H O M O G E N O U S

S O C I A L   G R O U P S

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Nr. 100

August 1977

HOMOGENOUS SOCIAL GROUPS

(I Some Remarks on the Economic Relevance of the
Analysis of Institutions - II Homogeneity and
the Structure of Homogeneous Groups - III The
Emergence of the State and the Counter-State -
IV Homogeneous Social Groups as Functional Substi-
tutes as well as Complements to Economic and Poli-
tical Processes)

I

It is by now widely accepted that social institutions
exert a considerable influence on economic activity[1]
and therefore merit the attention of economists.
While neo-classical economics took these institutions
for granted, recent years have seen efforts to inte-
grate them into the theoretical framework of the
discipline.[2] Recognizing that certain institutions
form a precondition for economic activity, recent
research has concentrated on the operation of alter-
native structures and the institutional constraints
on economic behavior. - the purpose of this analysis
being provision of a comprehensive basis for effective
public policy.

In this paper, I tentatively analyze the impact of
the homogeneity of groups on both the structures and
relationships in which transactions take place.
More specifically, the concept of homogeneity con-
tains a set of conditions which describe properties
of institutional relationships which reduce the
costs of transactions among group members. The con-
cept of homogeneity (to be defined in section II)
serves to integrate such disparate fields as econo-

mic anthropology, Public choice and the economics
of delinquency, The purpose of this paper is to in-
troduce the concept of homogeneity so as to give a
coherent economic interpretation to apparently contra-
dictory phenomena such as the evolution of a legal
system and the emergence of mafia-type organization.
This is an attempt to provide a general analytic formu-
lation of what has up until now been either merely
described[3] or been given a narrow context-specific
economic interpretation[4]. It is argued that trans-
actions between homogeneous partners tend to be less
costly than those between heterogeneous actors.
Starting from this simple proposition, the relevance
of a guaranteed obligatory social order for a system
of voluntary exchange is explored. This is to show
extent to which social order is a means of reducing
transactions costs, and the extent to which this is
due to the homogenization of individual behavior by
the imposition of rules of public order. This is
followed by a rejection of the assumption implicit
in Public Choice literature that the public order is
unique. Rather, the social order is viewed as being
composed of the different norm-systems which exist in
a segmented heterogeneous society consisting of homo-
geneous groups. This approach serves as a frame of
reference for a selective survey of empirical studies
which analyze the social function of homogeneous groups
as intermedearies in both the market and the political
process.

Finally, an abstract characterization of homogeneous groups takes into account the results of both the theoretical analysis and the empirical research reviewed.

II

Homogeneity

Given a society (S) composed of n individuals:

(1)   (S: i: i=1,...,n)

Where each individual (i) has available a set of alternative actions which I shall call the individual action set: (A_i), where:

(2) $(A_i: a_i^j: j=1,...,m)$

Then the set of alternatives, or action set open to society (S) as a whole at any given time may be given by the matrix: $(\underline{A}_S)$, where:

(3)

$$
(\underline{A}_S) =
\begin{array}{l}
a_1^1, a_1^2, \ldots, a_1^m \\
a_2^1, a_2^2, \ldots, a_2^m \\
\quad \cdot \\
\quad \cdot \\
\quad \cdot \\
a_n^1, a_n^2, \ldots, a_n^m
\end{array}
$$

Then, a homogeneous group may be defined as any group of individuals (G), where (G) is a proper sub-set of the society (S):

(4) $G \subseteq S$ for all G

Where the homogeneity exists as a restriction on

the action sets of the individuals composing that
group. Thus, the existence of a homogeneous group
action set may be postulated, which forms
the outer bound of the   action sets of the indi-
viduals within that group. Thus:

For all (G), there exists an action set $(\underline{A}_G)$, such
that:

(5) $\qquad (\underline{A}_G) \subset (\underline{A}_S)$

and

The individual member of a particular homogeneous
group has an action set $(\underline{A}_{i(G)})$, where:

(6) $\qquad (\underline{A}_{i(G)}) \subset (\underline{A}_G)$

This restriction on the action sets of the indivi-
duals within the group, or of the group as a whole
may arise as the result of any of a number of
possible forces. Two general cases explaining the
existence of such a restriction may be where it
arises as the result of:

(a) the imposition (external, or internally by some
    subset of the group: elite),

(b) the (tacit) acceptance by the members of a group
    of $(\underline{A}_G)$.

Prescription

Prescription may be regarded as a special case of
the general restriction on the action sets of mem-
bers of the homogeneous group. Hence, a specific
action is prescribed, or indicated for a given cir-
cumstance - rather than a range of possible actions.
Thus, the already reduced action set of the indivi-
dual members of a particular group is narrowed down

to only a single element:

(7) $c_i^x \notin \underline{A}_{i(G)}$

Where

(8) $\underline{A}_{i(G)} = (a_i^x)$

(Where (c_i^x) is a circumstance, or stimulus (x),
affecting individual (i), who is a member of homo-
geneous group (G): and (a_i^x) is the response pre-
scribed under (c_i^x) for such an individual.).

Features

1. Reduction in Social Costs.The restrictions upon
the action set of the members of the homogeneous
group implies the potential reduction of social
decision costs of the group. Under the assumption
that the costs of social decisions are a positive
function of the complexity of the set of alternatives,
and if this can be measured by the number of alter-
natives to be sought out and / or considered, a
reduction of $(\underline{A}_S)$ to $(\underline{A}_G)$ will ceteris paribus
reduce the costs of social decision. By social
decision costs I mean generally the costs of search,
information, considering alternatives, and negotia-
ting agreements. Not all of
these vary with the number of alternatives consi-
dered, but some obviously do.[5]

2. Modification of the Environment of Individual
Decision. The reduction of the action sets reduces
uncertainty and therefore increases predictability
of individual relationships. Prescription lowers
decision costs to zero. Effective prescription

makes the behaviour of any one member of the homo-
geneous group completely predictable. A functionally
specialized communication network lowers the per-
-unit information costs. This network processes and
disseminates information:

- providing an increase in the quantity of
  information managed and
- increasing the quality by
  = noise reduction and
  = increased reliability.

