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Guide to Preparing Manuscripts

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Criminology & Public Policy (Print ISSN #1538-6473/On-line ISSN #1745-9133) is published quarterly on behalf of the American Society of Criminology, 1314 Kinnear Road, Suite 212, Columbus, OH 43212 by Wiley Subscription Services, Inc., a Wiley Company, 111 River St., Hoboken, NJ 07030-5774.

Information for subscribers. *Criminology & Public Policy* is published in four issues per year. Institutional print and on-line subscription prices for 2010 are: US$263 (U.S.), US$329 (rest of world), €210 (Europe), £168 (U.K.). Prices are exclusive of tax. Asia-Pacific GST, Canadian GST, and European VAT will be applied at the appropriate rates. For more information on current tax rates, please visit www3.interscience.wiley.com/aboutus/journal_ordering_and_payment.html#Tax. The price includes on-line access to the current and all on-line back issues to January 1, 1997 (where available). For other pricing options, including access information and terms and conditions, please visit www.interscience.wiley.com/journal-info. A subscription to *Criminology & Public Policy* also includes 4 issues of *Criminology*.

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EDITORIAL INTRODUCTION

White-collar crime and the Great Recession

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The origins of this issue of *Criminology & Public Policy* go back some 3 years. In June 2007, an inquiry directed mistakenly to the outgoing editor inquired obliquely as to whether "there would be any value in devoting a bit more attention and space to issues of white-collar crime [WCC] and public policy?" He responded that "a nice piece on WCC would be terrific" and noted further that in his 7 years as editor "we did not get a single submission on it (to my memory)." The exiting editor acknowledged that whilst editors were free to do so, there had been no requests for submissions on white-collar crime during his tenure. He expressed belief, however, that his successor probably "would like the idea" of devoting space to problems of white-collar crime. Accordingly, the new editor was contacted immediately and in July 2008 communicated interest in going forward with a special issue of the journal devoted to "The Global Economy, Economic Crisis, and White-Collar Crime."

Subsequently, a call for submissions was disseminated widely, and personal invitations to submit papers were sent to some 40 leading scholars on four continents. Many responded and indicated they likely would be submitting papers although in the final accounting, surprisingly and disappointingly few did so; by the time the deadline for submissions arrived, a total of 19 papers had been submitted. Of these, 5 were deflected, 10 were rejected after receipt of 3–4 anonymous peer reviews of each, and the 4 remaining papers are included here. We solicited policy essays from scholars with expertise in problems of white-collar crime. As with the original call for submissions, some persons who were contacted did not respond to our request. Overall, the 20 authors whose papers and policy essays are included here are located at universities on three continents and include both internationally respected and promising investigators in the area of white-collar crime. Several have extensive first-hand experience, particularly with oversight agencies and practices, either as ethnographic investigators or as state employees charged with

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investigating and cleaning up past epidemics of white-collar crime (e.g., Calavita, Pontell, and Tillman, 1999; Black, 2005).

Organizing Theoretic Framework

Academic criminology is a cacophony of diverse or competing theoretical approaches to explaining and predicting variation in crime, and this is no less true of interpretations of white-collar crime. Everything from anomie theory to self-control theory has been offered as answers to one or more of its explanatory challenges. Whilst academicians quarrel over theories of criminality and control, legislators have largely embraced the notion that crime is *choice*. In doing so they are in tune with culturally dominant interpretations of all manner of untoward or misguided actions. Casual acquaintance with comments by members of the public and by students and observation of the media are striking for statements that actors made “bad choices,” “poor decisions,” “must learn to make better choices” or “must live with the consequences of unwise decisions.”

The four papers published here are topically diverse. Their authors, however, point to a core set of variables that play an important part causally in the crimes and illegalities they examine. We believe these variables can be organized usefully by employing the concepts and explanatory linkages of crime-as-choice theory, an interpretive approach that has dominated policy making on matters of street crime for more than three decades. An additional advantage of using it here is that interpretations of white-collar crime in which the causal importance of criminal opportunities is stressed are essentially choice theories (e.g., Benson and Simpson, 2009). Opportunities become crimes only because of decisions made by volitional actors.

Crime-as-choice theory is imbricated but not coextensive with *rational-choice theory*. It departs from the latter chiefly by not incorporating an assumption *a priori* that criminal choices are rational. We reject this premise, because we believe that to accept it is to imbue the criminal decision-making process with enormous excess meaning that inevitably distracts readers and distorts dialogue about it. Distortion principally takes the form of intractable disagreement over the meaning of “rational.” Our rejection of the rationality assumption is motivated also by belief that regardless of how rationality is defined there is intractable disagreement over the question of how closely criminal decision making approximates it.

As we see it, the overarching problem for examination in this issue of *Criminology & Public Policy* is explaining and proposing ways to prevent extreme economic, social, and institutionally destructive variation in the aggregate rate of corporate economic white-collar crime. In other words, we are not interested in the reasons why some individuals and organizations commit white-collar crime more often than others. Although this analytic distinction is not clear in all the papers, the diagnoses offered by their authors and the logic of crime-as-choice theory highlight the importance of five causal variables: (1) the size of the pool of tempted/criminally predisposed individuals and criminally predisposed organizations, (2) the supply of lure, (3) prevailing beliefs about the credibility of external oversight, (4) how extensively and effectively internal oversight and self-restraint are deployed, and (5) the supply of criminal opportunities.

It may be discomforting to acknowledge, but experience teaches that at any given time there are persons in the larger world that are either bent on breaking the law or are easily tempted to do so. Likewise some organizations are *predisposed* to transgress. They are distinguished by structural, cultural, or procedural characteristics that increase the odds that their personnel will recognize and exploit lure. Tempted individuals possess qualities or experiences that make them more likely than peers who lack these distinctions to weigh illicit exploitation of lure. The size of the pool of the predisposed and tempted waxes and wanes depending upon a variety of other conditions in their worlds. These include the size of the supply of lure, prevailing estimates of the credibility of external oversight, and how extensively effective mechanisms of internal oversight and self-restraint are deployed.

Lure is something that is alluring—something that is attractive and covetable. It entails arrangements or situations that turn the heads of those who are tempted or predisposed (Shover and Hochstetler, 2006). Like tinsel to a child, lure draws their attention and turns it simultaneously to the credibility of oversight. White-collar criminal lure has diverse sources. Some lure is part of the natural world; wide expanses of uninhabited countryside are tempting to citizens and organizations with trash or toxic materials to dispose of quickly and cheaply (Gibbs, McGarrell, and Axelrod, 2010, this issue). An enormous supply of lure is created by states in policies and programs that make it available in the form of tax incentives, subsidies, low-interest loans, and other forms of access to public funds. Lure is created also by entrepreneurs who invent and make others aware of new ways of operating on the world that can be manipulated easily for criminal purposes if they are so inclined. When the U.S. Securities and Exchange Commission (SEC) approved use of mark-to-market accounting schemes by Enron Corporation, it simultaneously increased the supply of lure available to Enron employees and executives and to those of other corporations (McClean and Elkind, 2003: 39–42). Credit default options and derivatives trading are two of many exotic financial instruments and practices devised by Wall Street investment banks in recent decades that facilitated criminal exploitation. The supply of lure has been expanded for citizens and organizations across the spectrum of wealth and respectability, but privileged citizens and large corporations have been prime beneficiaries (Shover and Hochstetler, 2006). They demand access to tax coffers, protection from market forces, and freedom to conduct their affairs unconcerned with external oversight.

The growth of lure has not been uniform internationally. Despite the label "global economic crisis," not all nations have been affected to the same degree. Some managed to avoid the worst excesses of the epidemic, and variation in state policies are one of the most important reasons. J. Braithwaite (2010, this issue) reminds us that Canada did not experience the problems that developed in the United States, largely because state officials did not permit creation of the kinds of lure that developed south of the border.

