

On Why We Do Not Try to Walk off without Paying after a Tax-Ride

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out which does not impose an undue high burden on any country, taking into account its reserves.

The bank idea is certainly worth pursuing but it is important that non-

oil developing countries should have the courage to go it alone even if the oil exporting countries are, to start with, reluctant to participate. They are bound to join in good time.

up collecting perhaps twice the correct fare, not to mention the tip. Everybody would agree, taxi-drivers do not behave in this way. Therefore they must be irrational, because it was supposed, a few lines ago that this behaviour is the one in conformity with their self-interest. (Some defenders of faith would, however, be pleased to know that in the city of the author's residence, particularly in the late hours, taxi-drivers do occasionally give evidence of rationality.)

Herein lies the crux of the matter. The object of the above exercise was not to show that human beings are not guided solely by selfishness; but to demonstrate that given the order that attends the multitude of economic exchanges in society and the absence of anarchy and fraud, this *must* be so. The 'invisible hand' would not be able to co-ordinate a multitude of selfish acts to bring order — as it is supposed to do — if it was not aided by the adherence of individuals to certain commonly accepted values. The example in this paper shows that we can maintain that a subset of human beings conform to the "law" entirely because of self-interest; but that rules out, *by implication*, the same assumption for all the remaining individuals. Thus we have to make room for our sense of values, however small.

## II

In a lot of economic theorising it is *presumed* that all contracts are enforceable. Once this is granted, the efficiency of markets is ensured — barring of course the standard difficulties associated with externalities and returns to scale. It is only when considering markets like the one for loans, which are characterised by a long time-lag between the acts of the two parties involved in the exchange, do we talk of default (i.e. the possibility of one party backsliding on his part of the contract). This is what has led to the substantial literature on credit market 'isolation' and 'inter-linkage'. What is not always appreciated is that virtually all economic exchanges entail a time-lag. Like the taxi-driver, the barber brings the bill after the hair-cut, as does the waiter after the meal. And, as the above example shows, it is not possible to explain the absence of widespread default in these situations without making allowances for our sense of values and norms.

Thus while the absence of externalities, etc. is necessary for the efficiency of the invisible hand, a more *basic* assumption is that the agents involved in economic exchanges fulfil their obligations. And the ultimate gua-

## PERSPECTIVES

### *On Why We Do Not Try to Walk off without Paying after a Tax-Ride*

Kaushik Basu

#### I

THIS almost facetious question throws light on two conflicting claims about the order that prevails in society. The paradoxical claim (P) asserts that the pursuit of selfish aims by individuals is sufficient to generate social order. The unparadoxical claim (U) asserts that human adherence to certain commonly accepted values is necessary. Unless we define selfishness so loosely that it is difficult to conceive of unselfishness, (P) and (U) are conflicting claims. This is worrying because both occur within the social sciences: the former in economics and the latter in sociology. The purpose of this essay is to demonstrate with an example, which is representative of a class of real life situations, that it is the unparadoxical claim which is valid.

When we travel by taxi, we do not usually make an effort to run away without paying. Some economists have tried to model crime and marriage in terms of individual rationality, so they would no doubt explain our scrupulousness in terms of the probability of being caught and the agony of being jailed. In order to permit a relatively rigorous discussion let us place the problem at a greater level of abstraction.

An individual gets off from a taxi at a place where there is no one sufficiently near to bear witness as to whether he pays the fare or not; and in the absence of a witness, it is pointless contacting the police (with some police forces this is unconditionally so). Further, this is a large city and the passenger does not expect to require the services of this cabman in the future. Would the passenger try to walk off without paying? I think there will be no disagreement that, even in this situation, a vast majority of human beings would not choose to default. How do we explain this, excepting in terms of our sense of values, or our morality, or custom (essentially something *beyond* selfishness)?

The economist's 'trained incapacity' does not allow him to give in so easily. I posed this question to a number of economists; and barring one or two exceptions, the response was more or less the same: While the passenger's sense of values may indeed be the cause of his adherence to the law, the act could also be explained purely in terms of 'rationality'. Taxi-drivers are often quite strong (which, judging by my small sample, is by no means the most vulnerable assumption). So if the passenger tried to button up his pockets, the taxi-driver would in all likelihood either himself assail the passenger or gather people and try to ensure payment. It is this risk which makes the passenger 'behave'. This is a plausible argument and let us accept it.

But the moment we do so we land ourselves in a problem. The crack however appears elsewhere. It is now the taxi-driver's rationality which becomes questionable. Why do we expect him to retaliate against a passenger who tries defrauding him, and to attempt recovering the fare at the risk or despite the unpleasantness of a scuffle? To me, the most plausible reason seems to be his injured sense of fairplay or anger at his customer's violation of social norms (no doubt catalysed by the fact that he is at the receiving end). But to admit this is to grant the role of commonly accepted values — no matter how indirectly — in the prevention of anarchy. This leaves only one way out: to explain the taxi-driver's response in terms of his selfishness. To do so, one would have to argue that the agony of gathering people and a scuffle may be less than the reading on the meter. This may well be valid. But now comes the main difficulty. If that is so, why should the taxi-driver not try the same tactic even if the passenger has paid? That is, he could take the fare and then pretend that the passenger never paid and go through the same action as he would if the passenger had defrauded him, and thus end

rator of this assumption is our sense of values and norms. As Arrow puts it bluntly in his perceptive essay, 'A Cautious Case for Socialism' (in Howe, I (ed), "Beyond the Welfare State", Schocken Books, 1982): "The model of *laissez-faire* world of total self-interest would not survive for ten minutes; its actual working depends on an intricate network of reciprocal obligations, even among competing firms and individuals."

