

COMPENSATION OF VICTIMS OF CRIME:
AN ECONOMIC ANALYSIS

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November 30, 1999

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ABSTRACT

Public enforcement of law is by and large focused on the offender. In contrast to private law actions, the victim is traditionally accorded a passive role within the enforcement process and does not benefit directly from the sanction levied on its offender. Recent movements towards state-funded victim compensation and restitution by offenders have had only limited success in providing recovery for victims.

This paper suggests that the social interest might be served by transforming the standard public enforcement sanctions **B** fines and imprisonment **B** into monetary compensation awarded to victims. The analysis focuses on the effect that post-crime compensation might have on pre-crime activity by rational victims. It argues that monetary compensation **B** unlike other forms of sanction **B** would reduce the expected cost of crime borne by potential victims. If individuals expect crime to be less costly, their incentives to engage precautionary measures against crime will be diminished. The analysis explores various reasons and contexts in which this reduction in crime evasion expenditures would be socially desirable. It demonstrates that this substantial saving would make victims of crime better-off, without affecting the offender-centered deterrence goals of the criminal law, nor the pivotal role that the public agencies command in enforcement and prosecution decisions.

INTRODUCTION

Public enforcement of law is by and large focused on the offender. It seeks to sanction the offender, deter or incapacitate him, at times even rehabilitate him. The victim, under this focus, has a passive and insignificant role within the enforcement process. In sharp contrast to private law actions, where the victim is oftentimes the subject of mitigation duties and in which the victim is both the initiator of the enforcement process and its beneficiary, and thus captures a central function in implementing rules, the victim is a silent secondary character within the public enforcement of the criminal law.

This general phenomenon **B** the irrelevance of the victim, so to speak **B** can be traced historically to the shift from private legal actions to public enforcement schemes. In England, for example, the state had no role in enforcing against criminal actions. Interested parties **B** usually the victims **B** would investigate and prosecute their offenders and would collect the fine or the compensation award directly from the offenders. As the state assumed a more prominent role in enforcement, by prosecuting offenders and maintaining penitentiaries to administer the sanctions, the victims gradually exited from the enforcement process. Eventually, they lost both the discretion whether to bring action as well as a pecuniary stake in the outcome of trial.¹

In recent generations, however, victims have gradually reentered the public enforcement forum. Through various legislative reforms, victims of criminal offenses can more easily seek compensation for the harms they suffered. Whereas victims were traditionally required to initiate a separate tort action in order to translate the offender=s proven culpability into monetary relief, victims are now permitted to seek compensation within the public enforcement process itself. Primarily, victims may be compensated in two alternative manners. First, under various mandatory practices victims can seek, at the criminal sentencing stage, restitution² payments directly from the convicted offender. Second, most states have implemented victim compensation programs which tack on to the criminal trial and allow victims to receive monetary relief directly from the state. While these reforms have not added much to the victims= formal entitlement for compensation, they have sought to introduce new channels by which victims can capitalize on their entitlement, without having to engage in costly private litigation.

The movement towards victim compensation has been regularly (and quite

¹ W. McDonald, *toward a Bicentennial Revolution in Criminal Justice: The Return of the Victim*, 13 AMERICAN CRIMINAL LAW REVIEW 649, 653 (1976).

² Cite Restatement of Restitution

easily) justified by using an ex post perspective. Plainly, it is more fair that the offender should be placed under a financial burden than his victim.³ It affords the victim some relief without requiring her to engage in an expensive, time consuming, and highly uncertain action for civil remedies. Alternatively, as articulated by Justice Powell, victim compensation serves an offender-centered penal and rehabilitative goal.⁴ Because it is part of the sentencing process, many courts have rationalized it as ~~penal~~, rather than compensatory, in nature.⁵ And because it instills a sense of responsibility upon offenders, commentators have argued for the rehabilitative function of the restitution liability.⁶ Further, from an incentive perspective, victim compensation schemes have been noted to encourage victims to report crimes and to assist in their investigation, thereby giving victims a voice as well as improving the accuracy of the fact-finding process.⁷

This article offers a complementary, ex ante, perspective of the value of victim compensation schemes. The analysis focuses on the effect that post-crime compensation might have on pre-crime activity by rational victims. It argues that by implementing compensation schemes society can reduce the expected cost of crime borne by potential victims. If victims expect crime to be less costly, their incentives to engage in precautionary measures against crime will be diminished. It argues that in many applicable contexts, this reduction in crime evasion expenditures is socially desirable.

³ See, e.g., *The President's Task Force on Victims of Crime: Final Report (1982)*, at 79: ~~It is simply unfair that victims should have to liquidate their assets, mortgage their homes, or sacrifice their health or education or that of their children while the offender escapes responsibility for the financial hardship he has imposed. It is unjust that a victim should have to sell his car to pay bills while the offender drives to his probation appointments. The victim may be placed in a financial crisis that will last a lifetime. If one of the two must go into debt, the offender should do so.~~
See also Susan Hillenbrand, *Restitution and Victim Rights in the 1980s*, in ARTHUR J. LUIGIO ET AL., EDS., *VICTIMS OF CRIME: PROBLEMS, POLICIES AND PROGRAMS* (1990).

⁴ *Kelly v. Robinson*, 107 S. Ct. 353 (1986) (holding that state restitution orders are not ~~debts~~ but rather criminal penalties that cannot be discharged under Chapter 7 of the Federal Bankruptcy Act.)

⁵ *U.S. v. Satterfield*, 743 F.2d 765 (11th Cir. 1984) (victim restitution should be imposed as a criminal, rather than civil, penalty); *U.S. v. Bruchey*, 810 F.2d 456 (4th Cir. 1987); *U.S. v. Keith*, 754 F.2d 1388 (1985).

⁶ Josephine Gittler, *Expanding the Role of the Victim in Criminal Actions: An Overview of Issues and Problems*, 11 PEPPERDINE LAW REVIEW 117 (1984).

⁷ *Compensating Crime Victims: A Summary of Policies and Practices* 25 (National Institute of Justice, 1992); *Compensating Victims of Crime: An Analysis of American Programs* 6 (National Institute of Justice, 1982)

To illustrate, consider an individual who trades in securities and who is concerned that other market participants might be committing securities violations and reducing the value she could potentially extract from her trading activity. For example, she might be concerned that data disseminated by insiders is fraudulent. Or, she might be concerned that she is on the losing side of a transaction with an informed insider. These concerns of becoming a victim of securities offenses might lead the individual to take ex ante precautions. She might trade less frequently or exit the securities market altogether. Alternatively, she might hire the services of more experienced (and expensive) brokers to guide her through the transactions. These measures are socially costly. Even if they have a crime-reducing effect, it is achieved through expensive distortions of primary behavior, or through a significant increase in transactions costs. Now, suppose that the individual expects that whenever she is a victim of securities offense and the offender is convicted, she can latch onto the criminal proceedings and gain monetary compensation. This expectation reduces the expected harm from the offense, and diminishes the precautionary incentives to the individual. Without requiring her **B** the small investor **B** to be part of expensive civil litigation (from which, often, the lawyers are the main beneficiaries), she is guaranteed some probabilistic compensation and would ex ante be less concerned about, and cautious against, crime.

The analysis in this essay provides another piece within the growing study of the role of victims in criminal law. Previously, it has been recognized that victims' decisions to engage in precautions might be distorted. One way to correct this distortion is to condition the offenders' sanctions on their victims' precautions. It was shown that an appropriate "contributory fault" regime can induce victims to take the socially optimal level of precaution and reduce the magnitude of either excessive precaution or of victims freeriding on other victims' effort.⁸ But whereas the previous proposal regarding victims' "contributory fault" confronted implementation problems, victim compensation schemes can address the same distortions in a more direct manner. It will be demonstrated that victims' investment in precautions can be affected in a socially desirable manner by utilizing a credible commitment to make victims (monetarily) whole.

