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**Marina Della Giusta, Maria Laura
Di Tommaso and Steinar Strøm**

Department of Economics
University of Oslo

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Who's watching? The market for prostitution services

Marina Della Giusta[1], Maria Laura Di Tommaso[2] and Steinar Strøm[3]

Abstract

This paper presents an economic model of prostitution, which differs from the existing literature in that it makes no restrictive assumptions regarding the gender, pay, and nature of forgone earning opportunities of prostitutes and clients, and applies the same behavioural hypotheses to both. Our model gives a central role to stigma and reputation effects for both clients and prostitutes. We discuss demand, supply, and equilibrium results, indicating the possible effects of different policies on the industry and its different markets.

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Key words: Prostitution, Gender, Labour supply and demand, Reputation.

"All of us, with the exception of wealthy and unemployed, take money for the use of our body. Professors, factory workers, lawyers, opera singers, prostitutes, doctors, legislators – we all do things with parts of our bodies, for which we receive a wage in return. Some people get good wages and some do not; some have a relatively high degree of control over their working conditions and some have little control; some have many employment options and some have very few. And some are socially stigmatised and some are not."

[Martha Nussbaum, *Sex and Social Justice*, 1999]

1. Introduction

Prostitution has many features in common with other activities entailing bodily service. It differs from these activities in many subtle ways but the biggest difference consists in the fact that it is, today, more widely stigmatised. The stigma comes from a moral judgement: historically, prostitution has been seen as immoral because non-reproductive extramarital sex has been viewed as immoral (Nussbaum, 1999; Ryley-Scott, 1936).

Although prostitution is known as "the oldest profession", until recently economists have not been interested in analysing this type of human transaction. Recent contributions by economists to this field (Edlund and Korn, 2002; Cameron, 2002; Cameron and Collins, 2003) have shared the assumptions that the object of the prostitution transaction is sex, and that prostitution is one of the possible ways in which women (and occasionally men) can supply sex to men. Prostitution is viewed in these papers as a more or less close substitute to other forms of sexual exchange, and being a man is essential to demanding this service. Biological determinism is used to varying

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degrees of explicitness and sophistication as the underlying theory of human sexual behaviour, which implies that it is not possible to have a unified economic theory of prostitution independent of the sexual identities of the parties involved.

Our contribution consists in constructing a model, based on evidence from a wide range of studies of prostitution, which makes no restrictive assumptions regarding the gender, pay and nature of forgone earning opportunities of the prostitute, and applies the same behavioural hypotheses to prostitutes and clients. The main focus is the incorporation of reputation effects in the behaviour of both clients and prostitutes. Both clients and prostitutes have reputational potential which is not affected if they do not engage in prostitution. Buying or selling prostitution implies a stigma effect: reducing actual reputation to a lower level then the original potential. We first look at the prostitution market when reputational potentials are exogenous and then we consider the situation when those potentials are considered endogenous. In the endogenous case, it is assumed that if a higher quantity of prostitution is sold or bought in the economy, the stigma effect decreases and the corresponding reputational potentials increase. We discuss the possible implications of different policies and regulatory regimes on the industry and its different markets, and suggest ways forward for this research.

2. Studies of prostitution

The literature on prostitution is vast (recent authoritative monographs on the subject are O'Connell Davidson, 1998, and Lim, 1998) and representative of many different views and concerns. A substantial part of the literature on prostitution consists of studies of prostitution and its relationship with violence, health and drugs problems, and international migration, and is often devoted to investigating the desirability of alternative regulatory regimes and the definition of rights for sex workers (McKeganey

and Barnard, 1996; O'Kane, 2002; Thorbek and Pattanaik, 2002; Kempadoo and Doezema, 1998; Tiggey et al, 2000).

Prostitution is an activity mostly entered for economic reasons, and appears to be a job done largely but not exclusively by women (Aggleton, 1998; Sanchez Taylor, 2001). Supply and working conditions depend partly on the availability of other livelihood opportunities (not just other jobs and their pay, but also the working conditions) and partly on social stigma. Criminalisation and social stigma make this a high-risk activity for prostitutes, both in terms of health and of personal safety. Evidence suggests that specific skills are required in this occupation, which include the ability to maintain emotional detachment and separate one's identity of prostitute from one's other identities (Chapkis, 1997; McKeganey and Barnard, 1996), and the ability to defend oneself and cope with risks, given the occurrence of violence against prostitutes is widespread and often little protection is offered by institutions. As argued by Nussbaum (1999, p. 284), prostitution does require skills, but different from the ones we are used to measuring.

