



FINES V. PRISONS IN THE WORLD OF WHITE COLLAR CRIMINALS

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The paper deals with efficiency of prison term over fines in criminal sanctions given in white collar crimes like price fixing, tax evasion, securities fraud and bribery. The amount of fine depends on the level of income, and ability to pay of the individual. The essence of selecting white collar criminals is that these criminals have ability to pay and proving the assumption wrong that fines are always efficient in deterring criminals. The efficiency of prison term is established as the loss of income and reputation of the white collar criminals has more effect than fines. The paper also takes into consideration enforcement cost involved in detecting such crimes and enforcing the legal sanctions.

I. Criminal Sanctions and white collar crimes

The world is experiencing the growth of different business industries, which in turn have also led to an increase in the crimes committed while conducting these businesses. Whether to consider these crimes as a civil or criminal sanction was a topic of debate for long, however the paper does not go into that question and rather assumes that criminal sanctions are most efficient for such crimes. Criminal sanctions are majorly of two type fines and imprisonment. The debate between efficiency of fines and incarceration has

been a subject of many research projects. This paper addresses the debate with reference to white collar crimes. The paper focuses on determining the efficient punishment for white collar criminals indulging in crimes like price fixing, tax evasion, securities fraud, bribery.

Criminal sanctions usually depend on the theory used by the judges. They may be deterrent, retributive and reformative. As per the deterrent theory an offender is given a punishment which has a deterrent effect on him and society. As per the retributive theory the offender is given punishment equivalent to the harm he has caused to the victim and the society. Most of the criminal sanctions are based on the deterrent theory to reduce the crimes in future. The judges enforce the sanction as per the theory while not taking its enforcement cost into consideration.¹

The question before us is which sanctions are efficient to deter the white collar criminals from committing crimes. The 'white collar criminals' are those offenders who are more privileged than the other offenders, in terms of money. These criminals have more wealth and as a consequence more ability to pay fines. They have a reputation in the society. The crimes committed by these offenders are related to the amount of trust that is placed upon them, or not doing an act which they were supposed to do. These criminals commit different kind of crimes like price fixing, tax evasion, securities fraud, and bribery.

¹ Joel waldfogel, Are fines and prison terms used efficiently? Evidence on federal fraud offenders,38 Journal of Law & Economics 107(1995)



Price fixing refers to the situation where the company with other companies on the same side of the market fixes a higher price of the goods, and even controls the supply and demand of the goods to maintain that price. They don't let the market forces determine the price of the goods. This leads to the consumer paying more for the good, more profits to the companies and elimination of competition. Tax evasion refers to the situation here the companies misrepresent their actual income so that they have to pay less tax and they can retain a large part of their income. It refers to illegal action taken to avoid the lawful assessment of taxes. This is also a type of fraud committed against tax authorities. This leads to less amount of tax with the state which hinders the social welfare and creates inequality with those who show their actual income and pay tax.

Securities fraud refers to providing false information to investors so that they purchase or sale securities based on that information, which results in huge losses to the investors who rely on such information. Such an act violates securities law.

Bribery refers to the practice of making improper payments to judges, magistrates, or other judicial officers.³ These public officials in return for such payments act in the favor of the person.

The paper further analyses the two criminal sanctions in terms of these crimes. There are four motives in giving criminal punishments (1) justice, (2)

deterrence, (3) incapacitation, (4) rehabilitation.⁴

II. Fines

Fines are costless to enforce as they involve no fixed cost to be made by the state. Fines are said to be efficient as they don't involve cost and serve to deter criminals. After the criminals are convicted the optimal fine to be imposed is determined. To have an optimum fine so as to deter white collar criminals it should be equal to their wealth. The fines presently are determined by the amount of damage that a criminal act has caused to the society. The assumption made here is that all the criminals have an ability to pay, if they are solvent. Therefore any amount of fine which is equivalent or less than their ability to pay can be imposed upon them. The fine which is greater than the damage, which is equivalent to their income, is not enforced as it leads to overpunishment⁵ and less deterrence as the high and middle income individuals can easily bear such costs.