We believe that this inquiry into potential victims' incentives to engage in pre-crime precaution has significant empirical importance. Recent studies focusing on the social cost of crime have demonstrated that a large portion of it arises from precautionary activity by victims. The numbers are staggering. Economists estimate the cost borne by individuals to physically protect their property against crime to be hundreds of billions

⁸ See, e.g., Ben-Shahar and Harel, *Blaming the Victim: Optimal Incentives for Private Precaution against Crime*, 11 J. L. ECON. & ORG. 434 (1995).

of dollars annually, in the same magnitude as many estimates of the actual cost of property crime committed.⁹ That is, the social cost of crime is not borne only by actual victims, but with similar intensities by overly-cautious potential victims. This data, coupled with the observation that many of the precautionary measure employed by individuals have the sole effect of displacing crime, i.e., of diverting it to other victims, reinforce the conjecture that a huge over-investment in precaution takes place. It is in the background of this distortion that the victim-compensation schemes could be justified for their potential restraining effect on pre-crime precaution.

The article is structured as follows. We begin by describing some of the prominent victim-compensation schemes that have developed over the past generation. We then proceed with a positive and normative economic analysis of these schemes. From the positive perspective, we identify the ex ante incentive effects that such compensation regimes could have on rational victims. While this inquiry explicitly invokes a rational choice framework, we also pause to reflect on the adequacy of the rationality premise in the discussed contexts. We identify settings in which it makes more sense, and setting in which it makes less sense, to assume rational and informed behavior on the part of potential victims. From the normative perspective, the analysis applies a utilitarian view in assessing the value of the incentives accorded by the compensation schemes. It references empirical studies as well as theoretical and criminological insights to argue that the reduction-in-precaution outcome is socially desirable. Lastly, the article considers several implications of the analysis. Why should public enforcement facilitate victim compensation only when harm was caused by crime, not when it was caused by an accident/tort? What is the optimal combination of victim compensation, state-collected fines, and imprisonment? How does decoupling of liability and compensation affect our argument?

I. VICTIM COMPENSATION SCHEMES

This Section surveys various programs of victim compensation in the U.S. The first two subsections examine the main existing programs: restitution and state compensation schemes. The third subsection explores additional sources that could potentially be utilized to compensate victims.

A. *Restitution*

Historically, offenders were required to make restitution payments

⁹ A long footnote: Leband and Sophocleus, Posner and Philipson, Andersen.

to their victims.¹⁰ Gradually, as law evolved and as the state increasingly substituted for the victim as a party in criminal proceedings, it has in turn, become the primary recipient of payments made by the offender in the form of fines. While this evolution of the law has often been justified as promoting the retributive and deterrent goals of the criminal law, it has coincidentally discarded another major aim of the law, namely to provide compensatory justice for the victim.¹¹

Modern advocates of restitution do not regard it merely as a way of providing financial support for victims. Instead, restitution is justified for providing psychological support for the victims as well as rehabilitation to the offenders. It is not surprising therefore that the multiplicity of goals has also led to diverse programs which aim at achieving different purposes.¹² For example, under the Victim/Witness Assistance Programs, a variety of services are provided to ease the trauma of victims.

Under a Federal sentencing statute, courts are empowered, when sentencing a defendant convicted of an offense covered by the statute, to order in addition to, or in a case of misdemeanor, in lieu of any other penalty authorized by law, that the defendant make restitution to any victim of such an offense or to the victim's estate.¹³ Restitution can be imposed as part of the sanction, but it can also be imposed as a condition of probation.¹⁴ For some crimes, restitution is a mandatory provision.¹⁵ In response to the narrow interpretation of these provisions by the Supreme Court,¹⁶ Congress enacted the Crime Control Act of 1990.¹⁷ This Act widens the scope of restitution in two ways. First, it authorizes courts to order a restitution agreed by the parties in a plea agreement even when it exceeds the damage. Second when a defendant is convicted of an offense involving a scheme, conspiracy, or pattern of criminal activity, the Act authorizes restitution to any person directly harmed in the course of the scheme, conspiracy, or pattern. Recently Congress enacted the Mandatory Victims Restitution Act

¹⁰ For a brief description of the history, see Jennifer Gerarda Brown, *The Use of Mediation to Resolve Criminal Cases* 43 *Emory L.J.* 1247-1254-1257 (1994).

¹¹ ALON - FN

¹² A comprehensive report on crime victim restitution written in 1986 identified four different systems of restitution: two classified as "victim focused restitution practices" and two classified as "offender-focused restitution practices." See Daniel McGillis, *Crime Victim Restitution: An Analysis of Approaches* 13-19 (1986).

¹³ 18 USCS section 3663 (a) (1) (A).

¹⁴ See

¹⁵ 18 USCS 3773A

¹⁶ See *Hughey v. United States* 495 U.S. 411 (1990) (parenthetical)

¹⁷ See 18 U.S.C. section 3663 (a) (1994)

of 1996 (the MVRA) which further expands the group of victims eligible for restitution and makes restitution mandatory for certain crimes.¹⁸

Another type of programs that effectively enhance the amount of recovery victims may gain are the Victim/Offenders Reconciliation Programs (VORP). The programs of this type are characterized by face to face meetings between crime victims and offenders often in the presence of trained mediators.¹⁹ Victim-offenders programs provide a process by which offenders and victims may discuss the incident that has occurred, strive for greater understanding of the crime and negotiate restitution provisions.²⁰ The VORP are often regarded as part of the emerging philosophy of “restorative justice” – namely the view which treat crime “as a wrong done to a person and her community, rather than as a wrong to the state.”²¹

Since the introduction of a pioneer VORP program in Canada,²² similar programs have been implemented extensively in the US.²³ A report

¹⁸ See Pub. L. No. 104-132, Title II, sections 201-211, 110 Stat. 1214, 1226-40 (1996). For a recent discussion of restitution, see Nam E. Kim Sentencing Restitution 86 Georgetown L. Journal 1809 (1998).

¹⁹ See Brown p. 1261; Taylor 1188.

²⁰ Mark William Baker, Repairing the Breach and Reconciling the Discrdant: Mediation in the Criminal Justice System 72 N.C.L.Rev. 1479, 1484 (1994).See Brown at 1262-3. Some of the programs emphasize compensation while others emphasize remedying the psychological and emotional issues generated by the crime. For an attempt to highlight the psychological importance of the apology in the mediation of criminal cases, see Deborah L. Levi Note, The Role of Apology in Mediation 72 N.Y.U.L Rev. 1165, 1200-1204 (1997).

²¹ See Katie Long, Community Input at Sentencin: Victim’s Right or Victim’s Revenge? 75 B.U.L. Rev. 187, 227 (1995)

²² The first modern program of this type can be traced to an event which took place in 1974 in Canada. Jennifer Brown provides a succinct description of this event as well as summarizing the spirit underlying this exceptional experiment.

“One night, two young men in Kitchener, Ontario vandalized the property of twenty two people.: they broke windows, slashed tires and damaged churches, stories and cars. They pled guilty to twenty two charges. The offenders did not pay restitution to the court clerk’s office, however. Instead in an experiment.... The two young offenders met with each victim. It was hoped that meeting with the victims would help the offenders to see the restitution payments less as fines and more as compensation to real people for the losses they had suffered. Within six months, the young men had fulfilled their restitution obligations in full.”