Both men (the vast majority) and women demand prostitution services. Interviews with clients appear to suggest that they demand a complex service, which can tentatively be labelled 'control of sex', rather than, as conventionally believed, simply sexual services. Demand by both men and women appears to be at least partly underpinned by ideas of control and subjugation linked to patriarchy and racism, which provide an entitlement to use prostitutes by stigmatising them as inferior (McKeganey and Barnard, 1996; O'Kane, 2002; Thorbek and Pattanaik, 2002, Kern, 2000). As often found in qualitative studies of inequality, these same systems (patriarchy, racism, etc.) provide mechanisms for a partial subversion of the stigmatisation, so that both prostitutes and clients tend to describe themselves as in control of the relationship (Chapkis 1997; McKeganey and Barnard, 1996).

The industry is very fragmented and characterised by the presence of different types of intermediaries, which play a particularly important role, ranging from more to less exploitative (varying from slavery conditions to self-managed prostitutes and trade unions), and appear to differ in the different sub-markets (Tiggey et al. 2000, Sharpe 1998, Garofalo, 2002).

The economic literature has traditionally approached prostitution either showing how it is similar to other markets, or studying it as a form of crime and analysing the costs and benefits of alternative regulatory regimes, generally agreeing that the main motivation behind supply is an economic one (for a review, see Reynolds, 1986). More recent theoretical and empirical contributions have focussed on modelling prices (Cameron et al, 1999; Moffat and Peters, 2001; Edlund and Korn, 2002; Cameron, 2002), supply determinants (Cameron and Collins, 2003), health risk and the effect of condom use on prostitute's earnings (Rao et al, 2001; Gertler et al, 2003), and, more recently, the evolution of paid sex markets and the ways in which urban spaces favour sexual transactions (Collins, 2004). The latter collection is much broader in scope, with paid sex markets being studied as part of the wider sexual market in which people seek partners for reasons that include deficiencies in amount or range of sexual activities in which they participate, or diversification of sexual consumption (Collins, 2004, p.1634).

Edlund and Korn (2002) model prostitution as a highly paid, low skill female occupation alternative to marriage explaining high wages in terms of a loss of position in the marriage market. Cameron (2002), provides a more sophisticated explanation for high wages in terms of compensation for social exclusion, risk (assault, disease, arrest, punishment), front loading in wage profile (informal pension scheme or insurance), boredom and physical effort, distaste (potential psychological and physical costs), loss of recreational sex pleasure, anti-social and inconvenient hours, possible excess demand and prices used to screen quality, taboos, and agent fees (Cameron, 2002). Moffatt and

Peters (2001) find that prices are affected by duration of the transaction, location, and age of the prostitute, but that client satisfaction and price paid are affected by different factors. Stigma enters these models in the form of a barrier faced by prostitutes when wanting to enter other professions, but it is unrelated to the nature of the transaction between prostitute and client. Cameron and Collins (2003) model males' decision to entry the market for prostitution services, where the male has the choice to derive utility from one relationship partner and/or one paid sex partner. They distinguish between the motivations of men in relationships (variety, specific acts, frequency, outlet for stress) and single men ("relative search costs of finding willing sexual partners, or partners wiling to engage in specific sexual activities in an ad hoc or formal social context, and in a given time period" ibid. p.274). An econometric study of the characteristics of male demand for street prostitution services, with the aim of assessing the significance of different types of clients' motivations is contained in Della Giusta and Di Tommaso (2005).

Garofalo (2002) is the only paper, to our knowledge, that attempts a rigorous gender analysis of prostitution and explains the different prices paid in the different prostitution sub-markets in terms of the power asymmetries between contractual parties. Power has been incorporated in economic theory by the seminal work of Hirsch (1977) and Pagano (1999) introducing the idea of positional goods[4]. The idea of positional goods is used with reference to power, prestige, status symbol, and power asymmetries among members of a household are widely used in cooperative and non-cooperative bargaining model of the family[5].

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[4] In a two person economy, a good is defined as positional if the consumption of good x of individual I corresponds to a negative consumption –x for individual j. Power and prestige are positional goods because it is only possible to consume power if another person or group are the objects of the power.

[5] The first two papers in this field are due to Manser M and Brown M. (1980) and McElroy M.B. and Horney M.J. (1981). More recent work has been done by Schultz (1990), Lundberg and Pollak (1994, 2003), Dobbelsteen and Kooreman (1997), Chen and Woolley (2001).

In this paper, we assume that the demand for sex and the demand for prostitution are not perfect substitutes, to reflect the fact that clients' may have other motivations (such as desire for control). We also assume that prostitution is a necessary income generating activity, which is rooted in the lack of alternative earning opportunities.