1. Price fixing

The amount of fine to be imposed on the offenders involved in the price fixing will be equivalent to the damage caused by them i.e. loss to the customers. The cost involved in finding about this loss and determining which company earned more profits due to such price fixing is also high. Moreover the theory of justice says that all the offenders who have committed the same crime should be punished in the same manner. This leads to overpunishment of those who have made less profits and underpunishment of those

² Oxford law dictionary

³ Oxford law dictionary

⁴ Supra n1

⁵ Supra n.1



who have earned more profits. Therefore a lump sum amount of fine is imposed. Such fines do not assure that the companies would not involve in committing such a crime again in the future as they have attained more benefit than the fine they have paid.

Add an example

2. Tax evasion

The amount of fine to be imposed on these offenders will be equal to the damage done, i.e. the amount of tax unpaid. Such a fine does not serve as a deterrent factor because the firm has already benefitted from the funds that it did not report. The firm may use it as a service and hide its income from the tax authorities and use those funds to make further profits till the tax authorities come to know about the hidden income, it is noteworthy that probability of detection in such cases is low. However when the tax authorities come to know about it the firm will pay the amount of damage done, i.e. the tax unpaid. The other firms may start using the same method to earn more profits.

3. Securities fraud

The amount of fine involved in such cases is the damage to the stake holders, the offender will commit such kind of crime only when the benefit that it will give him is more than the cost he will incur. The cost of finding information regarding who committed the crime and how much loss is caused due to that crime is very high, therefore the fine imposed by the court may be less or more than the benefit earned by him. This asymmetric information problem leads to less deterrence.

4. Bribery

The damage in these cases is difficult to estimate and even if it is estimated it will be less than the benefit it has caused to the offender. The probability of detection in such cases is low as it involves the people who are to detect the crime. Therefore imposing only fines in such cases is inefficient.

Whenever a criminal act is done by white collar criminals, a cost and benefit analysis is done as they are aware about the law and will only do a particular act if its benefits are more than its cost.⁶ And the cost, i.e. the fine imposed on them is influenced more by the theory that the judge follows rather than his wealth. Therefore the fines in the case of white collar criminals do not serve as a deterrent factor but as a service factor which allows them to have the benefits from the criminal act at low cost. As the fine increases the probability of detection decreases as the individuals will make more efforts towards safeguarding themselves while committing crime so as not to be convicted.⁷ Therefore imposing a criminal sanction consisting of fine only is inefficient.

III.

Prison

Prison sanctions are considered costly because they involve a large amount of cost like constructing and maintaining prisons, giving salaries to prison authorities, taking care of the prisoners.

⁶ Mitchell Polinsky and Steven Shavell, the optimal use of fines and imprisonment, 24 Journal of public economics 89-99 (1984)

⁷ Mitchell Polinsky and Steven Shavell, Enforcement costs and the optimal magnitude and probability of fines, 35 Journal of Law & Economics 133-148(1992), ; See also David Friedman, *Reflections on Optimal Punishment, or Should the Rich pay Higher Fines*, 3 Res Law & Economics 185(1981)



Therefore when there is a choice between prisons and fines, in terms of cost fines are said to be more efficient. Even though imprisonment has a cost the deterrent effect that it has on criminals is more than the deterrent effect of fines. When the white collar criminals are given a prison sanction they suffer a large reduction in income and greater penalty in terms of opportunity cost.⁸ The opportunity cost involves earning higher wages if he would not have been convicted, more future job opportunities and loss of reputation i.e. if he would not have committed the crime he would still hold a good reputation in the society. He may lose the opportunities available in the business environment when he is in prison serving his terms. The quality of his human capital may also decrease for legitimate activities while he is in prison.

Goodwill is the essence of these white collar criminals, if they are imprisoned they lose their goodwill in the market further no companies will be willing to have transactions with them and investors will not invest in their companies.

1. Price fixing

If the individuals who were involved in price fixing are imprisoned, it will serve as deterrence to other companies and they will not indulge in such crimes. The probability of detection being low a longer prison term is imposed which leads to more loss in income.⁹ Imposing of fine will just lead to them being used as

service, prisons serve as a deterrence factor involving loss of income which is greater than the benefit they will get from committing that crime.

2. Tax evasion

The people who are imprisoned for hiding their income from tax authorities are deterred from doing it again due to loss of income and reputation.

3. Securities fraud

The individuals involved in giving out the false information to the investors are imprisoned for a long period due to low probability of detection, this imprisonment leads to decrease in his human capital to earn legitimate earnings and decrease in wages due to absence of trust on him by his employers.