See id at 1257. For a more detailed description of this case see John Bender, VORP: A Beginning, Victim-Offender Mediation, Special Issue 1990, at 1-3 cited in Susan C. Taylor, Victim-Offender Reconciliation Program – A New Paradigm Towards Justice 26 Memphis State University L. Rev. 1187 (1996).

²³ See, e.g., Bakker, supra note at 1483-4

produced in 1993 described the immense growth of these programs. Mediation programs expanded from 32 in 1985 to 65 in 1989 to 122 in 1993.

In sum, restitution is perceived by its advocates to achieve two primary roles. First, it helps to alleviate the economic losses of the victim.[ALON - FIGURES] Second, it confers emotional benefits upon the victim.²⁴ It is commonly argued that the programs help the victims to overcome the feelings of powerlessness and allows them to feel that they have a real voice in the criminal justice system.²⁵

B. *Compensation of Crime Victims By the State*

The first state to provide a program for financial assistance to victims of crime was California. Many other states followed this example and by 1982, over two thirds of the states had adopted compensation programs of one kind or another.²⁶ In 1982, the President's task force on victims of crime recommended that the federal government take a role in reinforcing these programs.²⁷

In 1984, the Victims of Crime Act (VOCA) was enacted with a strong bipartisan congressional support. This Act authorized federal funding to induce states to establish victim compensation programs and to adopt basic services designed for victims. Following a 1988 amendment which revised the conditions for federal funding of state programs, additional states enacted their own victim compensation programs.²⁸ By 1992, 27 years after California adopted the first American victim compensation program, all states have adopted a publicly funded program for compensating victims.

Yet, it is important to point out the serious limitations of victim compensation programs. Most programs do not compensate at all for property loss. Despite several attempts to include losses from property crimes, most programs elected not to include those due to the financial

²⁴ Bakker, at 1497-8.

²⁵ See Taylor supra note at 1188.

²⁶ See Desmond S. Greer, *Criminal Law: A Transatlantic Perspective on the Compensation of Crime Victims in the United States*, 85 JOURNAL OF CRIMINAL LAW AND CRIMINOLOGY 333 (1994)

²⁷ See PRESIDENT'S TASK FORCE ON VICTIMS, FINAL REPORT 42-43 (A[S]ubstantial progress has been made by many states in their attempts to compensate crime victims YHowever, the states=inability to fully address the problems that persist suggest that there is an important role for the federal government to play in this area.@)

²⁸ For a detailed description, see Dale G. Parent, Barbara Auerback, Kenneth E. Carlson, COMPENSATING CRIME VICTIMS: A SUMMARY OF POLICIES AND PRACTICES (1992).

burdens that such compensation will entail.²⁹ In addition, some states have adopted a means test as a requirement.³⁰ Also, state programs regularly stipulate a cap on the losses recoverable by victims.³¹ Thus, while victim compensation programs have the great advantage that compensation does not depend on successful detection and conviction of the criminal, they are subjected to numerous restrictions which severely limit the practical and pecuniary effects that these programs may have.

C. Additional Sources of Compensation

DISCUSS CIVIL LITIGATION AND ITS SHORTCOMINGS.
FOR EXAMPLE, SECURITIES FRAUD INVESTIGATION POWER OF
THE SEC.

II. ECONOMIC ANALYSIS

A. The Incentive Effects of Victim Compensation

Potential victims take precaution measures in attempt to reduce the cost of crime they bear. While some individuals often fail to conduct an accurate cost-benefit analysis of each available precaution measure, the body of potential victims as a whole ordinarily behaves in a way that conforms to the rationality paradigm. This paradigm implies, for example, that given a fixed threat of crime, the cheaper a precaution measure becomes, the more it will be purchased and employed. Similarly, and relevant to our analysis, this premise implies that given a fixed cost of precaution, the costlier crime becomes, the more precaution will be taken.³²

This observation is not surprising. It is often observed that individuals who are facing other types of risks, e.g., the risk of contracting a disease, utilize prevention measures in accordance with the rational choice premise. The less prevalent is an infectious disease, the less incentives individuals have to, say, vaccinate.³³ Likewise, individuals who

²⁹ See DEBORAH CARROW, *CRIME VICTIM COMPENSATION: PROGRAM MODEL* 34-35 (1980); Greer, *supra* note __, at 357-58.

³⁰ Greer 368-370.

³¹ Greer 374-75

³² See Ann P. Bartel, *An Analysis of Firm Demand for Protection against Crime*, 4 J. Legal Stud. 443 (1975)(evidence that firms' investments in crime protection are highly responsive to crime rates); Philipson and Posner, *supra* note __, at 422-8.

³³ See, e.g., PIERRE-YVES GEOFFARD AND TOMAS J. PHILIPSON, *DISEASE ERADICATION: PUBLIC VS. PRIVATE VACCINATION* (1995).

face the risk of crime would adjust their precautionary expenditures in accordance with the magnitude of the harm and its probability. The more likely is one's home to be subject to a burglary attempt, or the more valuable are one's possessions, the greater will be the investment in anti-theft devices such as locks, safes, alarms, and security guards. Or, the more dangerous a particular activity becomes (riding the subway, living in a specific neighborhood), the more likely are potential victims to engage in the ultimate precaution of refraining from the activity. Indeed, changes in crime rates have been statistically shown to cause urban flight, especially among high-income households.³⁴

If potential victims' incentives to avoid dangerous activity and to take precautionary measures are directly affected by the risk of crime they face, social policies that target and reduce this risk will have a restraining effect on victims' precautionary behavior. In this spirit, it is well recognized that increase in public protection outlays (e.g., police, jails) which reduce the risk of crime would have the effect of reducing private protection expenditures. Private and public protection measures are economic substitutes.³⁵

In general, there are various ways in which social policies can affect the crime risk that potential victims face. Policies can be targeted at prevention of crime (that is, reduce the likelihood that an attempted crime will succeed), or they can be targeted at deterring crime (by increasing either the probability of detection of criminals or the magnitude of sanction levied on convicted criminals). Most social policies that affect victim precaution, whether they are preventative or deterrent in their focus, do so as a byproduct of their primary target to reduce crime-related harms to actual victims. It is only indirectly that these policies also influence the incentives of potential victims to behave in a cautious manner. However, social policies may also take direct aim at victim precaution. In our previous work, we examined a doctrine which we labeled *Victim contributory fault*, which can be designed to directly affect victim precaution. By differentiating the sanction to the criminal in accordance with his victims' precautionary actions, i.e., increasing the sanction to an offender whose victim took reasonable care, victims can be driven to engage in the socially optimal level of precaution. That is, sanctioning policy can be tailored to deter, not only criminal actions, but undesirable

34 Julie Berry Cullen and Steven D. Levitt, *Crime, Urban Flight, and the Consequences for Cities*, NBER Working Paper No. 5737, 1996. [CHECK]

35 Philipson and Posner, *supra* note ___, at 408; Ben-Shahar and Harel, JLEO; Keith N. Hylton, *Optimal Law Enforcement and Victim Precaution*, 27 *Rand J. Econ.* 197 (1996) (showing how optimal public enforcement changes when victim precaution is taken into account).

precautions as well. But there is a more direct way to influence potential victims=precaution: through victim compensation schemes.