3. Modelling prostitution

We assume that people care about the effects of their actions on their social standing in the community. This assumption has origin in the economic sociology literature on embeddedness and social capital (Granovetter, 1985; Bordieu, 1986; Coleman, 1988; Putnam, 1993; Mansky, 2000), which point to two distinct ways in which reputations matter to economic agents: firstly because as social beings they derive utility from a positive evaluation by others in the social groups they belong to (Casson, 1991), and secondly because they are aware of the costs that social sanctions may impose on their material progress (Akerlof, 1980; Arnott and Stiglitz, 1991). Reputation has thus both intrinsic and instrumental value: it is desired per-se (provider of utility) and can be used to access other earning opportunities. Stigma is a loss of reputation, which can affect pay and working conditions and access to other jobs for prostitutes, and can affect clients similarly (depending on the sanctions imposed on them by their community if they are caught). Following Akerlof (1980), we therefore include reputation in agents' preferences. We allow agents to have a different concern for their reputation depending on their personal characteristics and the specific moment at which they exercise choice.

The model is, otherwise, a standard neoclassical one, based on maximisation of a utility function for representative agents, whose behaviour is rational. Clients' utility depends on the amount of sex they enjoy for free, the amount of prostitution bought, the

consumption of ordinary goods, and reputation. Prostitutes' utility depends on leisure (time spent not working in prostitution or other jobs), consumption of ordinary goods, and reputation. We maximise clients' utility subject to a budget and a reputation constraint, and obtain the marginal willingness to pay for prostitution in terms of consumption of other goods and reputation loss. Analogously, for prostitutes we obtain the shadow price of leisure time in terms of the net gain of supplying prostitution (which also includes reputation loss) and compare it with the market wage. Note that in our model everybody can be either prostitute or client, depending on his or her economic circumstances and available alternatives. We also assign a specific functional form to utility, which allows us to model different agents by introducing relative preferences for consumption, reputation, and consumption of prostitution and leisure. We thus derive demand and supply functions through which we obtain the market equilibrium. Through variation of the parameters the model can be applied to describe different sub-markets in the prostitution industry. We do not model intermediation or risk in the present paper.

3.1 The demand side, the clients

Let subscript c denote variables related to clients. Let the potential number of clients (as well as the number of prostitutes) be equal to 1. The model below describes the behaviour of a representative agent.

Let:

S_c^0 = sex enjoyed without prostitution, "freely exchanged sex"

S_c = amount of prostitution bought

C_c = ordinary consumption

I_c = income beyond subsistence level

R_c = potential for reputation losses of the client when no prostitution is bought

w = price of prostitution

We assume that the total and exogenous income, I_c, is spent on ordinary consumption and prostitution. Freely exchanged sex is, by definition, free. We thus have that:

$$(1) \quad C_c = I_c - wS_c$$

Reputation is reduced from the potential level R_c when prostitution is bought in the market. We do not model the probability of being seen as a client, therefore we assume that when prostitution is bought it is also observed in the community. To make things simple we let the clients realisation for the potential reputation, denoted r_c, be given by equation (2).

$$(2) \quad r_c = R_c - S_c$$

A low R_c means that clients are vulnerable reputation-wise when buying prostitution. Therefore a high status individual (politicians, judges) has a low R_c because he is vulnerable reputation-wise. Even a small amount of prostitution bought (small S_c) can ruin his reputation potential.

A high R_c means that clients have little to lose reputation-wise i.e. they have a higher capacity for reputation losses. An individual with a low social status has a high R_c.

We will assume that the utility of the client depends on amount of prostitution bought, consumption of ordinary goods and reputation, that is

$$(3) \quad U_c = U_c(S_c, S_c^0, C_c, r_c)$$

From (3) we note that prostitution and freely exchanged sex may be substitutes from a client's point of view. This does not preclude the existence of people for whom these are two very distinct types of goods. We will assume that the agent is maximizing utility, given the budget constraint. In what follows, and to keep things simple, we will assume that the amount of freely exchanged sex, S_c^0, is given and thus is constant. First, we have to find the criteria for buying sex at all. Inserting from (1) and (2) in (3) and maximizing with respect to S_c yields the following condition for participating in the prostitution market:

$$(4) \quad [\frac{\frac{\partial U_c}{\partial S_c}}{\frac{\partial U_c}{\partial C_c}} \,|\, S_c = 0] \geq w + [\frac{\frac{\partial U_c}{\partial r_c}}{\frac{\partial U_c}{\partial C_c}} \,|\, S_c = 0]$$

Thus, the client will participate in the market for prostitution if his willingness to pay for one extra amount of prostitution exceeds the price of prostitution, plus the marginal costs of a worsened reputation for consuming it for the first time.