Enforcement. For any given homogeneous group, there
exist specialized systems for the enforcement of
the restricted action set. These systems act to
enforce decisions - both social and individual -
and prescriptions especially within the action
set. Due to specialization, enforcement within the
homogeneous group is potentially less costly and/or
more accurate than social enforcement. This in turn
reduces the transactions costs arising from deviant
behaviour. Consequently, there is a potential reduction
of the transactions costs arising from contracting, gathering
information and policing[6].

Potential Defects. The rigidity of the homogeneous
group structure implies a potential for destabilizing
defects, if the group's environment (society) changes,
rendering non-considered alternatives relevant for the
group as a whole. Relatively high costs may be in-
curred as a consequence of not taking into account
alternatives outside of the restricted action set.
There is a potential increase (towards infinity) in

information costs concerning the non-feasible set.
The specialization characterizing homogeneous groups
can have adverse consequences. Relatively high costs
will be incurred in not taking account of the elements
outside the restricted set. This may manifest itself
in

- low quality of decisions or
- low reliability in relations.[7]

III

It has been long known that the establishment of a
system of guaranteed forms of agreement, enforced
rules and a singular (non-disputable) attribution
of alternative actions to individuals or collectives
is a necessary precondition for a system of voluntary
exchange.[8] Singularly attributed alternative actions
constitute 'property rights'. Thus a specified system
of legal regulation and social normation is an in-
stitutional prerequisite for the effective ope-
ration of the market economy.[9] Recent discussion
among Public Choice theorists has clarified these
conditional interrelations[10] and explained -
among other things - the emergence of the consti-
tuted state and the conditions of its existence.[11]
According to this view, the legal system is a collec-
tive good, from which no member of society can
be excluded.[12]
More specifically, a legal system is a collective
good in that:

(1) It operates effectively as a conflict-resolution procedure, preventing the accumulation of unresolved inter-individual conflict, which can, in the long run, prove to be destructive for society as a whole. This happens by rendering insecure the established system of property rights.

(2) Secondly, it provides all contracting actors with a scheme of reference on which they can rely in their transactions. The behaviour of all parties to a given transaction becomes predictable due to the homogenization of individual behavior by means of public ruling.[13]

(3) Where the legal rules are non-specific and ineffectively regulate any given transaction, causing conflict, and/or if the outcome of the legal process is not easily predictable (this is the area of _forensic process failure_); transactors cannot rely on the provision of the public good and will therefore demand a specific solution for their conflict. In this solution the private good effect[14] clearly dominates.[15]

It may be worth pointing out that the actors in conflict demand a reliable conflict resolution, but this resolution need not necessarily be supplied by the state legal system. Often, decentrally provided social normation will suffice. The analysis of the public good aspects of the legal system combined with a neglect of its private good aspects has induced many Public Choice theorists to consider only one such

system for any given society. The legal system,
however, is only one facet of the aformentioned
institutional structure. It operates efficiently
only to the extent that the heterogeneity of citi-
zens and the complexity of their conflicts can be
overcome by recourse to the formalization of rules
and conflict resolution procedures.[16] The more
heterogeneous the population and the more hetero-
geneous the object of their respective transactions
and conflicts, however, the more conflict-relevant
information is foregone during the process of abstrac-
tion and subsumtion under formal rules. Decentralized
procedures, adopted to specific local and social
conditions may integrate more information necessary
for conflict resolution than can be integrated
into a forensic procedure. Therefore additional
social normations, special ethics,[17] codes of con-
duct in personal (friendship) relations, families,
tribes, ethnic minorities and religious communities
etc., as well as ideologies in political parties
and business organizations, from which rules of
conduct and 'expected' attitudes and actions can be
- often implicitly - derived; complement as
well as substitute the formal legal system.

The case of complementarity will be referred to only
in an exemplary form in section IV, while I now turn
to consider the case of substitution.in more detail.

Concentration of Institutions

Imagine an anarchic society (S) of n persons (i);
(m) different commodities (k) (k : i = 1, ..., m)

are traded. An exchange involves the production of
the service (z_j) by means of a technology (T_j) gene-
rating the costs of production of this service
$C_T \cdot z_j$ per unit.

(z_j) is the intermediary service transfering the
commodity (k_j) from its producer to its consumer.
Subsequently, the production of (k_j) will be ignored
and I shall only consider the production of the
related service (z_j).

The technology (T) consists of an institutional
device which selects an optimal pair from all po-
tential producers and consumers, establishing a
particular connection, which makes the technical
transfer feasible and guarantees the realization
of the exchange in <u>protecting it from all interfe-
rence</u> be it internal or external to the particu-
lar connection. This may be described as an <u>insu-
rance</u> of the transaction. Whilst dependent upon
the nature of the commodities transferred and the
complexity of the exchange, it is assumed that the
production of (z_j) involves decreasing average
costs.[18]

Given that the number of exchanges per period of
a particular commodity (k_j) is equal to $x(k_j)$ and
the service demanded is correspondingly $x(z_j)$, an
institutional technology (T_j) may not operate at
its optimal capacity because of the limited occur-
rence of transfers in (k_j). Here it may be desirable
for the owners of (T_j) to modify the technology
(institution) so as to make possible the exchange

involving an additional cost of $\Delta C_{T_{j+1}}$, $\Delta C_{T_{j+2}}$ etc. .

In what follows, it will be assumed for the sake of simplicity that all increments

$$\Delta C_{T_{j+1}}, \quad \Delta C_{T_{j+2}} \quad \text{etc.}$$

are of equal size, although in the real world this will certainly not be the case. Starting from a particular technology (T_j), a concentration process comes to an end when either all commodities exchanged are included, or for some commodity ΔC_T exceeds the benefits from increased scale.

Insert Figure 1

Typically this will be the case if the exchange is complex (cannot be easily formalized) or infrequent (or both).