Potential victims take precautions to reduce the cost of harm they suffer as a result of crime. In an ideally rational setting, the victim will compare each additional \$1 invested in precaution with its associated incremental reduction in expected private cost of crime. At the optimum, a reduction of \$1 spent on precaution will generate exactly \$1 increase in the private crime cost. Suppose that the potential victim who follows this decision pattern decides to spend \$X on precautions. Consider now the effect of a new post-crime compensation scheme on this potential victim. Under the new scheme, the victim can receive monetary compensation for some of her harm. Spending \$X will no longer be optimal for this individual, as it now buys her a smaller crime reduction benefit. In virtue of the compensation scheme, crime becomes less costly and thus crime reduction becomes less valuable. This victim will find it desirable to reduce precautions: a reduction of \$1 spent on precaution will generate *less* than \$1 increase in expected crime cost, and would thus create a net saving. [OMRI - ADD FN] At the extreme, if victim compensation equal the full harm and each potential victims is guaranteed to be fully compensated and thus to bear zero costs from crime, she will invest \$0 in precautions. And in the more realistic setting in which victim compensation is partial and uncertain, the potential victim will set her precaution investment at her new privately optimal level, between \$0 and \$X, but below the initial \$X.³⁶

In deriving the prediction that victim compensation would reduce victim precaution, the analysis invokes the assumption that victims make the rationally optimal decision ex ante by weighing costs and benefits of each precautionary measure and rejecting only those that are not worth their expense. This assumption might have more or less empirical validity, depending on the context of the crime. If, say, the probability of solving the crime and convicting the offender is small, the victim's chances of gaining compensation are also small and the effect of compensation schemes on victim precaution might be negligible.³⁷ In this case, even a perfectly operated restitution program, reaching every victim of a convicted criminal, would eventually apply to only a small fraction of actual victims (leaving out victims of unsolved crimes) and would have a small ex ante effect. But this incentive-ineffectiveness may discredit not only the argument proposed here, but any ex ante justification of punishment such as deterrence, and may undermine many of the ex post justifications of punishment as well. When detection rates are low, the threat of punishment

³⁶ Find an analog from public health, showing that either discovery of partial drugs that alleviate the effects of disease, or implementation of insurance/free treatment schemes reduce the precautionary spending of individuals

³⁷ Give some statistics about apprehension rates (find in Robinson, NW L R 1997?)

B as well as the promise of compensation **B** attains a diminished weight in the ex ante calculation of actors, offenders and victims alike.³⁸ In fact, whereas low detection rates could seriously dilute the deterrent effect of sanction of offenders, the low rates of detection are less significant in affecting victims' incentives. Since victims are ordinarily easy to identify, their entitlement to compensation can be - and under state programs it indeed is - independent of whether or not this offender was apprehended. However, even if compensation of victims is linked to detection of the offenders, the ex ante incentives of victims in a regime of low detection rates can be affected in much of the same way as ex ante incentives of criminals: by raising the magnitude of the ex post liability.³⁹ Hypothetically, victims who receive actual compensation or restitution payments from their offenders should not be doctrinally constrained by the harm principle, i.e., by the magnitude of their harm. Punitive components can be added on to offset the low probability of detection.⁴⁰ Trebling of damages in antitrust enforcement is a step in this direction.

DISCUSSION OF OTHER WEAK LINKS OF THE ARGUMENT:
PROPERTY LOSS V. PHYSICAL LOSS, THE SENSE OF
VICTIMIZATION, ETC. BUT ARGUE THAT EVEN IN THESE AREAS,
IF THE LIKELIHOOD OF COMPENSATION WERE HIGH, OR IF
COMPENSATION WERE SIGNIFICANT, MANY OF THESE
INTUITIONS MIGHT CHANGE

While the ex ante incentive effects of victim compensation schemes may be debatable in the context of classical crimes against persons, where potential victims may be motivated by incommensurable security interests, it may be less controversial in the context of violations of economic legislation. Consider the securities regulation example. Investors in the market may be harmed by, say, fraud committed by corporate managers. In anticipation of such harm, investors might take various precautionary measures to avoid becoming victims.⁴¹ [DISCUSS SOME EXAMPLES]. As argued by Easterbrook and Fischel, the prospect of having to compensate their fraud victims as part of the outcome of the criminal

38 Cite articles on the futility of deterrence in light of low probabilities, E.g., Robinson.

39 General reference to Becker-type of arguments in favor of raising sanction to counter the low probability

40 Reference to Polinsky and Shavell, Punitive Damages Harvard Law Review.

41 Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. R. 623 (1992) [READ]; FRANK H. EASTERBROOK AND DANIEL A. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 334 (1991)

procedure can affect not only the incentives of managers, but can affect the incentives of individual traders and lead them to reduce precaution levels. Or, in the context of antitrust enforcement, new entrants into a market might be harmed by predatory anti-competitive behavior of an incumbent firm. Precautionary measures can affect various decisions of the entrants, such as the operational size of the entrant entity, the timing the entry, or even the decision to enter in the first place.⁴² Monetary compensation ex post can change the calculus of these decisions and drive the entrants to exercise less precaution.⁴³ In this, as in many economic settings, potential victims are ordinarily engaged in rational cost-benefit calculations, and facilitating ex post compensation would lead them to abandon some of the precaution measures they otherwise would utilize.

B. The Case for Reduced Victim Precaution

The analysis in the previous section argues that making victim compensation a component to (or a substitute of) other elements of the criminal sanction would reduce spending by potential victims on precaution. This section will attempt to show that many contexts exist in which this reduction in precaution is a desirable outcome. It will argue that absent social intervention, victims might often over-invest in precaution. The reduction in precaution costs affected by compensation schemes could potentially benefit society as a whole, and each victim individually.

The analysis begins, and eventually boils down to, an assessment of empirical indicators collected in recent economic literature measuring the cost of crime. While many popular perceptions regarding the heavy burden of crime already exist in the public, economists have ventured to come up with precise quantitative estimates of the dollar amounts lost as a result of illegal activity. The figures are, of course, staggering, but are not of direct interest here.⁴⁴ Relevant to our analysis, however, are the estimates of one component of the cost of crime: the cost of victim precaution. Unlike some other components of the cost of crime, victim precaution costs are a pure deadweight loss. Consider property offenses: the welfare loss from these crimes can not simply be measured by the value of the lost property to actual victims. As long as the lost property is not destroyed but is eventually transferred to another party, the total value of assets in society does not necessarily decline. Obviously, society might wish to discount the

⁴² Reference to Laffont and Tirole, Tirole, on predation strategies.

⁴³ Cite

⁴⁴ See the excellent recent article by David Andersen, *The Aggregate Burden of Crime*, 42 J. Law & Econ. (Forthcoming, 1999), for a survey of previous estimates, as well as an original assessment, of the total social costs of crime.

value that offenders gain from stolen property, and thus to view the loss to victims as net social loss.⁴⁵ However, even under such conceptions of social welfare, which many economists endorse,⁴⁶ theft and various economic offenses might, at the same magnitude that they reduce victim well-being, increase the legitimate well-being of innocent parties, such as good faith buyers.⁴⁷ For example, fraud in securities trades might benefit innocent traders almost as much as it harms others, with a total net effect of close to zero.⁴⁸ But while the value transferred away from the victim is *not* always a net social loss, the value spent on precaution against such transfers *is*. If property owners buy more alarms and locks; if traders refrain from investing in securities or make costly verification inquiries; if entrepreneurs avoid entry into markets dominated by predators, these resources spent in precaution are a social waste. They have no social value other than their crime evasion effect.