Given that (4) holds, then the first order condition for consuming prostitution is given by:

$$(5) \quad \frac{\frac{\partial U_c}{\partial S_c}}{\frac{\partial U_c}{\partial C_c}} = w + \frac{\frac{\partial U_c}{\partial r_c}}{\frac{\partial U_c}{\partial C_c}}$$

Eq. (5) states that at utility maximum the marginal willingness to pay for prostitution (in terms of consumption of ordinary goods) should be equal to the price of prostitution plus the marginal cost of a worsened reputation.

To obtain more specific results we will assume the following functional form of the utility function

$$(6) \quad U_c = \alpha_0(S_c^0) + \alpha_1 S_c + \alpha_{11} S_c^2 + \alpha_2 C_c + \alpha_3 r_c + \alpha_{33} r_c^2$$

Thus, we postulate utility as quadratic in consumption of prostitution and reputation and linear in consumption of ordinary goods. The functional relationship for how freely exchanged sex enters utility is not specified, but we note that from our specification freely exchanged sex and prostitution are not substitutes. To bring in this substitution is straightforward.

From (4), (5) and (6) we now get:

$$(7) \quad S_c > 0, \ \text{if} \ a_1 \geq w + (a_3 + a_{33}R_C)$$
where

$$(8) \quad \{a_1 = \frac{\alpha_1}{\alpha_2}; a_{11} = \frac{2\alpha_{11}}{\alpha_2}, a_3 = \frac{\alpha_3}{\alpha_2}, a_{33} = \frac{2\alpha_{33}}{\alpha_2}\}$$

Here a_1 and a_3 are both positive[6], and in order to have a quasi-concave utility function the following must hold

$$(9) \quad a_{11} + a_{33} < 0$$

With $a_{11} < 0$ the marginal utility of consuming prostitution is diminishing with consumption, given reputation. If $a_{33} < 0$, the marginal utility of a higher reputation capacity declines with the size of this capacity. Note however that it is not necessary for the quasi-concavity of the utility function that both these two parameters are negative, only the sum of them has to be negative.

Provided $a_{33} < 0$, we observe from (7) that the higher the reputation capacity is, the lower is the marginal cost from reputation effects of consuming prostitution, and the more likely it is that prostitution is consumed.

Given that S_c is positive, the demand for prostitution is given by:

$$(10) \quad a_1 + a_{11}S_c = w + a_3 + a_{33}r_c$$

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[6] Note that a_1 and a_3 could depend on observed as well as unobserved individual characteristics such that a high status individual may have a higher a_3 than a lower status individual.

From (10) we can derive the demand for prostitution as a function of the price of prostitution and reputation capacity. However, to describe the demand curve it is more convenient to consider the price w as a function of the amount of prostitution bought, S_c. We thus get:

$$(11) \quad w = a_1 - a_3 - a_{33}R_c + (a_{11} + a_{33})S_c$$

From (11), the demand for prostitution is a downward sloping function of price, provided that the utility function is strictly quasi-concave, that is $(a_{11}+a_{33})<0$.

The demand curve implies a higher willingness to pay for the first amount of prostitution the higher the reputation capacity is. Note that the more vulnerable a person is with respect to ruining his reputation the lower is R_c. Thus the demand curve of a person of high social status will be below that of a person with less social status. The demand curve is given in Figure 1."

[Figure 1 here]

3.2 The supply side.

Subscripts p denote variables related to prostitutes. The amount of prostitution sold reduces both leisure and reputation for prostitutes. To make things simple we measure reputation and leisure in the same units as prostitution sold. Let H_p denote hours available for work in prostitution above those worked elsewhere. So if H_p is high, prostitutes have few other options than selling prostitution; if it is low, prostitutes have many other options. Thus leisure, denoted L_p, equals $L_p = H_p - S_p$. Prostitutes derive utility from consumption of goods and services, C_p, which is financed by total income

$I_p + wS_p$. I_p is an exogenous income, while wS_p is the income from selling prostitution. Let R_p denote the reputation capacity of the prostitute. A high R_p means that prostitutes have little to lose reputation-wise when selling prostitution and a low R_p means the opposite.

The actual reputation is denoted $r_p = R_p - S_p$.

