality to increase corruption. Inequality creates a divisive political issue—redistribution. Within a given democracy, the

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[51] See Edward Glaeser, Jose Scheinkman, and Andrei Shleifer, *The Injustice of Inequality*, 50 J Monetary Econ 199, 200 (2003).

[52] The story becomes more complex when we consider more than two individuals and apply interest group theory, but the essential point remains: it is harder for citizens to influence political actors with money when everyone has the same amount of money than it is when there are some citizens who have a lot more than others. In general, an interest group's influence depends on a variety of factors, but one is the amount of resources its members are willing to bring to influence official action. One might think that the larger the interest group, the more influence it would have, but the offsetting effect is organizational costs which rise with the number of members. Mancur Olsen, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard 1965), sparked a large literature exploring how small groups have an advantage in organizing to use government power to enrich themselves at the expense of the rest of society. See, for example, Daniel A. Farber and Philip P. Frickey, *Law and Public Choice: A Critical Introduction* (1991); Saul Levmore, *Public Choice Defended*, book review of Gerry Mackie, *Democracy Defended*, 72 U Chi L Rev 777 (2005). Wealth exacerbates this problem because now a small group is not only easier to organize, but also may have greater resources than the much larger majority group it opposes. Even where groups of equal size care equally about some issue (as with individuals *A* and *B*), inequality means that the relative wealth of some groups gives them an incentive to use their wealth to influence officials.

HeinOnline -- 2010 U. Chi. Legal F. 38 2010

greater the inequality, the greater the expected demand for redistribution. The median voter would gain by redistribution, at least in the common situation where the median income falls below the mean income (because wealth is skewed toward the upward levels since it is bounded by zero at the lower level). So inequality creates a reason for the rich to defeat the political preferences of the majority for redistribution. "As income inequality increases, the rich have more to lose through fair political, administrative, and judicial processes . . . [and] will also have greater resources that can be used to buy influence, both legally and illegally."[53] Being a minority, the rich cannot rely on voting power to prevent redistribution; they must use their superior wealth to influence the political process.

As a normative matter, libertarians might defend this non-majoritarian outcome as being fair or efficient, at least if the rich earn their wealth meritocratically by superior effort, talent, or risk-taking. But the problem does not end with non-redistribution. Where median voter theory predicts the demand for redistribution from the rich to the poor—what Glaeser, Scheinkman, and Shleifer call "Robin Hood Redistribution,"— we often observe the opposite—what they term "King John Redistribution" from the poor to the rich.[54] Once the rich invest in corrupting the political process, they don't stop at defeating redistribution to the poor. "[T]he haves can redistribute from the have-nots by subverting legal, political, and regulatory institutions to work in their favor. They can do so through political contributions, bribes, or just deployments of legal and political resources to get their way."[55] Glaeser, Scheinkman, and Schleifer argued that inequality thus leads to the corruption of institutions, particularly the judiciary, a point for which they provide two compelling examples—the Gilded Age in the United States and the former Soviet transition economies of the 1990s.[56]

The empirical literature on inequality and corruption is relatively thin and what exists is conflicting. Two political scientists, Jong-sung You and Sanjeev Khagram, recently completed a major study.[57] Using two-stage least squares and instrumental variables, they examined the relationship between income inequality

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[53] See Jong-sung You and Sanjeev Khagram, *A Comparative Study of Inequality and Corruption*, 70 Am Soc Rev 136, 138 (2005).

[54] Glaeser, Scheinkman, and Shleifer, 50 J Monetary Econ at 200 (cited in note 51).

[55] Id.

[56] Id at 211–14.

[57] You and Khagram, 70 Am Soc Rev 136 (cited in note 53).