Estimates of the magnitude of crime precaution costs vary. Available data is often incomplete and imprecise. Conceptual problems arise in merely defining the type of activity that constitutes precaution. To what extent is the employment of, say, a receptionist in an office building a safety-related act? Is a household's decision to migrate from the inner city to a suburb motivated by safety or other quality-of-life concerns? Although methodological problems are abundant, the quantitative magnitude of the phenomenon is undisputable. One study estimates that victims have collectively spent in one year over \$160 Billion merely on preventing physical access to property (i.e., guards and locks).⁴⁹ Another study estimates the value of time that victims spend annually on securing assets at \$90 Billion, with an additional \$30 Billion spent on production of prevention assets.⁵⁰ An overall estimate of the cost of prevention incurred by victims has been given at \$300 Billion.⁵¹ These estimates do not include much of the indirect cost of victim precaution, such as the cost of out-of-

45 Refer to Becker-Stigler debate; McChesney.

46 Cite

47 Reference to art theft

48 Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 646 (1996); Mahoney, at __; Adam C. Pritchard, *Markets as Monitors: A Proposal To Replace Class Actions with Exchanges as Securities Fraud Enforcers* (forthcoming, VA. L. REV., 1999).

49 Leband and Sophocleus. This study examine 1985 data. Adjusted to current costs, the figures might be quite substantially higher.

50 Andersen, Table 4.

51 Philpson and Posner.

city migration (costs of commute, decline in property values, and so on). In all, victim precaution costs far exceed the cost incurred by the public on enforcement, jails, and the legal system.⁵² They are very much in the magnitude of the combined harm suffered by victims of property offenses.⁵³ Thus, quantitatively, they are as important a cost of crime as the harms suffered by actual victims. It would seem, then, that along with the abundant social policies aiming to reduce the cost of *actual* crime, society should pay comparable attention to reduction of the cost of *potential* crime, that is, the reduction of victim precaution costs.

The fact that the social cost of precaution is so high does not yet mean that it is wasteful. Theoretically, this resource investment could be socially worthwhile if it generates savings in the form of reduced crime that exceed its cost. However, there are strong reasons to believe that the reduction-in-crime effect generated by victim precaution is not that high, and does not justify the cost. The discussion below explores several reasons for the divergence between the private and the social value of victim precaution and thus illustrates why, in the absence of government intervention, victim precaution would be excessive.

1. *Negative Externalities*

Any rational individual will engage in precaution measures only if their cost is less than the value of the reduced crime risk that they generate to this individual. An individual will build a fence around her house only if the cost of the fence is less than the expected cost of burglary that she expects to avoid. However, the victim's private gain **B** the reduction in her own vulnerability **B** is not necessarily a social gain as well. It might well be that the only effect of this victim's precaution is to divert crime in the direction of other, less protected, victims. Thus, for example, the fence will prevent burglary of the fenced house, but at the same time it will increase the risk facing other non-fenced houses. The burglar who is deterred by the sight of the fence might simply walk down the street to the closest less-protected house.

⁵² The combined cost of public enforcement by federal, state, and local police agencies is estimated at \$47 Billion annually, with an additional \$23 Billion by other government agencies that play some role in law enforcement (e.g., IRS, INS). Jails and detention centers account for a total cost of \$36 Billion. Judicial and legal services amount to \$19 Billion of annual expenditure. See Andersen, *supra* note ___, for discussion of these figures.

⁵³ Occupational fraud is estimated at \$200 Billion; financial institution fraud is estimated at \$53 Billion; personal theft **B** the classical criminal law offense **B** is estimated at \$4 Billion. See Andersen, *supra* note ___.

Economists and criminologists have explored this diversion of crime, or crime displacement, effect arising from victim precaution.⁵⁴ While some have commended the crime distribution outcomes arising from the diversion effect, most writers share the view that this phenomenon could significantly undermine the social value of victim precaution. Studies have shown, for example, that crime rates cause an exodus out of cities and into suburbs, only to increase the victimization levels of remaining city residents.⁵⁵ Recognizing the magnitude of this phenomenon, some have questioned the basic competence not only of victim precaution, but of any anti-crime measure as means to deter and reduce the amount of a particular kind of crime.⁵⁶ If, say, a perfect device exists to fully deter any car burglary, the adverse result might be to increase home burglary.⁵⁷ Thus, the consensus among those who have studied the effects of victim precaution is that significant negative externalities exist: actions by one victim adversely affect the well-being of other victims.

Last, there are more specific instances in which private precautions generate negative externalities. For example, investors in securities markets may reduce the volume of trading in precaution against fraud. This might lead to reduced liquidity and to higher trading costs for those who remain in the securities markets. Or, entrepreneurs contemplating entry into markets may be deterred by the fear of illegal predatory behavior on part of incumbent firms. This could lead to reduced competition, higher prices, lesser heterogeneity of products, etc= **B** a negative effect on the well-being of consumers in this market. Finally, crime avoidance measures practiced

54 See, e.g., Clotfelter., at 398 (arguing that "protective measures which have the effect of diverting crime from one household to others constitute a class of externalities which may result in an inefficient allocation of resources"); Clarke, *Situational Crime Prevention*, supra note 2, at 227, 245-47 (describing "the range of displacement effects that have been observed and hypothesized" and reviewing "selected research findings on whether, when and to what extent displacement occurs"); Cornish & Clarke, (invoking a framework of criminals' rational decisionmaking to study the theory of crime displacement); Barr & Pease, at 283-93 (examining "how displacement or deflection of crime can be used to achieve [an equitable] spread of crime"); Hui-Wen & Png, at 94 ("Additional security expenditures by one victim surely will divert criminals to the other."); Shavell, (considering the theft reduction effect plus the diversion effect if precautions are observable or unobservable). For a discussion of the crime diversion phenomenon in the context of the right to carry handguns, see Daniel D. Polsby, *Firearms Costs, Firearms Benefits and the Limits of Knowledge*, 86 J. CRIM. L. & CRIMINOLOGY 207, 207-220 (1995) (questioning whether carrying firearms reduces the threat of homicide or merely diverts it).

55 Cullen and Levitt, supra note __; Ted Miller, Mark Cohen, and Shelli Rossman, *Victim Costs of Violent Crimes and Resulting Injuries*, 12 HEALTH AFFAIRS 186 (1993) (estimating victim costs per crime and associating it with crime rates).

56 Neal Kumar Katyal, *Deterrence vs Difficulty*, 95 MICH. L. REV. 2385 (1997).

57 Ayres and Levitt?

by individuals affect the well-being of others not solely through the diversion effect. While the diversion effect merely redistributes crime, victim precaution may also create crime. For example, potential victims who avoid walking the street because of the fear that they will be mugged leave the streets and neighborhoods empty and subject other individuals to greater risks, as overall crime increases. More generally, urban flight by potential victims of inner-city crime reduces property values in the city, affecting the wealth of other residents.⁵⁸

2. *Expressive Concerns*

The claim that individuals overinvest in precaution is supported by some of the recent arguments concerning the relative effectiveness of private and public precautions. Some commentators argue that the prevalence and conspicuousness of private precaution create an atmosphere of fear.⁵⁹ The sense is that members of the community believe “crime to be rampant and the law impotent,” and that highly visible private precaution might “erode deterrence by emboldening law-breakers and demoralizing law abiders.”⁶⁰ Hence, these commentators suggest, the belief that public and private precaution are interchangeable is false. In fact, public precaution measures are often superior to private ones because “they convey public aversion to crime more effectively and hence exert a considerably greater deterrent effect through the mechanisms of social influence.”⁶¹

The argument has numerous ramifications. It is sometimes argued that private precautions are less efficacious in deterring crime than public precautions, because of behavioral dimensions which are often overlooked by the standard rational choice framework. Under this view, both criminals and victims are more responsive to public precautions because public precautions reflect the public **moral** condemnation of crime.⁶² Thus public precautions do not merely deter criminals; in addition they help to promote a law-abiding culture while, in contrast, private precautions undermine the

58 Cullen and Levitt, *supra* note __, estimate that crime-related migration translates into \$5,500 decline in median housing values in high versus low crime cities. The negative effect on property values in the city is to some extent offset by the positive effect on property values in the suburbs.

