An Economic Theory for Rentboys

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Asymmetric information, where one party in a transaction has more accurate information than the other, generally leads to inefficient markets. Formal legal institutions, such as those that make contracts enforceable, reduce the two problems created by asymmetric information: adverse selection and moral hazard. Adverse selection is asymmetric information before a transaction occurs and is a problem when the market attracts more buyers/sellers that we would rather avoid than those we want to do business with. Moral hazard is asymmetric information after the transaction has taken place and happens when the absence of formal commitment causes one party to behave in a way that disadvantages the other. Both of these problems can result in market failure when an otherwise willing participant in a market decides not to partake for fear of negative repercussions.

In the U.S. alone, the market for male sex workers involves millions of transactions and generates revenues in excess of one billion U.S. dollars per year. Given the illegality of the market, and the non-enforceability of contracts, we would expect problems of adverse selection and moral hazard to be rife—leading, potentially, to market failure. As recent research shows, however, the online nature of the market, through male escort websites, serves as a proxy for legal institutions by creating a community in which "rentboys" can reliably signal their trustworthiness and clients can police themselves.* How can clients tell a rentboy is trustworthy? The old fashioned way—by looking at his face.

Clients who seek male sex workers in put themselves at considerable risk. The adverse selection problem could lead to a misrepresentation of either the worker's characteristics or of the services he is prepared to perform. The unenforceability of the contract could lead to severe abuse, including taking payment without providing services, theft or even violence. After the transaction has taken place, the client is exposed to blackmail and harassment, particularly if he has family relationships or a profession that would be put at risk if the client's behavior was exposed. If this is the case, male sex workers who can reliably signal their trustworthiness should be paid a premium on the market and in fact, this is the case.

Male sex workers signal that they are not misrepresenting themselves by including face pictures in online advertisements. The premium paid to a worker with a face picture compared to one with no face pictures, and perhaps only nude body shots, is 20%. At an average price of $200 per customer, this premium is approximate $40, so that a worker with face pictures who sees an average of 20 clients a month will earn $10,000 more per year than one without face pictures. The more pictures the better, in fact every additional face picture will increase the price the worker charges by an average of 1.7% per picture.

How do face pictures solve the adverse selection problem? When a client first meets a sex worker who has posted face pictures he can immediately tell if the worker has accurately represented himself. This gives the client the opportunity to reduce his losses since it would be obvious that worker is not honest. Also, workers who post pictures of their faces demonstrate they have less to hide and, by being publicly identifiable, make it less likely that they will violate the terms of the arrangement or prove to be a threat after-the-fact. In fact, workers who do not post pictures are effectively anonymous, making it easier to behave in a way that has negative consequences for his clients.

You might very well be thinking that the wage premium paid to workers who post pictures is really a return to their good looks and that good looking sex workers post pictures and less attractive ones do not. The authors test for this using a subjective rating scale on beauty (determined by a panel of homosexual men) and find that while more attractive sex workers get paid more, the premium to beauty is insignificant.

The argument that communities can deal with problems of asymmetric information without formal contract enforcement is not new and evidence goes back to the Maghribi traders of the 11th century who used reputation to solve the adverse selection problem of trading in an overseas markets.** What is new, is that a solution to this problem exists even when a community is widely dispersed and clients are unknown to each other. The implications of this evidence are important and go beyond understanding this specific market. International development agencies, like the World Bank, have long held that if the developing world wishes 'catch up' with the developed world they must first adopt formal legal institutions, including those that use the judicial system to enforce contracts. This line of research demonstrates that when those formal institutions are absent, even when the market is large, the adverse selection problem is solvable, particularly when clients can police themselves.

* Logan, Trevon and Maisha Shah (2009). "Face Value: Information and Signalling in an Illegal Market." NBER Working Paper 14841.

** Avner Greif (1989). "Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders." The Journal of Economic History, 49, pp 857-882.