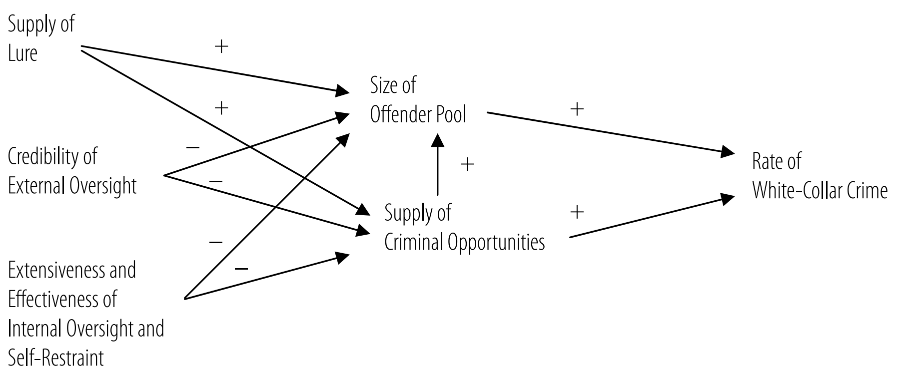
Temporal and spatial variation in the strength of prevailing estimates of the credibility of external oversight is an important reason why the pool of the tempted and predisposed may expand and contract. Where individuals and executives/managers of organizations believe that others and agencies charged with oversight of their conduct are vigilant, capable of detecting infractions, and likely to sanction any violators caught out, the pool contracts. Where oversight is seen generally as non-credible, the pool swells. There appears to be near unanimity that the weakening of external oversight of economic actors in the past 2–3 decades has been a major cause of the epidemic of white-collar crime some nations have witnessed. In the United States, the Great Recession was preceded by the Savings and Loan debacle of the 1980s (Black, 2005; Calavita, Pontell, and Tillman, 1999). Another reason for a rapid expansion of the pool of offenders is the casino-like air of exuberance and euphoria that took root and flourished in financial circles.

It is not only prevailing estimates of the credibility of external oversight that constrain the pool of offenders but also how extensively effective systems of internal oversight and self-restraint are employed. For individuals, this is conscience, regard for others, and volitional control of the appetites. For organizations, it is the inclusion in corporate governance documents of unambiguous statements about the priority of obeisance to law, the existence of compliance assurance programs, and unequivocal support for both from top leaders.

Criminal opportunity is lure in the absence of credible or effective oversight, whether external or internal. Put differently, a widely shared perception that credible oversight is lacking transforms the supply of lure into a tide of criminal opportunities. Criminal opportunities are arrangements or situations that offer potential for criminal reward with little apparent risk of detection or penalty. The importance of variation in the supply of criminal opportunities as a source of variation in the rate of white-collar crime is highlighted by most of the authors of papers included in this volume. The causal relationships between the variables/conditions behind variation in the aggregate rate of white-collar crime are depicted graphically in Figure 1.

FIGURE 1

A Choice Model of Variation in White-Collar Crime



Following the papers and policy essays, we will conclude with a section that sets out regulatory strategies consistent with crime-as-choice theory.

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Walls of secrecy and silence

The Madoff case and cartels in the construction industry

Henk van de Bunt
Erasmus School of Law Rotterdam

Research Summary
Most analysts of the causes of the contemporary credit crunch have concluded that the supervising agencies failed in their duties. The same is true for studies of several major fraud scandals, including the Madoff affair and the Dutch construction fraud. The remedy seems immediately obvious: more and better regulation and supervision. However, this line of reasoning seems somewhat simplistic by ignoring the question of how illegal activities can remain hidden for many years from supervising agencies, victims, and bystanders. This research article argues that the problem also lies in the successful concealment of illegal activities by the perpetrators and in the presence of silence in their social environment.

Policy Implications
The cases analyzed in this article suggest that financial misconduct also could be controlled by breaking the conspiracies of silence. The strengthening of supervision is unlikely to be effective without simultaneous efforts to encourage people to speak out and to give them incentives to want to know and to tell the truth.

Keywords
Madoff, Ponzi fraud, secrecy, silence, corporate crime, cartel crimes

The author would like to thank Nicholas Dorn for his useful comments. Direct correspondence to Henk van de Bunt, Erasmus School of Law, Erasmus Universiteit Rotterdam, Postbus 1738, 3000 DR Rotterdam (e-mail: vandebunt@frg.eur.nl).

> Bernie stole our trust. Most of us were honest, hardworking people with families. We thought we were living the American Dream and felt privileged to work for such a brilliant, wonderful, generous man who was doing such good and charitable things. Now we feel like fools.
>
> (Squillari, 2009: 22).[1]

This article explores how major frauds—such as the Madoff Ponzi scheme and the massive bid-rigging within the Dutch construction industry—can remain hidden from supervising agencies, victims, and bystanders. It is argued that the problem extends beyond failing supervision to the successful concealment of illegal activities by the perpetrators and the silence maintained within their social environments. Strengthening of supervision alone is unlikely to be effective in controlling large-scale fraud without simultaneously encouraging people to speak out and giving them incentives to want to know and tell the truth.

The Problem and the Cases

On December 11, 2008, the Securities and Exchange Commission (SEC) charged Bernie Madoff with securities fraud. According to the SEC's complaint, Madoff had admitted that the investment advisory business of his firm, Bernard Madoff Investment Securities (BMIS), was "just one big lie" and "basically, a giant Ponzi scheme."[2] For years, he had been paying returns to investors from their own money or from that of subsequent investors rather than from any actual profit earned. Madoff's swindle went undetected for nearly two decades. His house of cards collapsed when too many investors —needing cash because of the general U.S. financial crisis in late 2008—tried to redeem their funds. Madoff could not meet these demands, and the scam was exposed.

The scale of the Madoff securities fraud (up to $50 billion) exceeds that of any previous financial scandal—but it is not just its size that makes this case so fascinating. What is remarkable is that, for many years, silence surrounded Madoff's actions. Neither the SEC nor his investors became suspicious or asked critical questions.[3] With hindsight, we can say that almost everyone ignored the red flags raised throughout the years by numerous experts.[4] In this respect, the Madoff case resembles other notorious fraud cases, such as the Enron affair,

1. Eleanor Squillari was Bernie Madoff's secretary for 20 years.
2. See the complaint by the SEC against Madoff to the U.S. District Court, Southern District of New York, 2009.
3. In 2009, the Senate conducted several hearings on the Madoff affair to look at how the Madoff fraud escaped detection for so long. These hearings were held by the U.S. Senate Committee on Banking, Housing, and Urban Affairs.
4. Madoff's most persistent critic was Harry Markopolos, who voiced his suspicions that Madoff was running a Ponzi scheme as early as 1999. In 2005, he wrote a letter to the SEC in which he documented his concerns and raised 29 red flags concerning the operations of Madoff's investment advisory division (Markopolos, 2005). In 2007, the SEC looked into Madoff's activities, but the agency did not refer the matter to commissioners for legal action.

Parmalat, and Ahold. Reflecting on these cases, it is difficult to imagine how these corporate malpractices went undetected so long.

This contribution uses the Madoff case and a large-scale Dutch case known as the construction fraud to examine the background of such secrecy and silence.[5,6] The Dutch construction fraud consisted of extensive cartel arrangements among several companies involved in, among other things, the construction of buildings, roads, and bridges.[7] Despite a tightening of the ban on cartel agreements in 1998, the construction firms engaged in secret price and market agreements preceding government tenders. In practice, no real competition took place among the firms because they all would agree in advance on who was to submit the lowest bid and thereby obtain the contract. In this way, they divided the work among themselves. The mutual agreements were recorded meticulously in so-called shadow accounts. When during the secret talks company A granted a project to B, B would become indebted to A and would then allow A to submit the lowest bid during the next round of consultations on public tenders.

In 1999, Ad Bos—a former director of a construction firm—tried in vain to alert the public prosecutor's office to these illegal activities. Only after he appeared in the media with concrete evidence, however, was the Dutch Parliament stirred into action. In 2002, the scale of the cartel's practices finally was revealed by a parliamentary inquiry. The inquiry committee estimated that the cartel arrangements had resulted in unjustified price increases of approximately 8.8% per project. The committee did not hazard an estimate of the total damage caused by the sustained and massive cartel practices, but it expressed shock and amazement at the "underground system" of arrangements that apparently had dominated the construction industry for so many years. "Where was the government all those years? Where were the monitoring and supervisory agencies, such as accountancy firms?" (van de Bunt, 2008: 131).

What this case has in common with the Madoff fraud, despite the obvious differences, is that the perpetrators were "trusted criminals" (Friedrichs, 2010) who could carry out illegal activities throughout an extended period of time, thereby causing massive financial damage.

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5. The information about the Madoff fraud is derived from public sources, chief among which are the complaints and the court proceedings against five suspects apprehended to date, (i.e., Bernard Madoff, his right-hand man Frank DiPascali, his accountant David Friehling, and two computer programmers, Jerome O'Hara and George Perez) (U.S. Attorney, Southern District of New York, 2009; U.S. Department of Justice, 2009a, 2009b; SEC, 2009). In addition, I have made use of documents published by the U.S. Senate Committee on Banking, Housing, and Urban Affairs (2009a, 2009b, 2009c). These documents contain the testimonies of, among others, Harry Markopolos, John C. Coffee, Robert Khuzami, and John Walsh (U.S. Securities and Exchange Commission, Office of Investigations, 2009). For the benefit of the Senate Committee, an extensive report on the role of the SEC in the Madoff case was prepared by the SEC's Office of Inspector General. The public version of this Office of Inspector General (OIG) report, titled "Investigation of failure of the SEC to uncover Bernard Madoff's Ponzi scheme," was published on August 31, 2009.