59 See Dan Kahan, Social Influence, Social Meaning and Deterrence 83 Va. L. Rev. 349 (1997) [CITE OTHERS]

60 See *id.*, at 385

61 See *id.* at 385.

62 Thus, Kahan argues: “[O]ne might convey public aversion to crime more effectively... and hence exert a considerably greater deterrent effect through the mechanisms of social influence.” See Kahan p. 385.

willingness of individuals to conform with the law. In addition, it is argued that private precautions have negative psychological externalities which are often ignored, namely they reinforce a sense of insecurity and chaos.⁶³

These arguments support the view that the investment in private precautions may be too high. They support this view because they suggest that private precaution measures intensifies a feeling of insecurity which is conducive to high rates of crime. This negative “expressive” externality erodes deterrence “by emboldening law-breakers and demoralizing law-abiders.”

The expressive concerns reinforced by public precautions can be rephrased in communitarian terms. A person who is concerned about the disintegration of communal relations may believe that a healthy community is one which reinforces publicly mutual trust and understanding. Precaution, in particular, visible precaution, reinforces mutual distrust. It is partly these sentiments which explain why individuals are so concerned at the proliferation of guarded communities – communities which are isolated and closed to individuals who are not members of these communities. Moreover, precautions often constrain the intensity of individuals’ social interaction with others. In particular, precautions such as avoiding public places reduce the frequency of interaction of individuals among different classes or ethnic backgrounds and could thwart the emergence of various forms of communal and civic ties.

3. *Egalitarian Concerns*

Egalitarian concerns may also provide support for the argument that public precautions are superior to public one. Private precautions generate great inequality in the provision of protection among those who can afford to invest in private precautions and those who cannot. Reducing the incentives to invest in private precautions by provision of compensation to victims of crime reduces the inherent inequality which currently characterizes the distribution of protection from crime.

⁶³ Kahan bases this conclusion on the results of criminological studies [cite]. In his view visible private precautions: “convey members of the community to be rampant and the law impotent.” See Kahan p. __ Two objections might be raised to this argument. First, it could be argued that the relevant distinction drawn by Kahan between private and public precautions is misleading. The relevant distinction is between **visible and invisible** precautions. The prevalence of police in the streets (a public precaution against crime) can also generate feelings of discomfort for the same reasons that the visible proliferation of private precautions has negative implications. Second, it could be argued that the visible proliferation of private precautions, if indeed reflects the prevalence of crime in the community, is actually desirable because it provides information to innocent bystanders who in the absence of such information be oblivious to the risks facing them.

Arguably, the reduction in the incentives to invest in private precautions does not promote inequality. After all, it merely means that resources which otherwise would be invested in private precautions will instead be used for other purposes. Thus, arguably if an individual is induced to reduce her investment in private precautions, the overall inequality is not affected.

There are two weaknesses, however, in this argument. First, it can be shown that investment in precautions may lead to greater inequality than investment in other goods. Second, it could be argued that inequality in vulnerability to crime is a greater social evil than other forms of inequality.

Private investment in precautions leads to greater inequality than private investment in other goods. Private investment in precautions does not merely better the position of those who make these investments. It also worsens the position of those who do not or cannot invest in private precautions by shifting the crime towards them. Hence, the effect of initial endowments on the overall inequality resulting from the investment in private precautions is greater than its effect on the overall inequality resulting from the investment in other goods. Consequently, shifting resources from investment in private precautions to other goods diminishes the overall inequality.

Note that although this argument relies upon the displacement of crime, it is nevertheless a fundamentally different argument than the one discussed earlier. The negative externality that emerged through the diversion effect implied on excessive *overall* level of precautions. On top of this inefficiency, the displacement of crime is also detrimental to equality. It is detrimental to equality because investment in private precautions does not merely better the position of those who are better off, but, unlike investment in other goods, it worsens the position of those who are worse off, namely those who cannot afford to invest in private precautions.

Yet, even if reducing the investment in private precautions is not conducive to **overall** equality, it is nevertheless beneficial from a justice-based perspective. Justice-based concerns are often grounded not in the concern for overall equality but in the concern to reduce inequality with respect to certain goods and not with respect to others. In his recent book on distributive justice, Jon Elster labeled this concern as a concern for “local justice” – justice in the allocation of particular goods whose equal distribution is of particular importance.⁶⁴

There are powerful reasons to believe that protection from crime is one of the goods for which equal distribution is of particular importance. Consequently, inequality in the provision of protection from crime is more disturbing from a social perspective than inequality in the provision of other goods. Given that the protection from crime is the primary service that the

⁶⁴ Jon Elster, *Local Justice*

state provides to its own citizens, great inequalities in the exposure to crime may be perceived as an indication that the state neglects its fundamental duty to protect its citizens. Equal protection from crime could therefore be regarded as a particularly urgent concern given that it is perceived as a good for which the state has primary responsibility.

C. *The Desirability of Victim Compensation*

There is broad evidence and agreement that in various sectors of their lives, individuals take excessive precaution against crime, and that the magnitude of the distortion is possibly enormous.⁶⁵ While the academic literature discussing this distortion is rich, few have proposed policies through which society can directly target this distortion. Of course, any policy that affects crime levels would also, indirectly, affect victim precaution levels. But are there additional measures that society can take to tackle directly the victim precaution problem? Naturally, the government can tax precaution devices that are diversionary in nature⁶⁶ or subsidize desirable activities by potential victims. Yet a major limitation of this approach is the high informational requirement due to its macro-level application: it needs to identify categories of socially undesirable devices *ex ante*; it cannot be applied on a per-victim basis.

We offer a different approach. If victim compensation indeed has the potential of reducing the incentives to engage in precautions, it could be selectively given to victims who have abstained from using precaution measures that negatively affect others. *Ex post*, courts could evaluate whether or not the specific victim was *at fault* in her selection of precaution. That is, if a victim has taken self-protection measures which reduce her own vulnerability but increase others', she could be deemed comparatively blameworthy and denied part or all of the compensation award. Accurately applied, this regime could discourage victims from using socially undesirable precautions and encourage them to use precautions that are socially effective. Appropriately applied, this mechanism could provide individuals who seek to qualify for the *ex post* compensation with an incentive to select measures that do not cause crime-diversion. That is, victims would be driven to forgo some precautions and to substitute some of their *ex ante* security for *ex post* compensation. Of course, the magnitude of this incentive and the effectiveness of such a scheme would depend on the size of the compensation award victims receive. The greater this

⁶⁵ While the discussion above has focused on factors leading to excessive precaution, there are also factors that might lead victims to take too little precaution. For discussion of such factors, *see e.g.*, Shavell, *supra* note ___; Ben-Shahar and Harel, *Attempts*; Ayres and Levitt, *Lojack*.

⁶⁶ Check Shavell, does he propose taxation?

remedy, the more likely is substitution away from crime-diverting measures to occur.

This approach is more general and escapes some of the information burdens of the fiscal tax approach. Courts are experts at making post hoc determinations of fault, both of offenders and victims. They utilize this bilateral criterion of fault regularly in tort adjudication. The victim compensation scheme we discuss has, in principle, much in common with tort liability doctrines, as it conditions the victim's eligibility for recovery on the type of precaution measures employed by the victim. In similar fashion to a civil court that, say, applies the Learned Hand formula in assessing the value of an untaken precaution, a criminal court can apply cost-benefit analysis in assessing the value of precautions taken (or untaken). In fact, current victim compensation schemes have already implemented an eligibility criterion concerning victims' contributory misconduct. Under all state-run victim compensation program, victims whose behavior contributed to their victimization are excluded from receiving compensation.⁶⁷ Additionally, victims who failed to cooperate ex post with the law enforcement effort are also denied compensation.⁶⁸

The only element we propose adding into the adjudication of victim compensation is a broader definition of victim misconduct. Victims would be ineligible for compensation not only when they unreasonably risk themselves, but also when their precaution unreasonably risks **B** or places excessive burdens on **B** others. And just as victims' ex post cooperation with law enforcement is believed to be encouraged by conditioning compensation on cooperation,⁶⁹ victims' ex ante behavior regarding the anti-crime effort could be monitored by conditioning compensation on such optimal behavior.