This may be illustrated graphically in Figure 1. Apart from the good (k_j) and the related service (z_j), four further goods and connected services are assumed to exist. The costs of modifying the institutional device are, starting from C_{T_J}, equal additions for all (z_{j+1}), ..., (z_{j+4}).

The quantities traded are equal for all five categories of goods, and the process starts from C_{T_j}.

Insert Figure 2

Figure 2 shows that both aggregate and average transaction costs decrease with the further introduction of commodities into the institutional device. The institution consequently grows up to

CONCENTRATION OF INSTITUTIONS

$\Delta C_{T_{j+4}}$
$\Delta C_{T_{j+3}}$
$\Delta C_{T_{j+2}}$
$\Delta C_{T_{j+1}}$
C_{T_j}

COSTS OF TRANSACTIONS

$x(z_j)$ $x(z_{j+1})$ $x(z_{j+2})$ $x(z_{j+3})$ $x(z_{j+4})$

O

I
II
III
IV
V

T_1
T_2
T_3
T_4
T_5

AMOUNT OF TRANSACTIONS

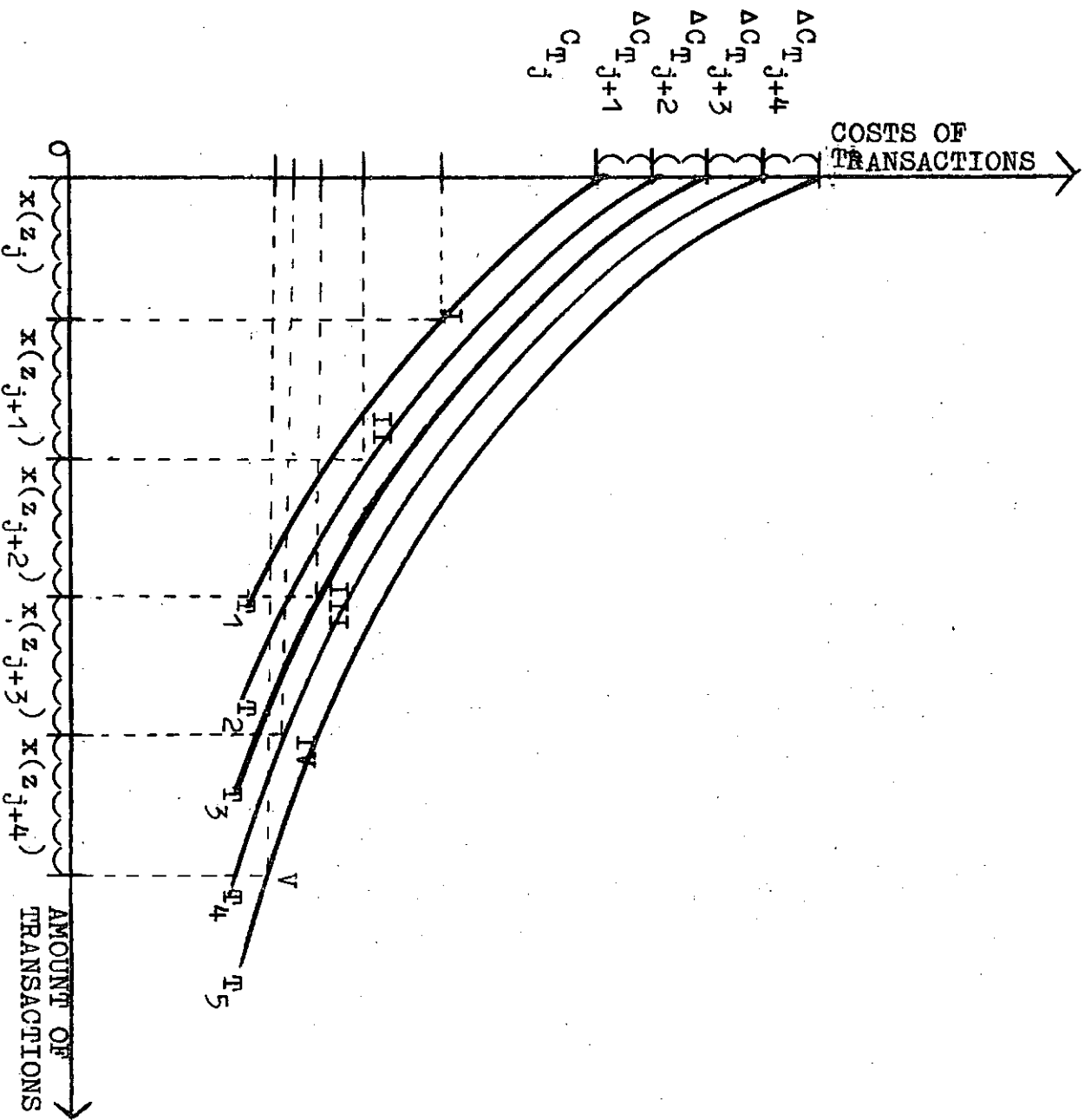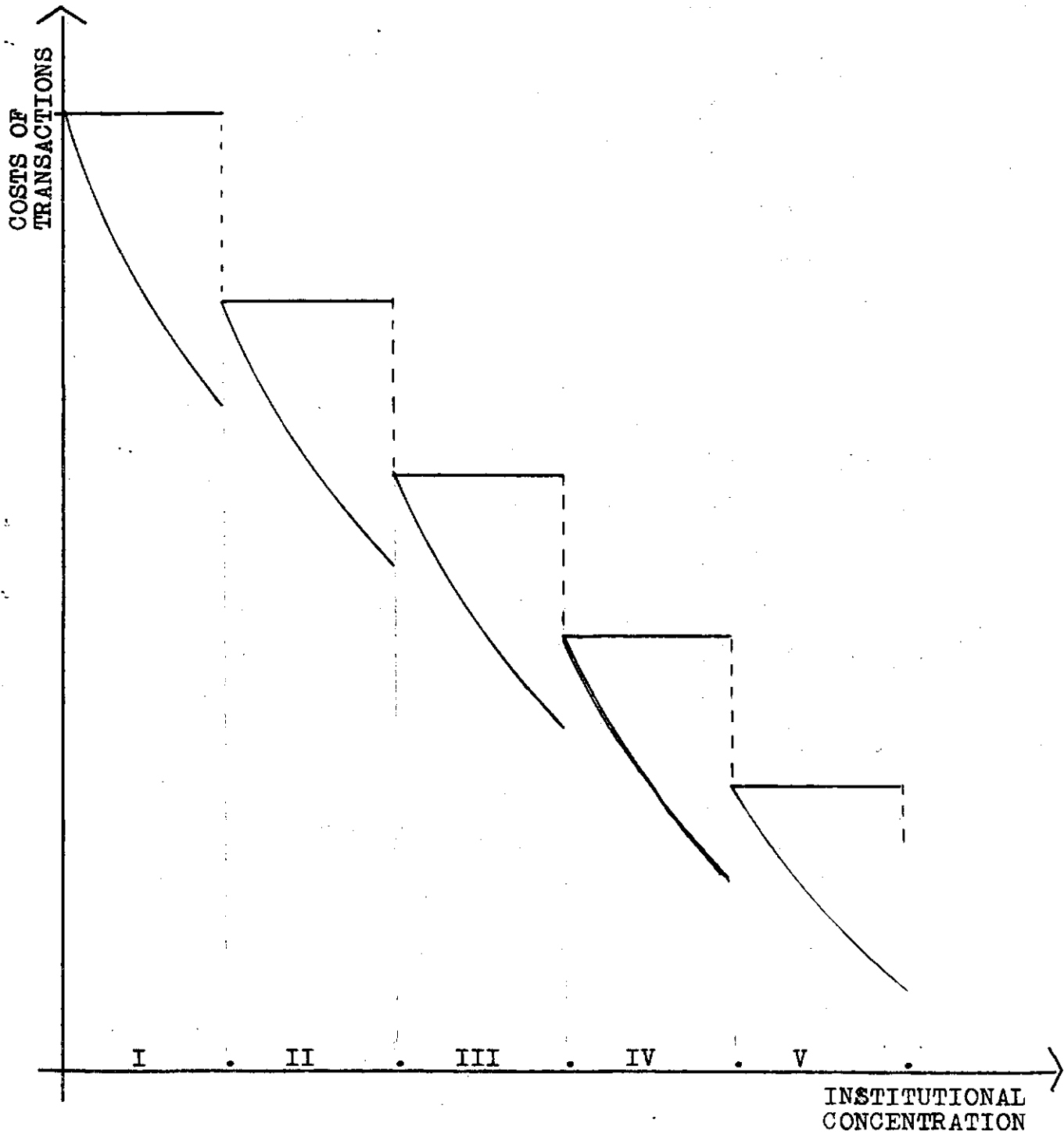Figure I