The utility is given by

$$(12) \quad U_p = U_p(L_p, C_p, r_p)$$

Again, we have to start with the condition for participating at all as a prostitute. Assuming that the agent is maximizing utility with respect to offering prostitution services, we get the following participation criteria:

$$(13) \quad S_p > 0 \text{ if } \left[\frac{\frac{\partial U_p}{\partial L_p}}{\frac{\partial U}{\partial C_p}} | S_{p=0} \right] \leq w - \left[\frac{\frac{\partial U_p}{\partial r_p}}{\frac{\partial U_p}{\partial C_p}} | S_p = 0 \right]$$

Thus, an individual will start to sell prostitution if the price for selling the first amount of prostitution, minus the costs of a worsened reputation for doing so, exceeds the shadow price of leisure evaluated at zero prostitution sold. Given that the individual participates as a seller, the optimal amount of prostitution sold is determined by the following condition (together with the hours and budget constraints):

$$(14) \quad \frac{\frac{\partial U_p}{\partial L_p}}{\frac{\partial U}{\partial C_p}} = w - \frac{\frac{\partial U_p}{\partial r_p}}{\frac{\partial U_p}{\partial C_p}}$$

Thus, at optimum the shadow price of leisure (the term to the right in (14)) equals the marginal net gain of supplying labour through the sale of prostitution. This

marginal net gain equals the price of prostitution obtained in the market minus the shadow price of reputation.

Again to proceed with more specific results we will assume that the utility function of the prostitute can be specified as

$$(15) \quad U_p = \beta_1(H_p - S_p) + \beta_{11}(H_p - S_p)^2 + \beta_2(I_p + wS_p) + \beta_3(R_p - S_p) + \beta_{33}(R_p - S_p)^2$$

Let

$$(16) \quad \{b_1 = \frac{\beta_1}{\beta_2}; b_{11} = \frac{2\beta_{11}}{\beta_2}; b_3 = \frac{\beta_3}{\beta_2}; b_{33} = \frac{2\beta_{33}}{\beta_2}\}$$

A necessary condition for the utility function to be quasi-concave is that $b_{11}+b_{33}<0$. Again a sufficient condition for this is to assume that both the marginal utility of leisure is diminishing in leisure enjoyed and the marginal utility of reputation is declining in the level reputation. Each of them will be negative. This will be assumed here.

We now have that :

$$(17) \quad S_p > 0, \text{ if } b_1 + b_{11}H_p \le w - (b_3 + b_{33}R_p)$$

We can see that:

- the higher the price of prostitution, the more likely it is that an individual will supply prostitution;

- the lower the availability of alternative working opportunities (i.e. the higher H_p), the more likely it is that the individual will take part in the prostitution industry($b_{11}<0$);

- the more it takes to ruin one's own reputation (the larger R_p) the more likely it is that prostitution will be sold ($b_{33}<0$).

Given that $S_p > 0$, then the optimal amount of prostitution can be derived from the following supply function:

$$(18) \quad w = b_1 + b_{11}H_p + b_3 + b_{33}R_p - (b_{11} + b_{33})S_p.$$

The supply curve is an upward sloping linear curve and it is given in Figure 2.

[Figure 2 here]

If the reputation capacity, R_p, increases, the supply curve is shifted downwards. This means that at a given price of prostitution, the prostitute is willing to supply more. Again, as in the case of clients, a higher value for R_p means that more prostitution can be sold without destroying ones' own reputation. The same type of shift will occur if Hp increases, which means that if a person has fewer other working possibilities than prostitution, they will be willing to offer more prostitution, given the price.

We will now turn to market equilibrium, when both clients and prostitutes participate in the market.

3.3 Market equilibrium

At market equilibrium the price of prostitution as seen from the demand side has to be equal to the price of prostitution as seen from the supply side. The amount of prostitution sold has to be the same, here denoted S*.

From (11) and (18) we then get

$$(19) \quad S^* = \frac{(a_1 - a_3 - a_{33}R_c) - (b_1 + b_{11}H_p + b_3 + b_{33}R_p)}{-(a_{11} + a_{33} + b_{11} + b_{33})}$$

Note that due to the quasi-concavity of the utility functions, the denominator in (19) is positive.

The equilibrium amount of prostitution sold and bought in the market S* is a function of the exogenous parameters, i.e. $S^* = f(R_c, R_p, H_p,)$

Table 1. Changes in S* and w from increases in$\{R_c, R_p, H_p\}$

Change in	R_c	R_p	H_p
S*	+	+	+
W	+	-	-

The table describes the impact of changes in the key parameters on the equilibrium price and quantity of prostitution.

Column 2 shows that more prostitution is sold at a higher price to clients with a high reputation capacity, i.e. less vulnerable clients, or clients who are able to cover to a great extent their consumption of prostitution.

Column 3 suggests that if it is difficult to have one's reputation ruined by being found out as a prostitute, then a lot of prostitution will be sold at a low price. This is consistent with the evidence of some temporary immigrant prostitutes in Europe who aim to work in prostitution only for a limited amount of time to accumulate savings and then return to their country (see Thorbeke and Pattanaik, 2002; Corso and Trifirò, 2003).