III. APPLICATIONS

A. *Compensation of Victims' Losses under Securities Law*

When the Securities and Exchange Commission files an enforcement action against a securities offender, courts are empowered to award civil monetary

⁶⁷ DALE G. PARENT, BARBARA AUERBACH, AND KENNETH E. CARLSON, COMPENSATING CRIME VICTIMS: A SUMMARY OF POLICIES AND PRACTICES 23 (NATIONAL INSTITUTE OF JUSTICE 1992)

⁶⁸ *Id.*, at 25-6

⁶⁹ *Id.* (The victim cooperation requirement [...] achieves the purpose of encouraging victims to report crimes and to assist in their investigation.)

penalties and disgorgement as part of the sentencing process.⁷⁰ Beginning in the 1970's, the movement in favor of victim compensation within public enforcement procedures has gained momentum.⁷¹ A 1990 legislation authorizes the court to substitute the statutory prescribed fine with a victim compensation equal to the gross amount of the offender's gains. This authority has been traditionally rationalized as a deterrence measure. Accordingly, courts have debated whether the disgorgement remedy should be measured by the injury to the victim or the gain to the offender.⁷² The debate is part of a more general unsettled issue in securities law: when should injury-based damages, and when should restitution-based damages, be awarded.⁷³ Again, this debate has traditionally been framed with reference to the offender and the way his incentives will be affected. For example, in discussing the choice among the two criteria for remedies, Easterbrook and Fischel point out that the injury-based measure is overcompensatory as it fails to account for gains to third parties and would thus generate excessive deterrence, whereas a restitution-based measure often involves very subtle determinations of the components of the illicit gain.⁷⁴

Our analysis supports the movement in favor of victim compensation within SEC enforcement actions, but offers a complementary perspective as to the value of these monetary remedies. Monetary compensation is the type of penalty that victim benefit most from, and would have the greatest effect in reducing the cost of victim precaution.⁷⁵ In fact, the analysis suggests that within the ongoing debate between injury-based and gain-based remedies, the injury-based measure of damages might be more desirable than previously suggested. True, as many have pointed out, this ex post measure overstates the social harm from the offense, as it fails to offset the benefit that third parties enjoy. If, say, a corporation makes a fraudulent statement, some investors lose but other investors gain. Taking only the losses into account places an excessive

70 Sections 20(d) of the Securities Act, 21(d)(3) and 21B of the Exchange Act

71 This movement originated with the court decision in *SEC v. Texas Gulf Sulphor*

72 *SEC v. First City Financial Corp.* 890 F.2d 1215 (D.C. Cir 1989) (disgorgement serves to prevent unjust enrichment; the remedy is a key to deterrence of other violations and should equal the value fo the ill-gotten gains);

73 Easterbrook and Fishel, *supra* note ___, at 333, and cases cited therein.

74 *Id.*, at 334-5.

75 See also James R. Farrand, *Ancillary Remedies in SEC Civil Enforcement Suits*, 89 HARV. L. REV. 1779, 1803 (1976) (Compensatory awards are "uniquely suited to redress or cancel unfairness and promote investor confidence in securities transactions.")

liability burden on defendants.⁷⁶ However, viewed from the investor's perspective, the promise of full ex post compensation would diminish (eliminate?) the incentive to take any precaution, removing the main source of social waste attributed to fraud. In contrast, the more stingy gain-based damages would only partially compensate the actual victim and would not return her to the pre-violation status quo. Although the gain-based remedy might improve the ex ante prospects facing each investor (potentially tipping these prospects into the positive expected value region), they do not eliminate the risk and the associated incentive to take precautions. Thus, if the cost of victim precaution is the main social loss from fraud-on-the-market, damages that eliminate victims' risk and eliminate the incentives to reduce the risk would be socially desirable.⁷⁷

Further, securities law seems as a particularly fertile area in which the approach we offer would apply. First, victims are often rational individuals who seek to maximize pecuniary gains and on whose incentives are influenced by changed monetary prospects associated with the compensation scheme. Second, offenders often have deep pockets from which significant compensation payments can be drawn. Along general observations made in the law-and-economics literature on optimal law enforcement, this is an area in which socially costly sanctions like imprisonment could be traded off with their monetary fine-equivalents.⁷⁸ But whereas this fine-instead-of-jail argument was rationalized solely on the basis of the cost of administering the sanctions and allowed the state to pocket the monetary sanctions, the analysis here provides an additional rationale based on the ex ante effect on victims and requires that victims be the beneficiaries of the monetary sanctions. Lastly, victims of securities violations are often dispersed, small-stakes, investors. The civil action route of class action would ordinarily leave them under-compensated, having to account for the cost of legal representation. When compensation is awarded within the SEC's enforcement actions, this representation cost is saved (or borne, to a much lesser extent, by the SEC), thereby promising a more significant **B** some even claim more accurate⁷⁹ **B** recovery.

⁷⁶ Easterbrook and Fishel; Pritchard; Mahoney, at 627-9

⁷⁷ Investors might still verify if they thought their verification efforts would be profitable. Establishing fraud allows speculators to sell fraud short; and compensation would not affect the profitability of this strategy - indeed, in so far as it enhances willingness to trade it makes verification more profitable.

⁷⁸ Shavell

⁷⁹ Farrand, *supra* note ___, at 1805. For the restitution payment to be fully compensatory, it might be required to treat the corporation - not merely its officers - as the offenders, and dip into its deep pockets.

B.. *The Scope of Current Victim Compensation Schemes*

The benefits of victim compensation highlighted in the analysis of Section II require courts to condition the eligibility for compensation of each individual victim on her pre-crime precautionary behavior. One constraint on the operation of this approach might arise from a moral objection to this criterion, which endorses a non-intuitive principle for discriminating among victims. Courts, faced *ex post* with victims' needs, might be unwilling to implement an exclusionary criterion based on *ex-ante* efficiency grounds. However, statutory provisions already make compensation conditional on individual behavior of the victim, and courts are instructed to refuse or reduce compensation if the victim's "behavior at the time of the crime was such that the victim bears some measure of responsibility for the crime."⁸⁰

Another practical constraint on the implementation of the precaution-oriented eligibility criterion is the unverifiability of individual victims' precaution levels. Many forms of excessive precaution are difficult to verify in trial. For one, it might be impossible to measure the investment in precaution that preceded the crime, as in the case of a reduction in some level of activity (such as one's presence in public areas.) In addition, it might be difficult for courts to assess whether a particular observable precaution (e.g., a fence) has the negative diversion effect, that should disqualify its owner from receiving compensation. Finally, even if the above variable are verifiable, expanding the adjudication process to include their assessment might add a non-trivial administrative burden.