Figure II

AGGREGATE AND AVERAGE COSTS
IN SUCCESSIVE STAGES OF IN-
STITUTIONAL CONCENTRATION

the point of marginal equalities.[19]

The Evolution of the Counter-State

If, however, (T) is more narrowly interpreted as
the legal structure, the political nature of the
state has to be taken into account. The state is
not simply a device to economize on the costs of
transactions by designing institutions which faci-
litate exchange. Rather, the state as a moral in-
stitution exerts its souvereign power to prohibit
certain transactions. This raises instead of de-
creases the cost of transactions involving the
commodity $(\bar{k}_j)$, the exchange of which contradicts
the state policy in question. These prohibitive
policies are, however, not necessarily welcomed by
the citizenssubject to the ruling. There exists a
demand $D_{\bar{k}_j}$ for $(\bar{k}_j)$ and the corresponding demand
for the   service $(\bar{z}_j)$. However, this transaction
involves the cost $P_{\bar{z}_j}$ i.e. the cost of the 'real'
transaction as well as the expected punishment,[20]
which increases with the number of exchanges effected.
It follows from the discussion in section II, that
there may exist an institutional device - a homo-
geneous group - which serves as an insurance
against interfeárence from the state. In the ab-
sence of such an institution, if there is a large
positive difference between $P_{\bar{z}_j}$ and $D_{\bar{z}_j}$, the trans-
action will not take place. If, however, the state
happens to prohibit an exchange which may be effected
within a pre-existent social group (e.g. an ethnic
minority with few outside contacts[21] and which -

consequently - evades political control), the set-
-up costs of an alternative institutional structure
may be relatively small. Within this alternative
structure, $(\bar{z}_j)$ as before implies an insurance against
interfe·rences which might endanger the transaction,
particularly interfe rence by the state, if effective,
imposing a cost of $P_{\bar{z}_j}$.

Insert Figure 3

Once the alternative structure has been established
and commodity $\bar{k}_j$ traded, further commodities may be
included - as discussed before - into the illicit
exchange system.[22] As noted previously, this will
involve additional costs ($\Delta C_{T_{j+1}}$, $\Delta C_{T_{j+2}}$ etc.).
This is illustrated in Figure 3.
Again, latin numbers indicate the stages of successive
integration.