6. The data on the Dutch construction fraud were drawn from public reports by the Dutch parliamentary inquiry committee into price-fixing agreements in the construction industry. These reports contain detailed descriptions of the cartels' modus operandi, which include verbatim transcripts of 67 public hearings featuring testimony from building contractors, civil servants, and experts. Public reports of the National Anti Trust Authority (NMa) about construction firms ordered to pay administrative fines also were studied.

7. See van de Bunt (2008) and van den Heuvel (2005).

Hundreds of companies were involved as perpetrators in the construction fraud, and for this reason alone, one would not expect their actions to remain a secret for long. Madoff's organization, however, was surprisingly small, and it seems that only a handful of people really knew that BMIS's success was a big lie.[8] What is remarkable in Madoff's case is that so many investors, intermediaries, probably his associates, and his next of kin, were unaware of the fraud.

In the social response to catastrophes and malpractices, supervising agencies are invariably blamed for having failed in their duties.[9] The remedy to failed supervision from this perspective seems immediately obvious: What is needed is more and better regulation and supervision. This is exactly what happened with the Dutch construction fraud, and what is happening now with the Madoff case.[10] In the following sections this study argues that the problem lies not just in failing supervision but also in the successful concealment of illegal activities by the perpetrators and the presence of silence in the social environment. The perpetrators necessarily maintained secrecy—and this issue certainly played a major part in the perpetuation of their big lies—but the silence of the victims, bystanders, and relevant control agencies also contributed significantly to the longevity of the frauds.

Maintaining Secrecy through Isolation and Concealment

Secret Societies

The effectiveness of secrecy seems, on the surface, to be strongly dependent on the extent to which perpetrators can shield their activities from the world outside: The greater the isolation, the greater the chance that secrets will be kept. Terms such as "closed worlds," "underground movements," "cults," and "terrorist cells" often are used. The German sociologist, Georg Simmel, termed such associations "secret societies," by which he meant groups that protect their activities by maintaining secrecy (Simmel and Wolff, 1950: 345). This "protective function of secrecy" is important when the activities, ideas, or values of the group are not tolerated by the outside world. Secrecy is achieved by selectively providing information, which implies that the external environment is being kept uninformed as to the true nature of the group's activities. According to Simmel, it is essential that all secret society members can trust each other not to betray the secrets of the group to any nonmember. The risk of treason or careless talk always is present, which can endanger the continued existence of the group. Secrets cannot be guarded permanently, and when two people share a secret, it is no longer a secret. Simmel suggested that groups sharing a secret always have the same characteristics because the organization of the relationships between the members is determined by the need for secrecy and mutual trust. A

8. From Madoff's inner circle, only his accountant, his right-hand man, and two computer programmers have been indicted for involvement in the fraud.

9. The same is true of most analyses of the credit crunch (see, inter alia, Dorn, 2009).

10. The High-Level Group explicitly refers to the Madoff case. It states that this case illustrates the importance of better controlling the quality of processes and functions when it comes to funds, funds of funds, and delegation of responsibilities (2009: 26). The Senate hearings focus on the SEC's failing supervision in exactly the same way.

clear hierarchy exists, intent on gaining complete control over the members of the group. Total surrender and dedication are expected to ensure that no one is tempted to betray his fellow members. New members are required to undergo initiation rites to mark the moment of their admittance. According to Simmel, secrecy can be maintained effectively as a result of these organizational features.

Madoff's Secret Society

To mislead his clients, Madoff assured them that their money was being invested profitably. He had a reputation for delivering stable returns, but in reality, he never invested a dollar and the "profits" from his investments were reconstructed (after the fact) on the basis of actual developments on the stock exchange. Every month his investors were sent statements documenting transactions and investment returns. The paperwork seemed real, but it was not.[1111] Obviously, Madoff could not produce and mail the millions of pages of text and figures sent out annually all by himself, so he had no choice but to share his big secret with several others. His organization corresponded in several ways to the characteristics of secret societies. First, he ensured that his people were screened off from the other employees of BMIS.[12] Their office was on a separate floor, accessible only to the people who worked there. His team consisted of several persons who had joined the firm at a relatively young age, were well paid, and who enjoyed certain privileges within BMIS (Arvedlund, 2009: 180).[13] Madoff had bought their dedication, and he ensured that no one had an interest in giving away the big secret.[14] The flow of information to the world outside was controlled carefully. It was only Madoff and his right-hand man, DiPascali, who would explain the firm's investment strategy when asked to do so by investors. For a long time, Madoff was successful in keeping the SEC at arm's length. He avoided registration and the SEC's subsequent disclosure rules by claiming that he was a broker/dealer and not an investment advisor. It was not until 2007 that Madoff was required to register as an investment advisor, which meant that he would have to comply with more stringent demands for accountability. In other words, Madoff effectively concealed his big lie, and in this sense, his fraudulent operation could be characterized a secret society. With the aid of his secret division, he could convince investors and supervising agencies that real investments were being made, and he had made sure that his assistants had no motivation to blow

11. See, particularly, Frank DiPascali's guilty plea.
12. BMIS consisted of three separately operating departments that engaged in proprietary trading, market making, and the investment advisory business. Madoff himself was involved mainly in the investment advisory business, where the fraud was committed. To all appearances, the other two departments operated legally and successfully. The investment advisory division made use of a stand-alone IBM computer not hooked up to the BMIS computer network.
13. DiPascali, Madoff's right-hand man, was paid approximately $2 million a year, even though he left high school without a diploma (U.S. Attorney, Southern District of New York 2009).
14. This achievement is illustrated by an incident involving two computer programmers who told Madoff in 2005 that they were "no longer willing to lie for him." They were offered a one-time bonus of $60,000 and a 25% salary increase, and they chose to remain silent (U.S. Department of Justice, 2009a).

the whistle. Although his assistants were not made to undergo any initiation rites or swear an oath of "omerta," Madoff's investment advisory division displayed many of the characteristics of Simmel's secret society.

Secret Activities without Secret Societies

The case of the Dutch construction fraud was different. Throughout a period of many years, hundreds of construction companies (i.e., thousands of individuals) were involved in illegal price fixing and bid rigging. They concealed these practices by meeting secretly in locations such as hotel lobbies and motorway restaurants, and by leaving their mutual arrangements out of the accounting books. In detail, the agreements were recorded in pocketbooks and notebooks hidden in cars, wine cellars, and even one participant's chicken coop, as revealed by the parliamentary inquiry committee. Despite such efforts to conceal their actions, the cooperative arrangement between the building companies does not conform to the concept of secret societies. In other words, the characteristics of secret societies mentioned by Simmel are not applicable to the open construction world of the Netherlands. The Dutch relationships had no specific organization between the enterprises designed to protect their illegal activities. Rather, the parliamentary inquiry revealed that it was fairly easy for companies to join the secret preliminary talks (Parlementaire Enquête Commissie Bouwnijverheid, 2003).

Silence

In both cases, the perpetrators were successful at concealing their illegal activities, but this feat does not explain how they could fool so many people for so long. Doubts certainly were warranted in the Madoff case, regardless of his efforts to hide his fraudulent operation from the world. Stephan Greenspan, professor of psychiatry and author of *Annals of Gullibility* (2008: 6)—who lost a good deal of his retirement savings to Madoff—recently wrote: "The real mystery in the Madoff story is not how naïve individual investors such as myself would think the investment safe, but how the risks and warning signs could have been ignored by so many financially knowledgeable people."[15] Recent publications about Madoff mention the many "red flags" that should have given rise to suspicion and critical questions but were ignored by almost everyone—laymen and experts alike (Gregoriou and Lhabitant, 2008; Hirsch, 2009; Markopolos, 2005; Vinod, 2009). With hindsight, we can conclude that Madoff's concealment was far from perfect and that at least a large part of the "mystery" surrounding the longevity of his fraud lies in the uncritical attitude adopted by the thousands of victims and experts involved—not to mention the supervising agencies.

The case of the construction fraud evokes the same sense of amazement. In addition to the thousands of perpetrators, thousands of civil servants were involved in the government tenders. They all were apparently unaware of the fact that almost all tenders had become a farce as a

15. In this book, Greenspan proposed a "multidimensional" theory to explain why so many people behave in a manner that exposes them to severe and predictable risks.

result of the construction firms' arrangements. The competition watchdog, the Netherlands Competition Authority (NMa), was similarly oblivious to the enormous scale of the cartel agreements. Again, several individuals and agencies must have known about this massive fraud, but they all remained silent (Vulperhorst, 2005).