Column 4 states that the fewer the alternative earning opportunities (H_p high), the more prostitution is sold at a lower price.

The equilibrium wage w* follows from either (11) or (18). In Figure 3 we show the equilibrium and we note that there is a unique equilibrium.

 [Figure 3 here]

3.4 The market for prostitution when norms are endogenous

In the preceding sections we assumed that the reputation variables were exogenously given and considered only demand and supply for representative agents on both sides of the market. Here we will relax the first assumption. Because of this, we also have to consider demand, supply and equilibrium for the population as a whole. We will not, however, introduce any heterogeneity in the model, which of course has to be done in empirical specifications. To simplify exposition we let the total number of clients and prostitutes be the same and equal to N, and without loss of generality we set N=1.

We follow Akerlof's theory of social custom (Akerlof, 1980), which incorporates reputation in individual's preferences. In Akerlof's model, the fact that people may tend to generally believe or disregard any social code, and the existence of a range of social codes, together may imply that multiple equilibria exist, each corresponding to a different social code a degree of acceptance of it. In our context prostitution is stigmatised in different degrees in different societies, and changing social attitudes towards it can therefore be expected to produce different market equilibria.

The reputation function in Akerlof depends on the individual's obedience of the code and the proportion of the population who believe in that code. Similarly, in our model we assume that the larger the market for prostitution, the more it will take for a single agent to ruin his or her own reputation supplying or consuming prostitution services. We therefore assume that reputation depends on the number of clients and prostitutes, respectively. Thus the larger the proportion of the population that is engaged in prostitution, the less stigmatisation and therefore the higher reputation capacities, i.e.

that it takes more to ruin ones' reputation. In our representative agent framework we then have

(20) $R_c = NS_c = S_c$.

(21) $R_p = NS_p = S_p$.

When the agents make their choice, we do not assume that they take (20) and (21) into account. The impact of individual sexual behaviour on the norms in the society has the character of being externalities.

From (11) and (20) we now get

$$(22) \quad w = (a_1 - a_3) + a_{11} S_c$$

By comparing (11) and (22) we note that the linear demand curve for sex now has been twisted around. It starts lower on the w-axis[7] and the slope is lower.

From (18) and (21) we get:

$$(23) \quad w = b_1 + b_{11} H_p + b_3 - b_{11} S_p$$

Again, by comparing (18) and (23) we observe that the supply curve now starts higher up on the w-axis[8] and the slope is lower.

Let S** denote the equilibrium level of aggregate sex sold in the market. From (22) and (23) we get

$$(24) \quad S** = \frac{a_1 - a_3 - (b_1 + b_{11} H_p + b_3)}{-(a_{11} - a_{33} - b_{33})}$$

The equilibrium when reputation capacity is endogenous, together with the equilibrium when the capacities are treated as exogenous, is given in Figure 4. We

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[7] The demand curve starts at $w = a_1 - a_3$ which is below $a_1 - a_3 - a_{33} R$ because a_{33} is negative.
[8] The supply curve starts at $w = b_1 + b_{11} H_p + b_3$ which is higher than $b_1 + b_{11} H_p + b_3 + b_{33} R$ because b_{33} is negative.

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observe that with reputation capacities being endogenous and increasing in prostitution, the impact on the price of prostitution services as well as the amount of sex sold is ambiguous. Figure 4 illustrates some possible outcomes.

[Figure 4 here]

We can distinguish between four different equilibria:

1) The reputation capacities are exogenous. The interpretation is that that the actions of the agents are not able to change moral standards. They are absolute and given. In this case an amount of prostitution sold is S* and the price is w*. This equilibrium may serve as the benchmark case. (Point A in Fig. 4).

2) The clients' reputation capacity increases with how much sex is sold. Reputations of the prostitutes' are not affected by the amount of sex sold. More prostitution is sold and the price is higher than in the benchmark case. (Point B in Fig. 4).

3) The prostitutes' reputation capacity is affected by what the prostitutes do, but this is not the case for clients. Less prostitution is sold at a higher price compared to the benchmark case. (Point C in Fig. 4).

4) Both the clients' and the prostitutes' reputation capacities are affected by what these two parties do. Almost the same amount of prostitution is sold at a higher price as in the benchmark case. (Point D in Fig. 4).