Insert Figure 4

As shown in figure 4, once the counter-institution
has been established, the re-legalization of trade
in $\bar{k}_j$ does not destroy the whole network. The process
of the evolution and concentration of counter-insti-
tutions is not easily reversible. Once established,
the network can survive on the exchange of $\bar{k}_{j+1}$,
$\bar{k}_{j+2}$ etc.; furthermore, it is not, of course, restricted
from facilitating the exchange of commodities z_j not
prohibited.
This explains how in heterogeneous societies, mafia-

DEMAND FOR /
COSTS OF
TRANSACTIONS

$D(\bar{z}_j)$
$D(\bar{z}_{j+1})$
$D(\bar{z}_{j+2})$
$D(\bar{z}_{j+3})$
$D(\bar{z}_{j+4})$

T_1
T_2
T_3
T_4
T_5
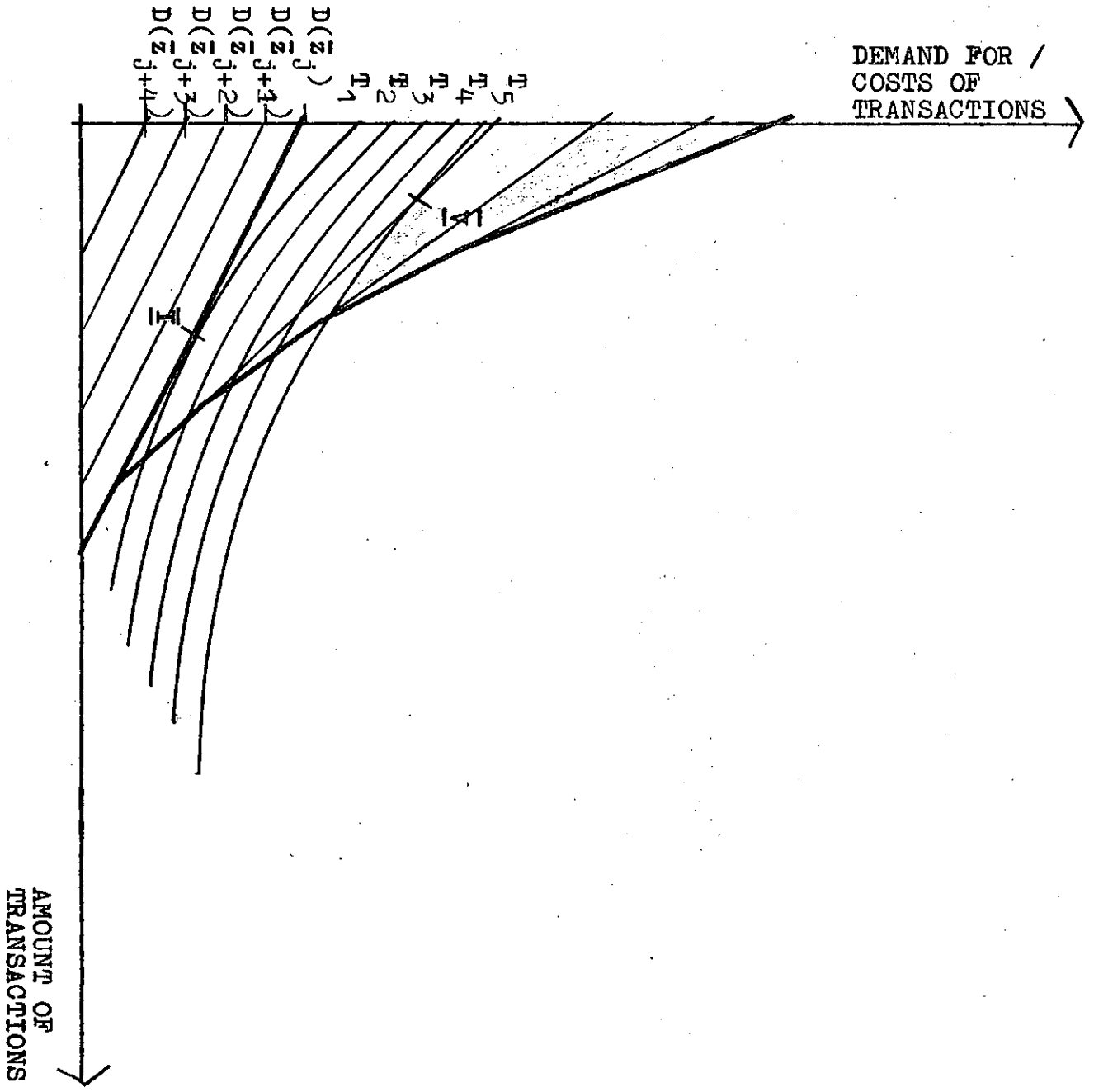
$J=1$

$J=1$

AMOUNT OF
TRANSACTIONS

Figure III
_____

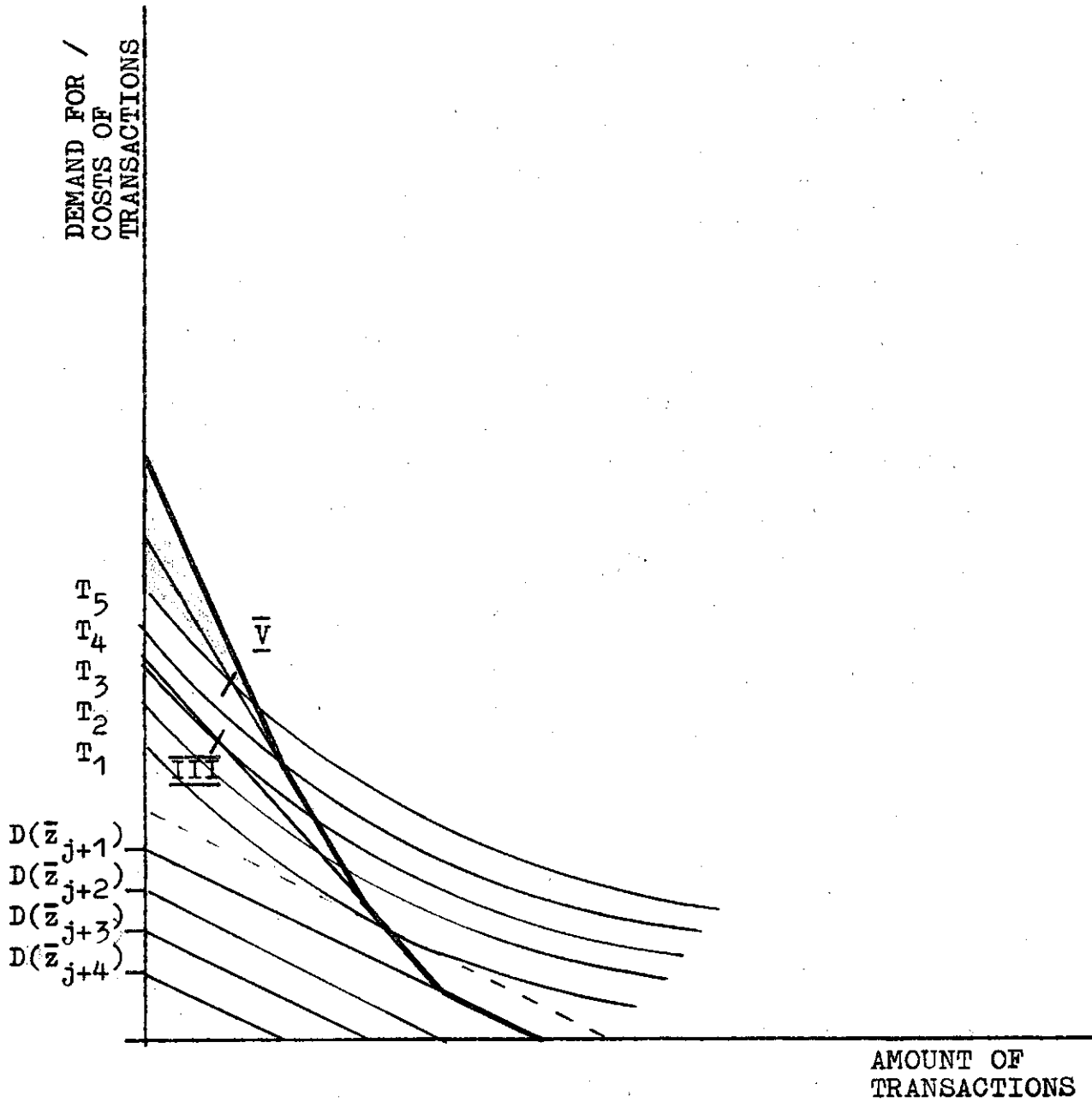THE EMERGENCE OF
MAFIA-TYPE ORGANIZATION

Figure IV

THE   PERSISTENCE   OF
MAFIA-TYPE ORGANIZATION

-type organization can evolve and persist.
Counter-institutions based on the principles of
restriction and prescription are able to profit
from

(c) reduced contract costs,

(i) reduced information costs and

(p) especially in case of prescription, reduced
     policing costs; in this case particularly re-
     ducing the risk of moral hazard[23]. To avoid
     this is, of course, essential for any insurance.

The profit, which is equal to the shaded area in
figures 3 and 4, is appropriated by the effective
'owners' of the counter-institution, On the basis
of this analysis it cannot be shown who these owners
are. We may consider either the homogeneous group
as a whole, an elite within the homogeneous group,
society as a whole, the consumers of the services
provided, or even an external agent.

IV

It would, however, be grossly misleading to think
of counter-institutions only in terms of substitute
networks engaged in illicit transactions. The pre-
dominance of illegal trade will in general be mainly
the result of unwise public policy. The studies
mentioned earlier[24] deal with:

- ethnically homogeneous groups[25] through which
   the trade of specific commodities is effected;

- homogeneity of local residents facilitating
   programs of community development;[26]

- <u>ethnic</u> homogeneity in Japanese neighbourhoods,
  effectively rendering police service superfluous; [27]
  further, in this case it is highly doubtful
  whether any state norm not shared by the homo-
  geneous neighbourhood could effectively be en-
  forced by the state (by means of police inter-
  vention);

- <u>ethic</u> homogeneity in professional groups facili-
  tating internal group communication as well as
  the enforcement of standards of competence,
  deviant behaviour being ultimately sanctioned
  by expulsion; this methods also prevents deviant
  behaviour in prisoners'-dilemma type situations, [28]
  where the common benefit is a monopoly or cartel
  profit extracted from the rest of society; [29]

As a final, though by no means exhaustive
example [30]:

- <u>personalistic</u> homogeneity of social groups