Facilitative Social Contexts

Simmel's notion of the "secret society" focuses on particular characteristics of illegal cooperatives as most likely to determine success in maintaining secrecy. It is, however, important to remember that secret societies never exist in isolation. Their members usually participate fully in other social groups and networks, and it is this social embeddedness that increases the chances of maintaining secrecy. This applies to Madoff's organization and to the Dutch construction companies. Secrets do not remain hidden because the people involved isolate themselves from the world, but rather because the actors and their illicit activities are socially embedded. It is precisely when perpetrators participate as "normal" people in their social environment that they are less likely to be regarded with distrust. Indeed, when their general demeanor inspires trust, they can rise above all suspicion. Secrets can remain hidden—not just because of the secrecy maintained by the offenders—but also as a result of the silence maintained within their social environments.

Respected Perpetrators Are above Suspicion

In almost every article and piece of commentary on the Madoff case, his impeccable reputation is mentioned (e.g., Clauss, Roncalli, and Weisang, 2009). Madoff definitely was above suspicion. He had played a leading role in the development of the NASDAQ stock market—even served as its chairman—had moved in high social circles in New York, and was known as a prominent Jewish philanthropist. It was a well-known fact that many of his intimate friends and respectable charities were among his customers. These circumstances in themselves contributed to the idea that Madoff was a reliable fellow. Speaking from experience, Stephen Greenspan noted: "[It] was seen as highly unlikely that such a person would be scamming fellow Jews which included many prominent Jewish charities" (Greenspan, 2008: 4). Madoff's credentials were so impeccable that anyone accusing him of fraud would be dismissed as jealous competitor, foolish crackpot, anti-Semite, or worse (Vinod, 2009).

Madoff's social environment (i.e., his investors) was his best advertisement. Throughout a period of many years, his investors were rewarded—thanks to the Ponzi scheme—with annual returns between 10% and 14% (sometimes more, sometimes less, but never below 6%). This pattern was all public knowledge, and it helped to instill confidence in Madoff's abilities (Hirsch, 2009). Moreover, when so many leading members of society believed in and seemed to profit from Madoff's investment skills, how could such an investment possibly be risky or dangerous? In other words, Madoff's strength lay not only in his ability to shield himself and his illegal activities from prying eyes, but also in the way he managed to gain people's trust by actively participating in his social environment.

Probably without Madoff being aware of it, he could take advantage of the theory of cognitive dissonance (Festinger, 1957), which states that people have a strong tendency to avoid inconsistencies in their cognitions (i.e., knowledge, attitudes, emotions, etc.) and behavior. Opposing cognitions result in cognitive dissonance, and this dissonance creates an uncomfortable feeling. People generally are inclined to reconcile their cognitions and their actions. Someone who has invested their life savings with Madoff will be particularly susceptible to opinions and facts that seem to support the idea of Madoff's integrity and reliability. Knowing that Madoff donated generously to charity, and that celebrities trusted him with their money, reinforced the conviction that it was a good idea to invest with Madoff. This behavior is why many investors believed unquestioningly in Madoff's summary explanation of an investment strategy that made the impossible possible (i.e., stable and relatively high returns, even in turbulent times).[16] In such an environment, dissident opinions, such as the criticism voiced by Markopolos, tend to fall on deaf ears.[17]

When they first heard of the scandal, most people found it impossible to believe that a man of Madoff's impeccable reputation could be involved in such a massive and unscrupulous fraud. The same kind of disbelief was expressed in regard to the managers of the construction firms in the Netherlands. Most politicians and civil servants simply could not believe that all those reputable firms—capable of realizing the most prestigious construction projects—secretly had been involved in price fixing and bid rigging. The few who were brave enough to rise above the collective imagination and express themselves in the public forum were met with resistance and skepticism. This response was particularly true of the whistleblower, Ad Bos (a former board member of a large construction firm) who was the first to speak out. After his dismissal from the company, he presented the public prosecutor with concrete evidence of illegal price- and market-fixing agreements in which he had been involved. So strong was the belief in the innocence of the respectable captains of the construction industry that even the public prosecutors thought it safe to ignore these allegations (van den Heuvel, 2005).

Similarly in the Madoff case, the supervising agencies seemed to be influenced by the reputation of a well-respected actor. An in-depth analysis of the SEC's handling of the Madoff case revealed that Madoff's prominent position "made it less likely for the SEC investigators to believe that he could be running a Ponzi scheme" (SEC, Office of Investigations, 2009: 389). Madoff himself also has been clear on the impact of his reputation on the SEC investigators.[18] According to his testimony, the SEC never investigated the possibility that he was operating a Ponzi scheme "primarily because of the reputation I had" (U.S. Senate Committee on Banking, Housing, and Urban Affairs (2009c: 11).

16. Madoff simply claimed that he could deliver stable returns by actively trading a specific portfolio of stocks and options. He called this investment the "split strike strategy." This story was bogus, and the fact that got away with it provides more evidence of the power of cognitive dissonance.

17. See footnote 4.

18. See Arvedlund (2009: 39) for a detailed description of the SEC's admiration for Madoff.

Absence of Interest in Disclosing the Truth

It is not just a matter of inability, but also of *unwillingness*, to hear or disclose an inconvenient truth. In his book, *States of Denial*, Stanley Cohen (2001) analyzed the denial behavior of perpetrators and bystanders. Why is it, he asks, that bystanders usually remain silent about the abuses and atrocities happening nearby? He mentioned the examples of adults hearing their neighbors beat their children, neighbors living opposite the concentration camp of Mauthausen, and white South-Africans in the days of apartheid. Why did they remain silent about what they saw, heard, or smelled?

Cohen (2001) explained that some people really did not know what was going on and, therefore, justifiably could claim to have seen nothing. Then, a second category consists of people who were aware of the situation but flatly deny that they knew anything about it (i.e., they are lying). In most cases, however, by-standers are aware of what is going on, but they are not lying when they deny or keep silent about the abuses. Thus, there is a third possibility of denial, situated in the twilight zone between knowing and not knowing. It is the attitude of aloofness—of looking away—which is characteristic of people who find themselves—against their will—confronted by uncomfortable situations or abuses they simply do not want to face. Everett Hughes (1964: 29) called this mindset the "absence of a determined and heroic will to know and to publish the truth."

Sometimes the search for truth is inconvenient because it is so much more attractive to continue to believe in a false impression of the real state of affairs. Aloofness is the attitude of people who have an interest in perpetuating a certain construction of reality. In his analysis of the Enron scandal, David Friedrichs (2004) showed that all sorts of people were willing to be taken in by the Enron management as long as there was money to be made. This was true not only of the well-paid internal and external accountants, but also of everyone else in a position to raise critical questions. "Even investors and employees were not strongly inclined to challenge the actions of the corporate leadership as long as they seemed to be reaping high rates of return on their investments" (p. 119).

They did not *want* to know, and they justified this ignorance by pointing out that they *could* not know. A major concern to people in such a position is their ability to "manage" their "ignorance"; they must have a "story" ready to explain their ignorance in case the malpractices are disclosed. Secrets can be kept as long as people think they can mount a defense when the secret gets out. According to Jack Katz (1979), this type of reasoning is used as an excuse by people who want others to believe that they were ignorant and, therefore, innocent. To support a claim of ignorance and to avoid guilty knowledge, it is best not to know too much. Lawyers often walk a thin line between legitimate protection of client interests and fabrication or obstruction of justice by not wanting to know harmful information about their clients. They simply have no interest in knowing too much because this knowledge could affect the quality of their defense work and damage their reputations. Various techniques (e.g., avoidance or admonishment) are used to discourage a client from disclosing damaging information (Mann, 1985). Within an organization where constant interaction occurs between managers and operatives, the need for information control results in a tacit understanding between the parties involved: "Both superordinates and subordinates have common interests in limiting the knowledge each obtains about the other . . . unspoken arrangements of concerted ignorance are essential to widespread organizational deviance" (Katz, 1979: 297).