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and corruption in 129 countries. Controlling for economic development, trade openness, natural resource abundance, democracy, federalism, religion, origin of legal system, and ethno-linguistic fractionalization and using different measures of corruption, they find a statistically significant, robust, and powerful correlation. In simpler models without instrumental variables, they find that a "one standard deviation reduction in income inequality" (which is a decrease in the Gini measure of 0.11) is associated with between 0.23 and 0.30 standard deviation reduction in corruption.[58] In more complex models, their "best estimate of the causal effect that inequality has on corruption" is that "a one-standard deviation reduction in inequality causes about a two-thirds standard deviation improvement in freedom from corruption."[59]

Providing some indirect confirmation, Glaeser, Scheinkman, and Shleifer ran a cross-country comparison that controlled for the strength of each nation's "rule of law" and found that inequality decreased growth only in countries with below mean rule of law measures, while inequality had no effect in nations with strong rule of law.[60] They took this as evidence of their particular theory that inequality decreases growth by corrupting institutions; when the institutions are sufficiently strong, inequality has no effect on growth.

Contrary to these findings is a working paper by James Alt and David Lassen.[61] Studying the variation among American states, they found a *negative* relationship between inequality and federal corruption convictions.[62] One may question the study for identifying the probability of detection and the amount of corruption solely through federal prosecutions, thus ignoring any variation in state or local corruption prosecutions. But the authors did note that the quality of data for American jurisdictions is far greater than available for transnational corruption studies, so the finding is significant. Alt and Lassen explained the result by the expected employment consequence of getting convicted for corruption: a public official caught taking a bribe will (perhaps

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[58] Id at 147.

[59] Id at 149. Eric Uslaner finds a more complex link: that inequality undermines trust and lack of trust causes corruption. See Eric M. Uslaner, *The Moral Foundations of Trust* 190–216 (Cambridge 2002).

[60] See Glaeser, 50 J Monetary Econ at 214–15 (cited in note 51).

[61] See James E. Alt and David Dreyer Lassen, *The Political Economy of Inequality and Corruption: Evidence from US State Governments*, Economic Policy Research Unit Working Paper Series (Aug 2008), online at http://www.econ.ku.dk/eprn_epru/Workings_Papers/wp-08-02.pdf (visited Oct 4, 2010).

[62] Id at 23 ("Higher income inequality apparently deters corruption.").

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after a prison stint) have to seek modest private employment and the greater the inequality in the state, the relatively worse the private job will be.[63] Thus, inequality deters corruption.

Though there is little empirical work on the idea that inequality causes corruption, there is a significant amount of work that corruption causes inequality.[64] Indeed, You and Khagram tested for and find causation in both directions.[65] As a result, if inequality does cause more corruption, the increase in corruption will cause more inequality. "As a result, many societies are likely to be trapped in vicious circles of inequality and corruption. This mutually reinforcing relationship possibly explains why income inequality persists within countries over time."[66]

CONCLUSION

The expectation of meritocratic inequality creates incentives for productive behavior. Nonetheless, like everything else in economics, there is some optimal degree of meritocratic inequality, given that there are costs as well as benefits. Some of those costs are intrinsic, as where one uses a social welfare function that gives weight to equality of welfare. But some of those costs are instrumental and do not depend on giving any weight to equality in the social welfare function. Here, I have identified only one of those costs. Economic theory and considerable empirical evidence shows that material inequality increases street crime. Economic theory also predicts that material inequality increases corruption, though the empirical evidence is mixed. Given this cost, and other costs not discussed here, it should be obvious that there is no reason to believe that the market supplies the efficient level of inequality. The costs described here are externalities because the extra crimes that inequality causes are external to the transactions that produce them. The current recession provides a plausible time for Americans to consider how much inequality they believe is desirable given that doing nothing will apparently produce more and more of it.

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[63] Id at 10.

[64] See, for example, Alberto Chong and Mark Gradstein, *Inequality and Institutions*, 89 Rev Econ & Stat, 454 (2007); Oguzhan C. Dincer and Burak Gunalp, *Corruption, Income Inequality, and Poverty in the United States*, Fondazione Eni Enrico Mattei Working Paper No 54.2008 (July 11, 2008), online at http://ssrn.com/abstract=1158446 (visited Oct 4, 2010).

[65] You and Khagram, 70 Am Soc Rev at 152–53 (cited in note 53).

[66] Id at 153.

HeinOnline -- 2010 U. Chi. Legal F. 41 2010

HeinOnline -- 2010 U. Chi. Legal F. 42 2010