4. Bribery

The probability of detection being very low in this case a high imprisonment period is given. Bribery conviction leads to loss of job, income and reputation.

The damage done to the society by white collar criminals cannot be compensated by their ability to pay, because these damages are huge and involve many people. The loss in income due to long imprisonment term is more than the fine levied on the criminal, these losses in income has a long term effect rather the fine has a short term effect. After the prison term the released offenders are monitored so the probability of committing further crime is reduced. Therefore imprisonment serves as an efficient sanction to deter further continuance of crime.

IV. **Collateral punishments**

The imprisonment and fines both lead to collateral penalties which are not taken

⁸John R Lott Jr., An attempt at measuring the total monetary penalty from drug convictions: The importance of individual's reputation,21 J Legal Studies 159 (1992)
⁹*Ibid*



into account by the court while giving a criminal sanction.

1. Long term Effects

When a person is convicted either by fine or imprisonment, in the future people will not trust him as on agreements made by him with reference to information regarding securities, his income statements, his pricing structure, and with public officials. Even though the short term cost of the crime may be low the long term effect on his reputation and his future agreements is very high.

2. Employee preferences

After an individual is convicted, he may not be able to secure a job position equal to his qualification as the employer would doubt his honesty, even if he is employed he may get less wages. No employer would prefer an employee who does not follow the law and indulges in criminal liability.

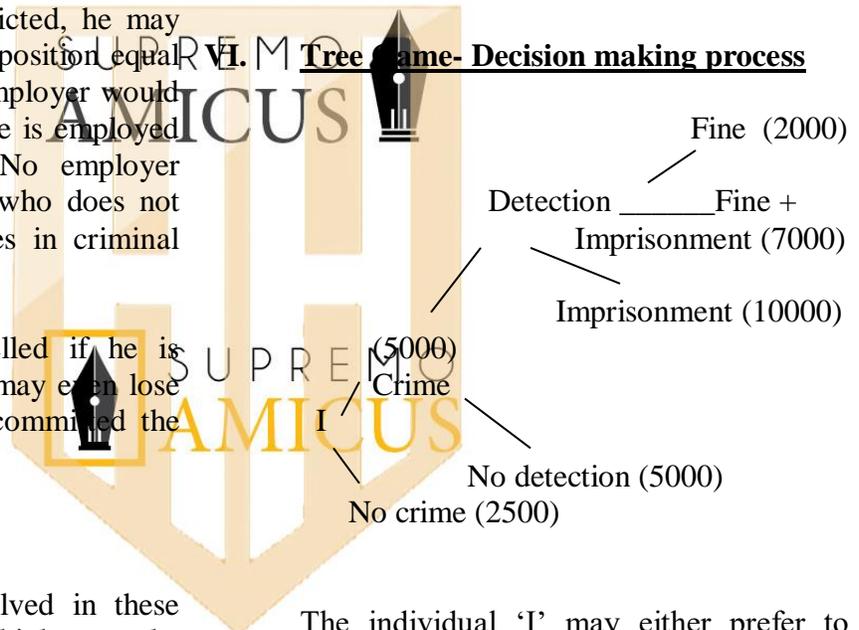
3. Debarment

His license may be cancelled if he is convicted of the crime. He may even lose his job through which he committed the crime.

and payment of huge fine may give money equivalent of fines to these officials, which is less than the fine imposed by conviction as it does not involve cost of trial, because they want to save themselves.¹¹ The public authorities will accept that amount because they are paid less by the state. The crime of bribery can also be decreased by increasing the enforcement cost.

The fines and imprisonment decreases as the enforcement cost increases as there will be more number of people among whom the cost of enforcement is to be divided.

Tree Game- Decision making process



V. Enforcement cost

The enforcement cost involved in these white collar crimes is high as the individuals have the ability to pay and their incentives to resist such penalties are high. The state has to incur prosecution, settlement and collection cost.¹⁰

The enforcement cost also increases while paying the public authorities who detect such crimes. The upper and middle class people who have a probability of detection

The individual 'I' may either prefer to commit crime of price fixing or refrain from doing so, the benefits earned by him in both the situation is 5000 and 2500 respectively. We assume that per month he earns 2000\$. We are assuming that the probability of detection is low due to low enforcement investment done by the state.