This behavior can lead to a form of "institutional schizophrenia." In reality, everyone is aware of the public secret, but some know about it, whereas others are "officially" kept in the dark. Because management does not want to be legally accountable and needs to be able to claim ignorance, management's message is conveyed subtly to the employees: "Corporate cultures often incorporate expectations from the boss to 'get it done, but don't tell me how you do it'. Concerted ignorance happens at all levels of complex organizations" (Braithwaite, 1989: 146).[19] In essence, these plots are conspiracies of silence. The key to a successful conspiracy of silence is that no one has an interest in asking what is going on, and the perpetrators have no interest in telling them. This scheme usually involves an unspoken agreement to remain silent. In this "twilight zone between knowing and not knowing" (Cohen, 2001), we can distinguish between two forms of silence: inaction in the face of knowing and ignorance.

Inaction in the Face of Knowing

Inaction in the face of knowing means that people know something is wrong, but they take no action. This concept is about *open* secrets; many are aware of the true state of affairs, but nobody has an interest in breaking the silence. The great conspiracy of silence in the Dutch construction industry can be attributed to the interests the perpetrators shared with each other and with other concerned parties. All the companies involved had an interest in perpetuating the cartel's crimes and, therefore, in preserving silence about its activities.[20] The elimination of competition meant the avoidance of uncertainty, the formalization and predictability of outcome, and the minimization of risks (Geis, 2002: 129). The shadow accounts enabled a system in which a contractor could grant a job to someone else, secure in the knowledge that he would get something in return at a later date. This regime of generalized reciprocity and fair turn-taking allowed the companies to secure a contract put out to tender at a time convenient to them (van de Bunt, 2008). According to Lenny Vulperhorst (2005), all the parties involved (including the principals) remained silent for so long because the system of illegal price and market fixing did not lead to exorbitant quotations. On the contrary, many projects were completed within the budgets estimated by the principals. However, this common interest

19. Within the corporations studied by Braithwaite (1989), middle management had erected a wall between upper-level management and the practices on the shop floor; they authorized violations of the rules without informing upper-level management. In case a serious legal problem would occur, some corporations even had a "scapegoat" in place on the board of directors—the so-called "vice-presidents responsible for going to jail" (p. 146).

20. Grat van den Heuvel (2005) argued that the relationship between the supervisors and principals, on the one hand, and the construction companies, on the other hand, was based on a "tacit understanding." As opposed to corruption, such an understanding involves no kickbacks to influence decisions, but somehow everyone is "on the same page."

gradually was undermined when, by the end of the 1990s, prices increased and the interests of the construction companies and the commissioners of the projects began to diverge. It was then that the first cracks began to appear in the wall of silence and that, finally, the someone blew the whistle on the cartel's practices.

Concerted Ignorance

The term *ignorance* applies to a situation in which victims, bystanders, or regulatory agencies "do not know" that something is wrong. Had they been aware of misconduct, they would have taken action to protect their own interests. This was the case for Madoff. The social response to Madoff's actions was characterized by "an absence of a determined and heroic will to know and to publish the truth." As long as the social environment benefited from the continuation of an existing situation, no one was inclined to ask difficult questions.[21] Investors "allowed greed to overrule advice and continued to flow in good faith, trusting only what they saw, i.e. the returns" (Gregoriou and Lhabitant, 2008: 15).[22] Some investors suspected that Madoff earned his profits through trickery and deceit, but they made no further inquiries because they saw themselves as the beneficiaries of his actions (Arvedlund, 2009). Robert Chew (2008)—who invested $1.2 million with Madoff and lost everything in the collapse of his Ponzi scheme—expressed this nagging feeling: "We all hoped, but we knew deep down it was too good to be true." Many could justify their ignorance by pointing to the fact that BMIS was audited by an accounting firm. Only a few of them wanted to know that this firm was small, consisting of a secretary and one active accountant.[23] Investors also could "manage" their ignorance by pointing to the fact that the SEC had given Madoff a "clean bill of health" in 2007 (Chew, 2008).

Nonetheless, the SEC was as ignorant about Madoff's long-running fraud as his investors were. The previously mentioned OIG report identified numerous organizational shortcomings that explain the SEC's failure in the Madoff case,[24] but it also indicated a failure to follow up on leads. No evidence exists of corruption or collusion to cover up wrongdoing, so we can conclude only that the SEC appeared unaware of Madoff's fraud. The SEC investigators might have been captured by Madoff's charisma; even when they caught him contradicting himself, his subsequent explanations were accepted at face value. Because the agency's investigators were perfectly willing to accept Madoff's version of the truth, the available evidence suggests that the SEC made little attempt to substantiate Madoff's legitimacy.

21. They had a material disincentive to raise doubts. Besides, Madoff had a habit of dealing summarily with institutions or individuals asking awkward questions; they were simply shown the door.
22. With all the attention focused on the victims, it is easy to forget that many investors made a lot of money thanks to Madoff. Throughout the years, the $50 billion now "missing" were paid out as fictional earnings to investors, minus the many millions Madoff paid out to himself and his associates.
23. Although accredited by the SEC, the firm was virtually unknown in the investment industry.
24. The OIG report traced the SEC's failure to shortcomings in several areas, including expertise, training, experience and supervision by management, inadequate internal communication and coordination among and within SEC divisions, and insufficient resources.

Fear of the Consequences of Disclosure

A difference exists between having an interest in the continuation of illicit activities and in having an interest in maintaining a secret. This difference is most apparent in the case of incest victims—many of whom actively are involved in denying and covering up the acts that have caused their suffering. They are ashamed of what has happened, and they fear the negative consequences of disclosure for the family, including the father. They feel guilty when their confessions cause a great deal of misery to everyone around them (Drayer, 1988; La Fontaine, 1990; Russell, 1986).[25]

Within corporations, branches of industry, and professional associations, the same mechanisms can be at work. Wrongdoing is covered up because disclosure might have a negative impact on the broader organization. For example, the Catholic Church hierarchies were well aware—for more than 30 years—that a disturbing number of their priests were sexually abusing young boys. When confronted with reports of this fact, the consistent response of the church had been to deny the crime, silence the victim, and defend the perpetrator, who simply was moved to another diocese (Hallsworth and Young, 2008).[26] Even supervisory agencies can be afraid of disclosures of misconduct, especially when the misconduct occurs openly in their jurisdictions, because revealing the facts would amount to an admission of incompetence. The threat of opposition also can lead to inaction. The question then becomes whether these agencies are able and willing to stand up to (corporate) power.[27] Fear of "reputational damage" can persuade even parties uninvolved in any wrongdoing to cooperate in a cover-up. Whistleblowers are reviled not only by the individuals and organizations they accuse, but also by third parties uninvolved in the objectionable practices.

The Madoff case and the construction fraud are far removed from the intensity of shame associated with incest or child abuse. Before Madoff's sentencing, several victims told the court about their personal suffering, and they did so without reticence. The victims of the construction fraud (i.e., the public authorities who paid too much for roads, bridges, and offices) likewise were prepared to display their distress. This behavior does not detract from the fact that, in both fraud cases, fear was involved and resulted in a postponement of the disclosure of the

25. It is not unusual for victims to carry the burden of their secret for many years, until someone asks them direct questions. Finkelhor et al. (1990) and Drayer (1988) observed that many respondents approached via a telephone survey never before had spoken about what happened to them. According to Drayer, this was true for 25% of the respondents discussing sexual abuse (1988: 42).

26. On November 26, 2009, the Irish Commission of Investigation into the Catholic Archdiocese of Dublin published a report on the handling by Church and State authorities of allegations and suspicions of child abuse against clerics of the Catholic Archdiocese of Dublin. In a damning report, the commission concluded that the Church stood by in silence, only was interested in the avoidance of scandal, and showed no concern for the welfare of the abused children (Commission of Investigation into Catholic Archdiocese of Dublin, 2009).

27. Christine Parker (2006) examined the ups and downs of a supervisory agency (the Australian Competition and Consumer Commission) trying to initiate action against companies in violation of the Australian cartel laws. The companies under scrutiny could mobilize political and societal support, and the agency was forced to climb down, which led to the resignation of its chairman. Experiences such as these undoubtedly will have a negative impact on the willingness of similar agencies to expose corporate malpractices.

malpractices. The parliamentary inquiry into the construction fraud revealed that the risk of exclusion constituted a major reason for companies to continue participating in the cartels. During the public hearings, several construction companies stated that they were treated like "pariahs" when they tried to win public tenders in open competition after leaving the cartel system. They encountered problems because they were no longer part of the subcontracting arrangements and could no longer rely on their former co-conspirators when they needed to subcontract work to others. As one contractor stated, "In the end, the system remained in place because no one could afford to leave. Everyone was afraid that the rest of the market would make life difficult for a company not involved in the preliminary talks" (van de Bunt, 2008: 143). Another contractor had left the cartel at one point, but then saw no option but to rejoin. As he explained in his statement to the committee, "It was like this: We were not being excluded by others, but we had excluded ourselves" (ibid.).