5. Different markets and policies

The model allows simulating the effect of different policies for prostitution. For example policies that recognise prostitution as a job and reduce the stigma associated with it, will have the effect of increasing the marginal net gain of supplying prostitution, and increase the marginal willingness to pay for prostitution. This should, in a closed economy, have the effect of increasing the price of prostitution and, given the same

availability of alternative earning opportunities and if there are constant intermediation margins, also increase the quantity supplied. However, in an open economy there always is immigration of illegal workers and out-migration of clients (sex tourism), which would help keeping prices low.

Another example is that of policies that increase the stigma of being clients, which have been used in the case of street prostitution where the latter is illegal, in the expectation that this would reduce supply in this market. According to our framework, this reduces the marginal willingness to pay for prostitution and may reduce the quantity of prostitution sold as well as the equilibrium price. But clients may try to reduce the risk of being caught rather than reducing their demand.

A third example is given by policies that increase alternative earning opportunities for prostitutes. The effect of these policies will be felt on that part of prostitution which is supplied for lack of earning alternatives. Our model then implies that less prostitution is sold at a higher price.

Clearly the effect of policies greatly depends on the particular segment of the industry that is being addressed, and our model allows the description of up to 32 different markets within the prostitution industry, depending on clients' reputation and their concern for it, and prostitutes' employment alternatives, their reputation and their concern for it**.**

Taking the demand side first, recall that a high a_1 means that the client is less concerned about reputation and a low a_1 means the opposite. Moreover, a high R_c means that clients have little to lose reputation wise when having paid prostitution, and a low R_c the opposite. Then let $F_c (i,j)$ mean a combination of i=H,L and j=H,L, for example (a_1 high, R_c low). Then there are four combinations:

(27) $\{F_c(H,H), F_c(H,L), F_c(L,H), F_c(L,L)\}$

For example, $F_c(H,L)$, may be a careless judge, who has much to lose if caught purchasing prostitution.

Now consider the supply side. For prostitutes, recall that a high b_1 means a relative preference for more leisure and less concern for reputation, and a low b_1 the opposite. Also, a high R_p means that prostitutes have little to lose reputation wise when selling prostitution and a low R_p the opposite. Furthermore, a high H_p indicates that prostitutes have few other options than selling prostitution, and a low H_p indicates many other options than selling prostitution. Again, let F_p (k,r,s) mean a combination of $\{k,r,s\}=H,L$ for example (b_1 high, H_p low, R_p low), so that all together there are 8 different cases for prostitutes. For example a student who prefers leisure and who is not concerned about their reputation, but has a lot of other options other than selling prostitution, and little to lose reputation-wise by selling prostitution far from their environment will have $F_p(H,L,H)$.

Matching the cases generates 32 different possibilities, which can potentially describe 32 different markets, or particular cases. A careless judge purchasing prostitution services from a student would be the combination $F_c(H,L)$ and $F_p(H,L,H)$. The price of prostitution will be high and the amount sold will be little compared to the reference case of $F_c(H,H)$ and $F_p(L,H,H)$, which could describe average status clients not concerned about their reputation purchasing street prostitution, where street prostitutes typically have few other jobs available and do not enjoy very high social status. This standard market relative to the others will have the lowest price and the highest amount of prostitution sold.

6. Conclusions

The prostitution industry is fundamentally characterised by stigma and our model shows that it is possible to endogenise this key feature to describe demand and

supply conditions, and determine different market equilibria on the basis of which policy implications can be discussed. We have made no restrictive assumptions regarding gender, pay, and nature of forgone opportunities for the prostitute, and concentrating on income, reputation, and personal attitude variables we have determined price and quantities of equilibrium for different submarkets and more importantly produced a framework in which the effect of policy can be simulated. We believe our analysis sheds light on many issues that have so far remained formally unconnected in economic analysis, and given the present reviews of prostitution policies taking place across several countries, hopefully will attract more economists to produce work that can be usefully applied to policy formulation.