  (identity groups) may be particularly relevant
  in political decision-making bodies such as
  committees. These groups serve as insurance
  systems against the risk of being defeated by
  vote, the group always voting as a bloc. following
  group decisions made earlier; the individual
  member substitutes the risk of being openly
  defeated against the risk of internal defeat,
  which is preferable :

(a) because of similarity of members' preferences
    (and to the extent of this similarity:homogeneity)
    as well as

(b) because of the avoidance of an open defeat which

might negatively affect the political power
attributed to the particular individual by
non-group members of the political body.[31]

In general, a homogeneous social group is characterized
by common reference systems, standardized behavioour
and modes of conduct, and the compatibility of the
ends of the individuals incorporated into the group.
Homogeneity is continually reinforced by processes
of social coercion, which work smoothly when members
meet. Where this fails, homogeneity is secured by (the
threat of) expulsion of deviant members.[32] Trans-
actions costs in homogeneous groups are markedly
reduced by a common language and social as well as
local proximity, both reducing the costs of communi-
cation, by standardization and consequent predicta-
bility of group members' behaviour, and, as a con-
sequence of both factors, specific insurance systems.
In-group insurance, in turn, is superior to outside
insurance because of the reduced costs of communi-
cation, monitoring of group members (reducing moral
hazard) and conflict resolution.

Not all of these characteristics are present in every
case mentioned. There exists, however, a close inter-
relationship between them. These interrelationships
deserve further attention by economists, apart from
the explanation attempted in this paper of the
emergence of concentrated and constituted institu-
tions and the emergence as well as persistence of
counter-institutions.

Footnotes
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(1) Institutionalism does, however, not reduce to Marxism,
    an opinion sometimes implied (see e.g. David Starret,
    "Social Institutions, Imperfect Information and the
    Distribution of Income", Quarterly Journal of Economics,
    vol. XC, no. 2 (May 1976)pp.261-284). To the contrary,
    in the United States this view has e.g. been hold by
    the institutionalist (Wisconsin) school of economics
    (sse e.g. John R. Commons, Legal Foundations of Capita-
    lism,(New York: Macmillan 1924; reprint Clifton:
    Kelley 1974; with a prefase note by J. Dorfman), liberal
    economists such as Hayek (e.g. Friedrich August von
    Hayek, Law, Legislation and Liberty: A New Statement
    of the Liberal Principles of Political Economy (Chica-
    go: University of Chicago Press, Vol.I 1973, vol.II
    1976) as well as by the German tradition of the ORDO-
    -school, which is aggressively anti-Marxist and on
    which Hayek to a certain extent relies.