The fear of the consequences of disclosing the cartel's practices had a major effect on the way agreements were enforced. The illegal nature of the agreements and the realization that all parties shared a secret imposed restrictions on the manner in which conflicts could be resolved. The companies obviously were not in a position to appeal to legal rules or jurisprudence to settle disputes; at the same time, they could not allow conflicts to escalate because this disagreement would bring the cartel's secret into the open. In practice, they resorted to an informal, underground system of arbitration, and the contending parties usually were amenable to a compromise. In other words, the collective fear of disclosure resulted in fraternization between the companies and the continuation of the illegal practices (van de Bunt, 2008.) The power of social control when it comes to silencing dissidents was made apparent in the treatment of Ad Bos, the main whistleblower in the construction fraud. He was ridiculed publicly and humiliated by former colleagues in the press. He never found work in the construction industry again, and even his son was no longer welcome in the world of the building contractors.

When the truth is too painful to share, especially when a family member is involved, most people prefer to deny it. This tendency might explain why relatives protect those closest to them by denying and normalizing their deviant behavior. The wives of men in the early stages of psychiatric disorders or alcoholism often refuse to face the truth. Yarrow, Schwartz, Murphy, and Calhoun (1968) described how women tend to deny the disturbed behavior of their spouses for as long as possible. When the painful truth finally is realized, all efforts are made to keep the problem a secret so that negative repercussions on the reputations of everyone involved could be avoided. What we know about Madoff is that he surrounded himself with close relatives.[28] Until now, his wife and his next of kin have denied all knowledge of his illegal activities to the

28. Madoff's brother joined BMIS in 1965. He was appointed senior managing director and chief compliance officer for the investment advisor and the broker-dealer businesses. Madoff's nephew joined in 1978 and served as the director of administration. His two sons joined in 1986 and 1988 as director of listed trading and director of NASDAQ trading, respectively. A niece served as the in-house legal counsel.

disbelief of many. Yet family members generally are the last to lose faith in a close relative, which is why they are usually the best guardians of the secret.

Discussion and Policy Implications

The Madoff affair unraveled at the height of the credit crisis. During the maelstrom of events, the affair was cited quickly as a prime example of the failure of governmental supervision. Throughout the world, questions now have turned to what lessons should be learned from the credit crisis and what measures should be taken to improve the supervision of the financial services sector. The collapse of several major banks not only caused a great deal of damage and suffering, but also exposed a serious violation of trust. The current consensus seems to be that governments and supervising agencies have been too trusting. The "trust and hope regulation" (Shover, 2008), which is largely dependent on the self-regulating abilities of organizations, seems obsolete. Does this evolution mean a return to the more formal command and control regulation under the old adage "it is good to trust, but it's better to verify?" In several recent authoritative reports, this question is answered positively (e.g., Financial Services Authority, 2009; The High-Level Group, 2009). The emphasis in these reports is on strengthening and broadening supervision with regard to the behavior of organizations. In addition to enhanced external supervision by governments and supervisory agencies, this increase in organizational supervision involves a strengthening of internal oversight (corporate governance), particularly by shareholders and supervisory boards. Arguments in favor of strengthening financial supervision also were made during the Senate hearings on the Madoff fraud, and a range of organizational measures was suggested to improve the quality of the SEC (Kotz, 2009).[29]

The enhancement of external and internal oversight is, in itself, a logical reaction to the failure of the financial markets' supervising agencies. In all likelihood, the Madoff fraud would have come to light much earlier had better supervision had been in place. But the Madoff case demonstrates further that the occurrence and continuation of serious financial misconduct cannot be attributed to a failure of supervision alone.

The major cases of white-collar crime that have come to light in recent years provide valuable lessons. This article focuses on two cases—the Dutch construction industry and Bernie Madoff—sharing an underlying problem: It took considerable time before the facts were "discovered." A host of employees, clients, and supervisors "should" have known that something was wrong, but it took years before the truth behind the façade finally was exposed. In essence, the present economic crisis also can be traced to this underlying problem: Financial service providers were optimistic and had little regard for the risks involved in encouraging a variety of forms of debt, bundling them into packages, and promoting them to institutional and personal investors. Seemingly solid reputations, convincing stories, and short-term profits

29. Several witnesses invited by Congress to testify on the Madoff case, among them Markopolos, argued in favor of improving the SEC's oversight.

contributed to a climate that did not invite critical questions, verification, or fact finding. This environment is how the conspiracies of silence came into being.

Encouraging Inquisitiveness

The first strategy suggested by the evidence presented here is that financial misconduct is best dealt with by breaking the conspiracies of silence. The mere strengthening of supervision is not likely to be effective without simultaneous efforts to encourage people to speak out and to give them incentives to *want* to know and to tell the truth. As to the latter, for too long, persons in key positions—be it the managers of Madoff's BMIS or the top executives of the Dutch construction firms—could distance themselves from financial misconduct by appealing to ignorance. More to the point, *concerted* ignorance prevailed because these people usually have their justifications ready. Targeted measures can be applied to this type of "ignorance," with the effect that an appeal to ignorance no longer constitutes an excuse. This strategy is the first that can be used in breaking the silence.

A prominent example is the U.S. Sarbanes-Oxley Act (2002), which requires CEOs and CFOs of companies listed on the stock exchange to certify, on pain of criminal penalties, their firms' periodic reports. These corporate officials no longer can appeal to ignorance because they are now personally liable when financial statements filed by the company are materially incorrect or misleading. Along these lines, a range of other measures and provisions could be considered, including the obligation to examine the creditworthiness and integrity of new customers (i.e., "know your customer" and due diligence), raising the level of expertise, and bringing in auditors.

Promoting Disclosure

The second strategy for breaking conspiracies of silence involves encouraging people to speak out by giving them an incentive to do so. This area is where whistleblowers are of great importance. The United States was one of the first countries to introduce whistleblower legislation, and it is considered a pioneer in these matters. The Space Shuttle Challenger disaster figured prominently in the passage of the Whistleblower Protection Act in 1989, which significantly strengthened whistleblower protections for federal employees. Thirteen years later, after the Enron and WorldCom scandals, provisions were included in the Sarbanes-Oxley Act (2002) to strengthen the position of whistleblowers in the corporate world.

These provisions include not only measures to protect whistleblowers, but also they allow for monetary rewards. For instance, the Whistleblower Protection Act (1989) ensures that whistleblowers receive a portion of the amount obtained in settlements or that is paid out in compensation in all cases for which they provide vital information. This incentive is intended to encourage insiders to speak out and to help them overcome their fear of possible reprisals.[30]

30. In the United States, numerous schemes encourage individuals to break silence by informing regulatory and law-enforcement agencies. For an overview of the different types of bounty schemes, see Ferziger and Currell (1999).

Offering this type of reward represents a thin line between encouraging whistleblowing and discouraging opportunistic behavior.[31] In the Netherlands, as in other Western European countries, awarding monetary rewards to whistleblowers is a matter of controversy. The underlying idea is that whistleblowers, as a matter of course, should have the public interest at heart, and therefore, it would be inappropriate to reward them for simply doing their civic duty. But perhaps this responsibility is asking too much of the moral principles of whistleblowers. If men were angels, then no incentives would be necessary (Grabosky, 1995: 275). Usually whistleblowers are met with skepticism and disbelief, or—as was the case in the construction fraud—they encounter substantial opposition and aggression. It is, therefore, advisable to devise more powerful incentives to encourage people to speak out. In this context, the "qui tam" provisions of the False Claims Act (1994), which enable whistleblowers and other plaintiffs to file lawsuits against fraudsters, should be mentioned.[32] The most far-reaching incentive is to give perpetrators reduced sentences or even immunity from prosecution if they confess their own transgressions and those of others. In the past decade, leniency has proven to be an effective means to penetrate cloaks of secrecy, and it can be particularly useful in detecting cartels. In the wake of the Dutch parliamentary inquiry into the construction fraud, the construction firms were given the opportunity by the NMa to release their shadow accounts and to supply information on cartel agreements. In a short period of time, almost 400 companies confessed and to relinquished their secret documents in the hope of receiving a reduced sentence or complete amnesty (van den Heuvel, 2004). Once mutual interests cease, a conspiracy of silence likely is to evaporate in favor of self-interest.

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31. Grabosky provided an excellent overview of the substantial shortcomings of giving rewards to whistleblowers (1995).

32. According to Braithwaite (2008), this type of privatized enforcement shows promise because it allow citizens as well as nongovernmental organizations to play a role in the enforcement of laws, and provides a structured way for private justice litigants and regulators to maintain a dialog about regulatory policy.