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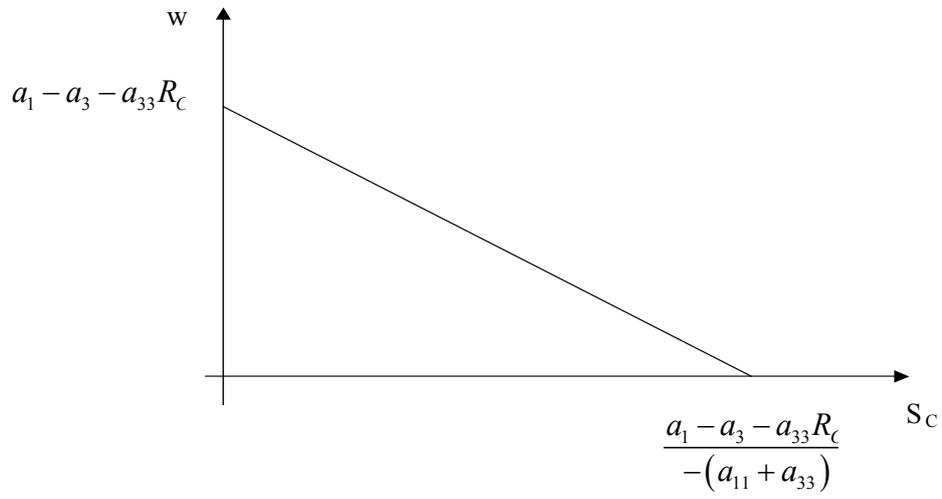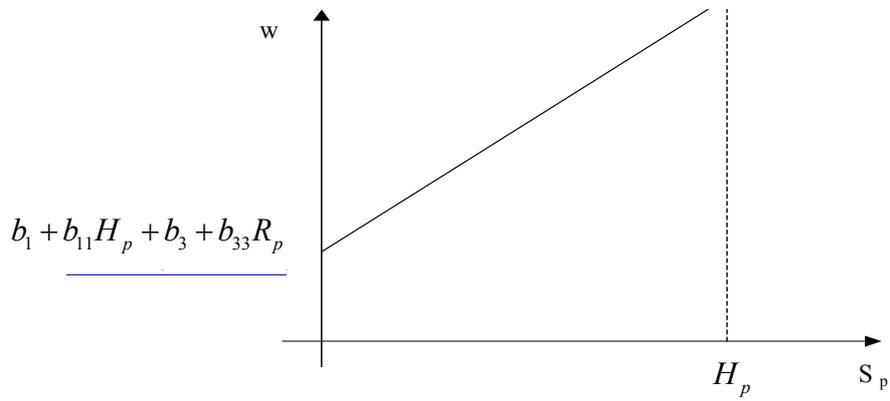
Figure 1: Demand

w

$a_1 - a_3 - a_{33}R_C$

$\dfrac{a_1 - a_3 - a_{33}R_C}{-(a_{11} + a_{33})}$

S_C

Figure 2: Supply

w

$b_1 + b_{11}H_p + b_3 + b_{33}R_p$

H_p

S_p

Figure 3: Equilibrium in the market for prostitution

$a_1 - a_3 - a_{33}R_C$

w^*

$b_1 + b_{11}H_p + b_{33}R_p$

S^* H_p $\dfrac{a_1 - a_3 - a_{33}R_C}{-(a_{11} + a_{33})}$ S
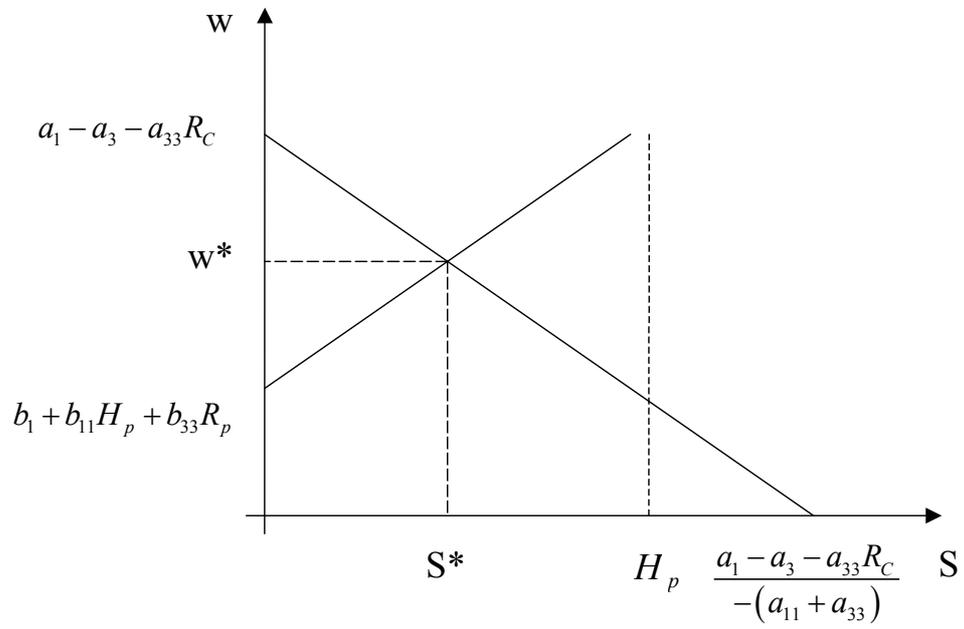
Figure 4: Market equilibrium when reputation capacity is exogenous, $\{w^*, S^*\}$, and when reputation capacity is endogenous, $\{w^{**}, S^{**}\}$