In light of these informational constraints, it might be desirable make compensation unconditional on the individual victim's behavior. Instead, compensation can be selectively provided to all victims of categories of offenses against which individuals are more likely to overinvest in precaution, and for which the prospect of unconditional compensation is likely to reduce the magnitude of investment in precautions. Under this implementation scheme, it is critical to identify the types of offenses against which individuals are overinvesting in precautions. One type of crimes for which *ex post* compensation would be *unlikely* to have any significant *ex ante* precautionary effect is violent crimes. An investment in precaution against violent crime is often motivated by safety concerns that are only weakly substitutable by monetary relief. For example, compensation the victim's estate for funeral expenses would surely have no effect on the motivation of any potential victim to take safety measures. Thus, the category of crime for

⁸⁰ Cite Louisiana statute.

which compensation is most likely to affect ex ante investment in precaution is property crime. To the extent that precautions are taken to protect the potential victims “net worth”, the prospect of compensation would more likely substitute for investment in precautions.

However, one thing that most current compensation schemes have in common is their restriction that state-funded compensation would be granted only to victims of violent crimes.⁸¹ The distinction between victims of violent versus non-violent crimes, restricting compensation solely to the former, is fundamental in every existing statute and reflects a deep rooted conviction that violent crimes generate grounds for compassion and compensation which property crimes do not. Thus, to the extent that compensation is not provided for categories of crime such as non-violent property crimes, against which most of the excessive precautionary investment is conducted (fences, private security, and the like), the potential ex ante benefit that these programs could generate is wasted. In part, private insurance contracts might provide an alternative source of recovery for property crimes and thereby have a similar effect as the one that compensation schemes have, of reducing the incentive to take socially undesirable precautions.⁸² However, given that insurance is currently available and yet the magnitude of over-investment in precautions is potentially large, compensation of victims of non-violent crimes could be justified on the grounds of efficiency. From this perspective, the dominant ex post concern underlying existing compensation programs conflicts with the ex ante justification.

⁸¹ 42 USC 10602(b)(1) which determines the eligibility of crime victims for compensation within federally funded programs dictates that

“A crime victim compensation program is an eligible crime victim compensation program for the purposes of this section if

(1) such program is operated by a State and offers compensation to victims and survivors of victims of criminal violence, including drunk driving and domestic violence for –

(A) medical expenses attributable to a physical injury resulting from compensable crime, including expenses for mental health counseling and care;

(B) loss of wages attributable to a physical injury resulting from compensable crime;

(C) funeral expenses attributable to death resulting from compensable crime; “

⁸² Inasmuch as the insurer can dictate the level of precaution that the insured is required to take, the insurer would have less of an interest in measures that divert crimes to other individuals, since at least some of these affected others are also insured by the same insurer.

Obviously, many competing interests might be served by victim compensation, and given the funding constraints it is almost natural that the ex post rehabilitative interest of victims of violent crimes would be ranked highest. However, the current legal structure severely limits the sources for victim recovery by preferring imprisonment sanctions and fines paid to the state over victim-collected judgments. Without sacrificing deterrence or burdening the government's budget, a desirable effect on victim precaution can be promoted by transforming the sanctions levied on offenders into payments to victims. Fines would not be payable to the state, but rather directly to victims; offenders whose pockets are deep enough to pay monetary judgments would receive reduced imprisonment terms and would be required to fully compensate their victims. The total disutility inflicted on convicted offenders could be held constant, but its components can be rearranged to better achieve the desirable effect on victim's precautions.⁸³

C. *Compensation of Victims' Losses under Antitrust Law*

The analysis in this paper can provide some insight into scope of victim compensation under antitrust law. Unlike other areas of law enforcement, antitrust violations only rarely lead to criminal enforcement by the government.⁸⁴ Thus, the potential for transformation the criminal sanctions into victim compensation awards is limited. However, the concern that justifies victim compensation—the problem of costly precautions—is very much present in the antitrust context. Predatory pricing might lead potential entrants to shy away from the market; price-fixing might lead consumers to reduce quantities purchased; illegal mergers might lead competitors to revise their business strategies; and so on.

Unlike other areas of the law, however, victims of antitrust injuries already have access to meaningful recovery. Not only do offenders have unusually deep pockets, but victims are entitled to trebled damages when bringing private actions. Given the unusual incentive to sue that the increased damage measure creates, and because

⁸³ Shavell has proposed an analogous transformation of non-monetary sanction into fines, to achieve a given level of deterrence in an administratively least costly way. See Steven Shavell, *Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent*, 85 Columbia L. Rev. 1232 (1985). The transformation discussed in this paper, of both monetary and nonmonetary sanction into victim-collected judgments, is consistent both with Shavell's administrative efficiency criterion and the ex ante incentives of victims.

⁸⁴ Although the actual application of criminal sanctions has been increasing, it is still very rare. It is estimated that only a few dozen fairly short prison sentences were imposed from 1890 to mid-1970s. See AREEDA AND KAPLOW, *ANTITRUST ANALYSIS* 63 (4th ed., 1988.)

liability is already prima facie established as a result of litigation by the government, a body of standing doctrines has developed to select the types of injured parties that are eligible to bring suit.⁸⁵ Different conceptual criteria, such as the “directness of the injury”, whether the plaintiff’s injury is connected with the purposes of the antitrust proscription, and who is the best situated party to bring suit, have evolved.⁸⁶ Recognizing the importance of victims’ precautions suggests, however, that a different criterion can be utilized to determine standing. A victim should be entitled to pursue recovery if the prospect of recovery would change the ex ante behavior of that particular victim in a socially desirable way.

Consider a situation in which, as a result of price fixing by the violator, the buyer-victim has had to pay a higher price but shifted the cost to a third party. Although allegedly not suffering any injury, the buyer can recover treble damages and the violator cannot prove that the buyer passed on the price increases to its customers.⁸⁷ In special situations, however, such as when the victim-buyer has a “cost plus” arrangement and with its customers, the absence of injury can be proven and recovery denied.⁸⁸ While the existence of an actual injury is difficult to assess given the cost shifting that goes on all the way down to the user-consumer, the criterion of victim precaution can provide guidance as to the entitlement for recovery. If, in the presence of price fixing the buyer took socially costly “precautions”, such as, say, reducing the quantity bought, and if the prospect of antitrust compensation would have diminished the incentives of the buyer to take these precautions, then the buyer should be able to recover, irrespective of his ability to pass on the injury downstream. Recovery according to this criterion would serve, not only the ex post compensatory interest of the victim and deterrence against price-fixing, but would coincidentally reduce the social cost of undeterred violations by reducing the distortion in the behavior of victims.

Similarly, courts often apply a remoteness test for standing, under which a party can qualify for trebled damages unless there is no other party more directly harmed that can sue.⁸⁹ Various factors bear on

⁸⁵ See *id.*, at 86-96 for a summary of the standing limitations.

⁸⁶ *Id.*, at 88.

⁸⁷ *Hanover Shoe v. United Shoe Mach. Corp.*, 392 U.S. 481, 489, 491-494 (1968).

⁸⁸ *Id.*, at p. 494 (“We recognize that there might be situation—for instance, when an overcharged buyer has a pre-existing “cost-plus” contract [—calling for a different result.”

⁸⁹ *Associated Gen. Contractors v. California State Council of Carpenters*, 459 U.S. 519, 542 (1983) (“The existence of an identifiable class of persons whose self-interest would normally motivate them to vindicated the public interest in antitrust enforcement diminishes the justification for allowing a more remote party to perform the office of private attorney general.”

the determination of remoteness, including the risk of duplicative recoveries and the nature of the alleged injury.⁹⁰ Recognition of the victim precaution problem suggest that an additional factor should be considered in determining whether the victim is sufficiently directly affected. An injured party whose acts were distorted as a result of the violation and who would have acted in a less distorted manner had it anticipated trebled recovery, should be cleared to seek recovery, even if this party does not satisfy the standard conceptual criteria of directness of injury.

⁹⁰ See Areeda and Kaplow, *supra* note ___, at 93-94.