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POLICY ESSAY

WALLS OF SECRECY AND SILENCE

Secrecy, silence, and corporate crime reforms

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Henk van de Bunt (2010, this issue) explores how both secrecy and silence are artifacts and explanations of some of the most notable corporate fraud in recent years. Two iconic cases are offered that point to a variety of individual- and firm-level factors that contribute to corporate deviance (e.g., employee inaction, deliberate indifference, and an unwillingness to hear or disclosure the truth). The solution to the successful concealment of illegal activities, we are told, is to focus on more than just failed supervision or the need for more and better regulation.[1] Instead, frauds of this kind must be countered by encouraging inquisitiveness and promoting disclosure in ways that defeat the deadening silence and inaction of employees and other insiders.

van de Bunt's (2010) argument is undervalued or overlooked too often in extant accounts of large corporate frauds where the default reaction is to suggest new legislation and regulation (see, e.g., Markham, 2006). To van de Bunt's credit, focusing on the harm that comes from secrecy and silence inside and outside the firm encourages something more than the uncritical acceptance that failed supervision, incompetent gate-keeping, and inadequate or poorly enforced regulations combine to explain all corporate deviance (cf. Coffee, 2006). And van de Bunt's argument resonates well with anecdotes of firms that are characteristically opaque and with corporate cultures that inhibit dissent, free communication of allegations of wrongdoing, active whistle-blowing, cooperation with law enforcement, and acknowledgment of wrongdoing (Miceli and Near, 1992). It also connects with accounts of firms that, on the surface, seem compliant but actually are not. Here, the failure may be one of governance, where there is insufficient oversight by the board of directors of the compliance function carried out by senior management (Laufer, 2006).

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1. Even though the problem is not reducible to new regulatory policies, van de Bunt (2010) notes several regulatory reforms in the United States with some approval, such as the Sarbanes-Oxley Act (2002), new Securities and Exchange Commission rules, and Qui Tam suits.

At the same time, van de Bunt's (2010) account is admittedly incomplete. It goes without saying that not all firms that engage in this kind of deviance have walls of secrecy and silence. Corporate crimes, and indeed corporate frauds, reflect a wide range of harms and wrongs that affect a diverse group of stakeholders and victims extending well beyond that observed in van de Bunt's sample of two notorious firms. It also is not always the case that walls of secrecy and silence in organizations are bad.[2] A comparably strong argument may be made that one or both, at times, are integral to the development and success of firms in generating rents (Anand and Rosen, 2008; Dufresne and Offstein, 2008).[3] The incentive to invest in innovation, for example, is tied to a firm's abilities to protect its intellectual property (Liebeskind, 1997). Of course, to be fair, van de Bunt is not addressing all corporate crimes and is not concerned with the legitimate use of secrecy and concealment to pursue lawful business objectives.

van de Bunt's (2010) account is incomplete, however, in another more important way. We may both agree that the near impenetrability of the corporate form remains a significant obstacle to effective law enforcement and regulation.[4] We also would agree, I suppose, that a handful of valuable reforms specifically address the problem of secrecy and silence. What is left unsaid, however, is that most reforms in the United States after periods of failed corporate governance, compliance, and responsibility over the past several decades recognize the problems and challenges posed by the "private nature" of public corporations. In fact, many of these reforms are designed to counter the kind of organizational opacity and group nondisclosure, both inside and outside of the firm, which contributes to or facilitates "conspiracies of silence." These reforms prize corporate transparency, disclosure, unbridled cooperation, and oversight over the management function by offering distinct incentives and disincentives for firms, as well as their officers and directors, to act in ways that are both proactive and appropriately reactive. The single thread that connects all these policies is the reasonableness of the firm's efforts to prevent illegalities and respond appropriately after the discovery of wrongdoing. Add to this the mantra of the good corporate citizenship movement to enlist corporations, in partnership with

2. Control over intellectual capital and property is a critical feature of corporations. Consider, for example, the premium placed on certain forms of secrecy and silence, such as elaborate "Chinese Walls" in banks, diversified financial services firms, and management consultancies to protect the flow of protected, confidential information.

3. The prospects of successfully encouraging "inquisitiveness" and "disclosure" is less clear in firms and industries where information is the primary currency, and where information advantages and asymmetries are competitive value propositions (e.g., investment banking). Taken to the extreme, inhibiting or dismantling secrecy and concealment may result in unintended and even perverse outcomes (e.g., the compromise of significant investment in propriety intellectual capital or violations of privileged communications and relationships).

4. Developing effective corporate crime policy from limited anecdotal evidence, as van de Bunt (2010) proposes, also raises some familiar and legitimate concerns (Laufer, 2006). Additional concerns attach if the two firms offered by van de Bunt conflate the diverse nature, quality, and kind of corporate wrongs.

the government, to investigate, cooperate fully, and voluntarily offer incriminating, inculpatory evidence (Laufer, 1994, 1996a).[5]

This essay will briefly review examples of policies offered by a combined account of these reforms in the United States (the "conventional account") and will touch on their prospects for addressing both secrecy and silence.[6] A cursory review of selected examples from the conventional account reveals more than a sufficient number of reforms to "break conspiracies of silence" in firms and "encourage people to speak out." Thus, attempts to wrestle with the Madoff case, the Dutch construction frauds, and other glaring governance and compliance failures, I argue, will require more than thinking creatively about the underlying dynamics of secrecy and silence, as van de Bunt (2010) suggests. Policy makers must also address why extant policies—which represent decades of work on the problem of firm and agent transparency, disclosure, and cooperation—continue, at times, to fail. We must consider how firms that are held in the highest regard, which have cutting-edge compliance practices, governance policies, and records of good corporate citizenship, are alleged to condone tacitly, tolerate, or participate actively in elaborate frauds (e.g., the "Abacus" fraud of Goldman Sachs).

The best answer requires a consideration of the most significant obstacle to all successful corporate regulation: the glaring lack of a constituency that genuinely and consistently favors corporate criminal liability—the ultimate lever that empowers less formal social controls, such as effective self-regulation, voluntary disclosure, and acceptance of responsibility (see, e.g., Ayres and Braithwaite, 1992; Braithwaite, 1982, 1998; Fisse and Braithwaite, 1993).[7] Without such a constituency and without a genuine threat of escalating formal social controls where compliance is not forthcoming, policies that target both secrecy and silence are subject to the kind of "gaming" by the private sector that typifies iconic corporate fraud cases (Laufer, 2006).

Sadly, this constituency is absent in the United States because of a shared ambivalence, which is now more than a century old, with formal corporate social controls that engender significant externalities (see, e.g., Healy, 2004). And this ambivalence persists even though the threat of the criminal law is the single most potent motivation for corporations to take the idea of self-regulation seriously (see Ayres and Braithwaite, 1992; Braithwaite, 1982). Without it,

5. The rallying cry of this movement appeals to a broad spectrum of business and political interests (Conaboy, 1995):

> [T]hose of you here today from the business community are in a position to do more than the bare minimum in taking a stand against crime. You must take on the obligation to lead this effort, to be in the forefront, not only by working to ensure that your companies' employees follow the law but by embracing and placing at the very top of your companies' priorities the basic good citizenship values that make law abidance possible.

6. How effective these reforms are at encouraging inquisitiveness and disclosure remains largely unknown. It is both trite and true that no matter which account actually underwrites reforms, there is a dearth of policy grounded in empirical evidence, no less anything approaching more systematic evidence-based research.

7. "Without a strong state capable of credible deterrence and incapacitation," as Braithwaite (1998: 12) noted, "you cannot channel regulatory activity down to the base of the pyramid, where trust is nurtured."

the extraordinary challenges of investigating and then building cases against large, complex, and well-counseled multinational corporations are daunting.

None of this, of course, undercuts the account of van de Bunt (2010) or its importance. Perpetrators shield their frauds in often sinister ways and revel in the silence and remarkable naiveté of their firms, their victims, the bystanders, and regulatory agencies. It is impossible not to join van de Bunt in marveling at the oblivious nature of stakeholders whose ignorance or deliberate indifference was matched only by the seeming legitimacy of their commercial activities that, only much latter, seem so wrong. And, as van de Bunt observes, Madoff and the Dutch construction firms brought a pristine reputation and respectability to large financial transactions, where the idea of corruption and fraud were simply beyond imagination.

If we assume that van de Bunt (2010) has explained some of the individual, group, and firm-level variance associated with some of the more notorious corporate frauds, the question remains: Why do policies that explicitly target silence and secrecy fail, at times? The answer to this question requires a better appreciation for the conventional account of corporate crime reforms.