Once this is appreciated, it becomes possible to understand many features of society without recourse to artificial 'economic' arguments. Consider, for instance, the threat of violence. It is well known that one way in which a moneylender in a backward agricultural region ensures that money owed to him is repaid is by using the threat of violence. This would appear as a paradox to the economist ("Why does he not anyway use such a threat and export money? Why does he bother to lend the money in the first place?"). But as soon as we accept the idea of norms and morality, such behaviour becomes easy to comprehend.

Similarly, to explain the larger incidence of default and fraud in economic transactions in some societies, we no longer need to claim an excess or a shortage of rationality on the part of their inhabitants, but may adduce the more reasonable explanation of differing social norms. And with this opens up newer dimensions in policy-making, in which social norms appear as a 'control variable'. What is important is to recognise that social norms can alter not only society *but even the prices of goods and services.*

Finally, consider a variant of Sen's delightful application of the two-person game, the Prisoner's Dilemma, to a common social problem (A K Sen: 'Behaviour and the Concept of Preference', *Economica*, 1973). Let us assume, as is quite reasonable, that (i) every city dweller prefers his city to be clean rather than dirty, and (ii) one person throwing litter on the streets does not make a clean city dirty. It is easy to see that each individual, acting atomistically, would prefer to throw litter on the street rather than go through the trouble of looking for a garbage bin to dispose of it. It being rational for each individual to litter the streets, all citizens — if they were rational — would do so. The city would be a dirty one and (given (i)) everybody would be worse off.

I find this story convincing and therefore believe, though it sounds facetious, that the dirtiness of, for example, Calcutta is a reflection of

the rationality of its inhabitants. This also shows how much we can gain from a little bit of irrationality. Actually there are two ways of solving this problem. One is to impose fines for dirtying the streets; the other is to inculcate in human beings suitable values. The former works by changing what is rational to the individual.

The latter works by making people accept a little bit of irrationality. It is true that the latter would take much longer to implement, but it is ethically clearly more attractive and ought to be the ultimate objective.

[I am grateful to Andre Beteille, Mrinal Datta Chaudhuri and Amartya Sen for discussions.]

## Informal Credit Market and Black Money

### ERRATA

[Editor's Note: *EPW* inadvertently published an old, uncorrected version of this paper by Shankar Acharya and Srinivasa Madhur in the October 8, 1983 issue, even though the journal had received the revised version by late April. We regret the resulting inconvenience for our readers and unhappiness caused to the authors. Though subsequent publication of an *Errata* page inevitably damages the readability of a paper, we (and the authors) feel that this cost is outweighed by the benefits of setting the record straight. The full revised paper is available on request from the authors. The following are the principal changes necessary in the published article to bring it into conformity with the revised paper that had been accepted for publication.]

(1) First, equation (1) and the two sentences preceding it; on p 1752 should read as follows: "We hypothesise that private sector demand for commercial bank credit is a positive function of income originating in the organised sector of the economy and is negatively related to the interest rate in the formal credit market. A simple linear specification is:

$$KO^d = a_0 + a_1 RO + a_2 YO \dots (1)$$

$$\pm \quad \quad \quad \pm$$

(2) Second, equation (1a) on p 1753 should be deleted, and the sentences immediately preceding and following equation (4a) should read as follows: "Basically, such a situation can be modelled by substituting for the demand function (4), the following form:

$$KI^d = b_0 + b_1 RI + b_2 YU \dots (4a)$$

$$\pm \quad \quad \quad \pm$$

Equations (1), (2), (3), (4a), (5) and (6) thus give an alternative version of our basic model...."

(3) The most extensive change is in the version of equations (8) and (9) and the paragraph following, that is, the final paragraph on p 1753. In the revised paper, this part reads as follows:

$$[a_0 + a_1 RO + a_2 YO - KO] + [b_0 + b_1 RI + b_2 YU] = d_0 + d_1 RI + d_2 YU \quad (8)$$

which can rearranged to yield:

$$RI = \left( \frac{a_0 + b_0 - d_0}{g} \right) + \left( \frac{a_1}{g} \right) RO + \left( \frac{a_2}{g} \right) YO + \left( \frac{b_2 - d_2}{g} \right) YU - \left( \frac{1}{g} \right) KO \quad (9)$$

where,  $g = (d_1 - b_1) > 0$  since  $d_1 > 0$  and  $b_1 < 0$ , by hypothesis.

In terms of equation (9), restrictive monetary-credit policy (that is, a reduction in  $KO$ ), will have the effect of raising the cost of funds in the informal credit market since  $g$  is positive and hence  $-(1/g)$  is negative. The transmission mechanism of this effect is quite simple. Consider a reduction in commercial bank credit,  $KO$ . All other things remaining the same, this leads to an increase in the excess demand in the commercial bank credit market (through equation 3) thereby leading to an increase in the demand for informal market credit (through equation 4). Given that the demand and supply functions in the informal credit market have the slopes hypothesised in equations (4) and (5) respectively the increase in the demand for informal market credit leads to a higher interest,  $RI$ . For a given value of  $RO$ , this increase in  $RI$  implies that the average cost of borrowings in the economy (ie, the average of the two interest rates,  $RO$  and  $RI$ ) has gone up. We now turn to a discussion of the empirical estimates of the parameters of equation (9) to use if they support our *a priori* theorising."

Footnote 5 of the published paper should be deleted.

(5) Finally, in the penultimate paragraph of the paper, the sentence beginning "This omission may not be of consequence..." should be deleted.