(2) See recently e.g."The Symposion on Economics of Inter-
    nal Organization", Bell Journal of Economics, vols.
    VI, VII, Nos. 1 (Spring 1975), 2 (Autumn 1975) and
    1 (Spring 1976), pp.163-180, 552-606, 105-131 respective-
    ly; and the "Symposion: The Economics of Information",
    Quarterly Journal of Economics, vol. XC, no.4 (Novem-
    ber 1976), pp. 591-666. See further Gordon Tullock (ed.)
    Explorations into the Theory of Anarchy and Further
    Explorations into the Theory of Anarchy, (Blacksburg:
    Center for the Study of Public Choice 1972, 1974) and
    the relating discussions by Public Choice economists.

(3) Examples are: David H. Bayley, "Learning about Crime:
    The Japanese Experience", The Public Interest no.44
    (Summer 1976), pp. 55=68; Bruce R. Bolnick."Collective
    Goods Provision through Community Development", Economic
    Development and Cultural Change, vo. 25, no.1 (October
    1976),pp.137-150; Thomas R. Ireland,"Gordon Tullock's
    Game: A Personalistic Analysis", paper presented at
    the 1976 Annual Meeting of the Public Choice Society,
    Roanoke, VA. 15-17.April 1976; Hendrik Laurens Van der
    Laan, Lebanese Traders in Sierra Leone (The Hague

and Paris: 'S Gravenhage 1975); Stuart Oskamp, Daniel
Perlman,"Effects of Friendship and Disliking on Co-
operation in a Mixed Motive Game", Journal of Conflict
Resolution, vol. 10, no.2 (1966);T.E. Silcock,"Special
Ethics in the Economics of Group Behavior", Malayan
Economic Review, vol. 7/8, no.1 (1962/63), pp.1-18;
Martin B. Sussman,"Family, Kinship and Bureaucracy",
in The Human Meaning of Social Change, eds. Angus
Campbell and Philipp E. Converse (New York: Russell
Sage 1972)

(4)   Janet Landa, "The Ethnically-Homogeneous Hokkien-Chinese
Middleman Group: A Club-like Organization for Economi-
zing on Contract-Enforcement Costs", paper presented
at the 1976 Annual Meeting of the Public Choice Society,
Roanoke, VA. 15-17 April 1976 and Janet Landa, "An
Exchange Economy with the Legally Binding Contract:
A Public Choice Approach" Journal of Economic Issues,
vol. 10, no.4. (December 1976), pp. 905-922

(5)   A cost approach to Social Decision Making has been
put forward in the seminal book by James M. Buchanan
and Gordon Tullock, The Calculus of Consent: Logical
Foundations of Constitutional Democracy (Ann Arbor:
University of Michigan Press 1962); see also the
critique by S. Sidney Ulmer, "The Role of 'Costs'
in Political Chlice: A Review", The Journal of Con-
flict Resolution, vol. XI, no. 2 (June 1963), pp.174-176

(6)   Thomas D. Crocker introduced this distinction. See his
"Externalities, Property Rights, and Transactions
Costs", Journal of Law and Economics, vol. XIV, no.2
(October 1971), pp. 451-464

(7)   The incidence of social decision costs depends on
the structure of the homogeneous group in which deci-
sions are taken. The above refers mainly to groups
in which decisions are taken jointly by all members.
If decisions are taken implicitly or hierarchically,
a further reduction of alternatives will occur infor-
mation processing capacity of the processes referred
to. - For the sake of simplicity of exposition, dynamic
aspects are excluded from the present discussion, al-
though they are to a certain extent implicit in what

(8)   See Dennis C. Mueller, "Public Choice: A Survey",
      Journal of Economic Literature, Vol. XIV, no. 2
      (June 1976), pp.395-433

(9)   See Mueller (1976, p.397) with further references
      to pertinent Public Choice literature. See also the
      references given in N.1

(10) I particularly refer to what has been called the
      "Theory of Anarchy", see Tullock (ed.) (1972, 1974)

(11) The most prominent attempt being by James M. Buchanan,
      The Limits of Liberty: Between Anarchy and Leviathan,
      (Chicago: The University of Chicago Press 1975

(12) See Buchanan (1975) ch. 7; see also Thomas R. Ireland,
      "Public Order as a Public Good" (unpublished manus-
      cript, Loyala University, Chicago, 1968); this view
      has been taken to an extreme by Randall G. Holcombe
      and Robert D. Tollison, "Lindahl Pricing of the Law"
      (unpublished manuscript, Texas A&M University and
      Law and Economics Center, University of Miami, 1976)

(13) It should be noted, however, that homogeneity is a
      necessary, not a sufficient condition for predictabili-
      ty of behaviour. Thomas R. Ireland, on the other hand,
      in an unpublished comment argues as follows: "However,
      'homogeneity' itself is not enough to reduce trans-
      action costs, as Backhaus assumes. Whether this will
      happen or not depends on the social structure within
      the identity group. (...) If I am a member of a group
      whose behavior is predictably unreliable, I will have
      lower costs in transactions with persons not in my
      group than with persons in it." Th.R. Ireland, "The
      Economics of Social Association" (unpublished manuscript
      University of St. Louis, 1977). To me, it seems to be
      difficult to conceive of a group (i.e. 'set' _and_
      structure) which could generate predictable unreliabi-
      lity. At least to the extent of predictability, there
      should be reliability. To make things lesse difficult,
      however, 'unbehaved' groups whose behavior becomes the
      less peliable the more restricted is the action set
      will be ruled out from further consideration.