¹⁰ Supra n.5

¹¹ David Friedman, Efficient institutions of private enforcement of law, 13 Journal of Legal Studies 379 (1984)



The commission of crime will lead to -

- 1) Fine being equal to his ability to pay, but less than the benefit he is earning from committing that crime so he will commit the crime by paying the fine. Fines depend positively on income.¹² Fine of 2000\$ under punishes as the harm caused is 5000.
- 2) Imprisonment for 5 months, which will lead to loss of 10000\$ as his monthly income will not be paid to him, and he may not even get the job in future. This sanction over punishes an individual because the harm caused is only 5000\$.
- 3) The imprisonment along with fines is said to be the most efficient option because it will not over punish or under punish an individual but will give optimal punishment with deterrence

satisfy the money debt only if the money debt to the society is less than the highest possible fine.¹⁴ Fines and prison sanctions are indeed substitutes of each other, when the individuals have an ability to pay.¹⁵ As the income increases fines increases and prison term decreases, because the shorter period of prison will lead to same loss of income as fines.¹⁶ The prison sanction though a substitute of fines is more deterrent as the collateral punishment involved with the serving of such prison term adds to more loss in income and reputation of the offender. The pain of imprisonment is the highest to the educated and sensitive individual, who has the ability and power to pay the amount of damage that he has caused.¹⁷ White collar crimes like price fixing, tax evasion, securities fraud, and bribery are grave in nature as they affect the society. They have a high enforcement cost as the cost of collecting information required for finding the offender, the damage amount, the parties affected by the offence is very high, salaries to be paid to public authorities to detect the crime. The high enforcement cost may not be incurred by all the states, therefore the probability of detection is low leading to choices between high amount of fine or long imprisonment term. High fines do not deter criminal who have the ability to pay and are earning more benefit from committing such crimes, they tend to use these fines as services without any long

VII. Conclusion

Indeed in terms of cost fines are the most efficient criminal sanctions, but they fall short of deterrent effect on middle and upper class criminals. The ability to pay and solvency of middle and upper class criminals, also known as white collar criminals enables them to use these fines as services and to commit more crimes. The fine imposed for individuals committing the same crime may be less than the wealth of most of the white collar criminals and therefore low wealth individuals pay everything they have and middle and upper class criminals pay fine which is less than their wealth.¹³ A punishment consisting of only fine can

¹⁴ Supra n.1

¹⁵ Ibid

¹⁶ Ibid

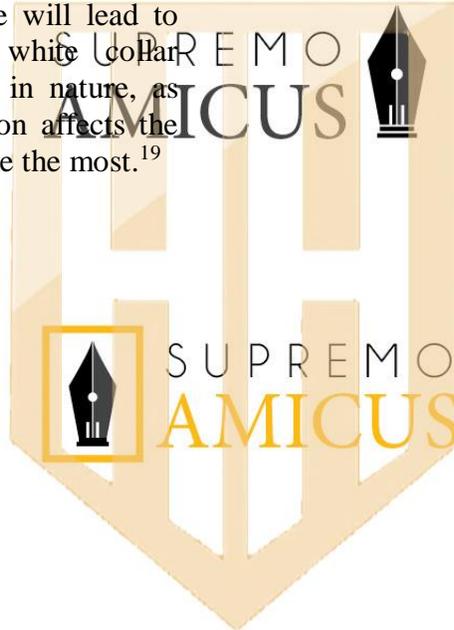
¹⁷ Richard Posner, Optimal sentences for white collar criminals, 17 American Criminal Law review 410 (1979-1980)

¹² Supra n.1

¹³ Polinsky, A.M. and Shavell, S., 1990. A note on optimal fines when wealth varies among individuals (No. w3232). National Bureau of Economic Research.



term effects which may lead to commission of the crime again because they are aware that they can escape liability by paying fines. The option left with the court is to award long imprisonment which leads to more deterrence as imprisonment has a long term effect on individual's loss of income and reputation.¹⁸ Imprisonment also leads to decrease in human capital, decrease in labor market activities of the individual as employers will avoid appointing him. Long imprisonment term increases the disutility of the individual, as his income is lost. This high deterrence will lead to less crime especially in white collar crimes, which are financial in nature, as loss of income and reputation affects the middle and upper class people the most.¹⁹



¹⁸ Ibid

¹⁹ See also M. Clinard, The black market- a study of white collar crime, 244(1969)