(14) The conflict resolution is a jointly supplied good with a <u>low</u> degree of publicness. The equilibrium number of club-members is typically <u>two</u>, the scale being defined between one (pure privateness) and infinite (pure publicness). See James M. Buchanan, "An Economic Theory of Clubs", <u>Economica</u>, vol. 32, no.125 (February 1965),pp.1-14

(15) Insofar as the specific rules can serve as a precedent for third parites, this wider applicability of the judge's sentence increases the publicness of the conflict resolution.

(16) See Mueller (1976; p.398) with further references.

(17) Silcock (1962) discusses the function of ethics in professional groupa. For related phenomena in the provision of medical care see also Kenneth J. Arrow, "Political and Economic Evaluation of Social Effects and Externalities", in <u>The Analysis of Public Output</u>, ed. Julius Margolis (New York: Columbia University Press; NBER Conf. Series) 1970)

(18) This assumption is a critical one and of pivotal importance for the argument put forward in this essay. Empirical evidence, however, at least to this authors knowledge can be cited exclusively in favor of the assumption. See e.g. John A. Mack in collaboration with Hans Jürgen Kerner, <u>The Crime Industry</u> (Farnborough: Saxon House; Lexington 1975). The pattern of diversification of criminal entrepreneurial activities once the communication and insurance network ('infrastructure') has been set up seems to be ubiquitous.

(19) Because of the assumption of the equality of the total cost increments this cannot be shown graphically. Under this very restrictive assumption, the institution grows up until the point where it encompasses all goods and services. Consequently, only <u>one</u> such institution will survive in any given society. This case is identical to that which has up to now received the exclusive attention of economists.

The suggestion of the singularity of the state in
this literature consequently rests on the implicit
assumption of the equality of total cost increments.
If this - as it seems: unrealistic - assumption
is dropped, the purely economic explanation of the
emergence and existence of the state no longer holds.
(This does not preclude, however, different explana-
tory attempts in economic terms.)

(20) For a graphical treatment of this relationship the
reader is referred to James M. Buchanan, "A Defense
of Organized Crime?, in The Economics of Crime and
Punishment, ed. Simon Rottenberg (Washington, DC:
American Enterprise Institute for Public Policy
Research 1973, 1976(2)), pp.119-132 (120)

(21) The Chinese heroin market in Central Europe may
be cited as an example.

(22) In the essay cited in N. 20, Buchanan argues in
"Defense of Organized Crime" that monopolistically
organized crime is preferable to non-organized
('competitive') crime because of its relatively
lower output of criminal activity. "If monopoly in
the supply of 'goods' is socially undesirable, mono-
poly in the supply of 'bads' should be socially
desirable, precisely because of the output restriction."
(p.119). For this surprising result to be correct,
however, Buchanan had to assume independence of
criminal activities (see p.127).see also the criti-
cism by Dagobert L. Britto in the same volume, pp.
175-178(177-178)). If however, different criminal
activities as such depend on an infrastructure and
insurance system etc., the assumption of independence
is untenable exactly because of decreasing average
costs for the inclusion of further activities into
the system.
The policy implication of this is that instead of
allowing the monopolization of crime, active distur-
bances of the internal network of criminal associa-
tions lies in the interest of the state.

(23) The concept of 'moral hazard' was intorduced by Kenneth J. Arrow, "Uncertainty and the Welfare Economics of Medical Care", <u>American Economic Review Papers and Proceedings</u>, vol. LII (May 1963), pp.941-973. In the case of professional ethics, e.g. public silence is <u>prescribed</u> as the adequate response upon receiving knowlegde of a colleague's act of malpractice.

(24) See Oskamp and Perlman (1966) and Silcock (1962), cited above N.3

(25) Through these groups the trade of specific commodities (import and luxory goods through Lebanese traders in Sierra Leone, rubber through through the Hokkien Chinese families in Singapore and Western Malaya was effected. While in Sierra Leone Lebanese traders were the only group maintaining outside as well as national contacts and therefore were able to engage in import trade, the Hokkien-Chinese reduced contract costs (in particular uncertainty due to unreliability of indigenous producers and further aggravated by peculiarities of the small holder rubber market) by means of dealing exclusively within their own families, thus reducing costs of information, transaction, conflict resolution etc.

(26) See Bolnick (1976) cited above N. 3

(27) See Bayley (1976) cited above N. 3

(28) The reader unfamiliar with this constellation of interests is referred to Duncan Luce and Howard Raiffa, <u>Games and Decisions: Intoduction and Critical Survey</u> (New York: Wiley 1957), pp. 94-102 = ch. 5.4, 5.5

(29) See the references given in N.17 above

(30) Further cases analyzed include: John C. Hause, "The Legal and Illegal Markets for Taxed Goods: Pure Theory and Application to State Government Taxation of Distilled Spirits: Comment", Thomas R. Saving, " The Legal and Illegal Markets for Taxed Goods: Comment", Rodney T.

Smith, "The Legal and Illegal Market for Taxed Goods:
Pure Theory and Application to State Government
Taxation of Distilled Spirits", The Journal of Law
and Economics, vol. XIX, no. 2 (August 1976), pp.433
-435, 431-432 and 393-430 respectively; in Smith's
analysis, the substitution between legal and illicit
trade is focussed, the homogeneous groups being firms.
Hiroaki Hayakawa and Yiannis Venieris, "Consumer
Interdependence via Reference Groups", Journal of
Political Economy, vol. 85, no. 3 ((June 1977), pp.
599-617 stressing homogeneity in consumption. Mark H.
Moore, "Policies to Achieve Discrimination on the
Effective Price of Heroin", American Economic Review
Papers and Proceedings, vol. LXIII, no,2 (May 1973),
pp.270-277

(31) See Th.R. Ireland (1976), cited in N.3 above

(32) See recently George Akerlof, "The Economics of Caste
and of the Rat Race and other Woeful Tales", Quarterly
Journal of Economics, vol. XC, no.4 (December 1976),
pp.599-617 (436)

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