The Conventional Account

The history of corporate crime in the United States is episodic and somewhat consistent. Scandals result in reforms, followed by periods of heightened regulatory scrutiny. Over time, the power and priorities of regulatory agencies change, encouraging periods of regulatory laxity. The cycle continues with front-page allegations of corporate deviance that seem, at least to the current generation, to be unprecedented (Laufer, 2006). This episodic pattern is far from perfectly consistent. It is, however, consistent and significant enough to have produced a loose but vast patchwork of reforms and policies that reflects the perennial tension between the regulatory power of government and the continuing emergence of corporate power. Markets encourage corporate risk-taking and innovation, yet corporations require vigilant regulation and faithful compliance; moreover, the government must maintain close ties to the business community, but such ties may inhibit regulation or make resort to laws and regulation problematic. These and other tensions and conflicts, I argue, moderate the power to regulate corporations, the specter of regulatory overreaching, and the shared priority given to advancing the interests of the business community, particularly in depressed economic times (Laufer and Geis, 2001).

This conventional account of failed compliance, governance, and responsibility reflects an obvious preference by private-sector actors for self-regulation, voluntary initiatives, and other informal social controls. It also reflects the state's desire to avoid capture and to recognize the inevitability that firms will "game" regulation. In the end, however, the realities of the corporate form (i.e., its insular, private nature), the low priority given to corporate deviance by law enforcement, the significant resources needed to police the private sector, and shared concerns about the externalities of formal social controls reveal a profound ambivalence with corporate criminal liability no less anything resembling a command and control approach. This, I maintain, undermines the self-regulatory suasion of the conventional account. It often invites corporations to enact a cosmetic compliance and creatively game governance rules.

The patchwork of compliance, governance, and corporate citizenship reforms should, at least in theory, offer significant guidance about transparency and disclosure for all the stakeholders, from agents and principals, boards of directors and corporate counsel, to industry associations, shareholders, creditors, lobbyists, chambers of commerce, the donor community, and nongovernmental organizations. Two simple-minded policies emerge from each reform in this mix: Compliant and well-governed business organizations must be proactive in establishing programs and policies that can reduce the likelihood of an unethical and illegal act, and these organizations must be appropriately reactive when such programs and policies fail (see, e.g., Kaplan, 2001; Kaplan, Murphy, and Swenson, 1993). Both—along with distinct incentives to investigate, cooperate, disclose, accept responsibility, and work as a partner with the government to continue as a good corporate citizen—are designed to root out the kind of secrecy and concealment that concerns van de Bunt (2010). Specifically, these incentives counter the kind of facilitative social contexts that van de Bunt (2010) associates with secret societies: the fact that respected perpetrators are often above suspicion, the absence of interest in disclosing the truth, the inaction in the face of knowledge, concerted ignorance, and fearing the consequences of disclosure.

Corporate Compliance

The history of the corporate compliance and good corporate citizenship movement in the United States might be traced to the late 1980s when scholars, practitioners, and members of the United States Sentencing Commission (hereafter, "Commission") debated optimal penalty theory and the ingredients of the first iterations of the Sentencing Guideline for Organizations (Etzioni, 1993; Kaplan, 2001). These guidelines were designed explicitly to constrain the discretion of federal judges in sentencing corporations. It was clear, however, that they served a greater prescriptive purpose. The Commission would provide guidance to corporations about how criminal liability, culpability, and blame are determined. With this guidance, businesses could fashion codes, policies, and procedures to be "in compliance" with the Guideline and, thus, minimize their risk of criminal investigation, liability, and sanctions (Kaplan, 2001; McKendall, DeMarr, and Jones-Rikkers, 2002).[8]

As corporations allocated vast resources to be compliant, the notion of corporate integrity assumed new meaning. The concept of corporate integrity, once aspirational, ideological, and normative, now assumes a practical, if not pedestrian, meaning. Integrity became synonymous with organizational due diligence (Laufer, 1994, 1996b, 1999). And this brand of due diligence

8. The Commission ultimately decided that organizations are more culpable when a "high-level" employee "participated in, condoned, or was willfully ignorant of the offense." Alternatively, organizations are more culpable where "tolerance of the offense by substantial authority personnel was pervasive throughout the organization." The Commission also provided five post-conviction culpability measures, including the maintenance of an effective compliance program.

soon became a more general proxy for what regulators, prosecutors, and courts would call good corporate ethics. The importance of due diligence cannot be overstated. It evolved into an organizing principle of behavior that imposes both ethical and legal obligations—demanding action by corporate agents to be consistent with self-selected and self-imposed values. These values are designed to drive the entity and shape the organizational structures, processes, and decision making.

Most important, the notion of due diligence compels acceptance of responsibility and the affirmative obligation to disclose practices that violate the law. Both proactive and reactive behaviors are driven down the corporate hierarchy to disrupt the kinds of secrecy, concerted ignorance, and silence that concerns van de Bunt (2010).

A series of memoranda from the Department of Justice (e.g., the Holder, Thompson, McCallum, and McNulty Memoranda)—which articulate principles or guidelines for prosecution—offers another prescription for organizations that undermines both secrecy and silence. In deciding whether to charge a corporation, the Department of Justice asks prosecutors to consider the complicity in or condoning of the wrongdoing by management, the corporation's timely and voluntary disclosure of wrongdoing, and its willingness to cooperate in the investigation of its agents. All of this offers incentives to design away the kind of opacity that encourages nondisclosure and organizational secrecy.

To gain access to the corporate form, the Department of Justice both recognized the value of privileged information protected by the attorney–client and work product protections, and the potential importance of its compromise to ensure the disclosure of the relevant facts concerning the misconduct (Bucy, 2007). Prosecutors simply view corporate disclosure as a direct measure of corporate cooperation (Laufer, 2002).

Several regulatory agencies instituted industry-specific compliance programs with elaborate voluntary audit protocols. These programs eliminate gravity-based penalties for firms that disclose and correct violations. Self-disclosure protocols are found across many regulatory agencies offering corporate leniency and amnesty programs, for example, the Office of the Inspector General, the Department of Health and Human Services, the Environmental Protection Agency, the Securities and Exchange Commission, and the Anti-Trust Division of the Department of Justice (Laufer, 2006).

Finally, where firms are at risk for the kind of secrecy and concealment described by van de Bunt (2010), many lean heavily on inside or outside counsel or allow corporate monitors to fill the niche. One such kind of monitor, for example, is an Independent Private Sector Inspector General (IPSIG), who may be hired to ensure compliance and possibly to prevent, deter, uncover, and report illegal conduct by agents or the firm. IPSIGs are independent, non-state regulators with specific forensic, audit, investigative, and loss prevention capabilities (Anechiarico and Goldstock, 2007). These are but a small sample of compliance reforms that attempt to ensure against concealment and the walls of secrecy and silence.

Corporate Governance

The corporate scandals epitomized by Enron, Andersen, Tyco, Adelphia, and WorldCom, along with the recent collapses of large financial institutions that have contributed to the global recession, are justifiably conceived as systematic governance failures (Gordon, 2002; Wade, 2002). Post-scandal reforms addressing vulnerabilities in internal financial control systems and problems of board independence reflect the nature and character of offenses committed by well-placed insiders. Calls for requiring increased independence of auditors, directors, and analysts; increased disclosure in annual reports; and changed accounting rules attempt to impose sufficient objectivity, transparency, and accountability that will break the silence represented by "closely held" deviance (Holder-Webb, Cohen, Nath, and Wood, 2007, 2008; Roe, 2004a, 2004b).

The premise of corporate governance reforms is not that firms with strong compliance efforts fail, but that companies with all types of compliance programs are monitored, overseen, and audited insufficiently (see, e.g., Rose and Rose, 2008). To bolster the power of existing compliance policies, the role of the board of directors in monitoring and overseeing senior management requires significant attention. New Securities and Exchange Commission rules, exchange rules, and proposed reforms range from the creation of chief risk officers and board-level risk committees, to ensuring additional objectivity, independence, and competence of directors (Romano, 2005–2006). Overall, policies are designed to ensure a competent board, systematic risk management policies, and fair compensation polices (Institute of International Finance, 2009).[9] Governance reforms came right after more than a decade of massive compliance expenditures. Both are now sold as insurance against liability—a hedge against the possibility, no matter how remote, that fraud and other criminal activity will result in liability for the firm (Laufer, 1999).

Corporate Social Responsibility

Advocates of corporate social responsibility (CSR) view the firm as more than a simple mechanism to return profit to shareholders (Smith and Lenssen, 2009). Corporations should return value, broadly defined, to its owners and other relevant stakeholders. Firms that stake a claim in CSR view their responsibilities as extending to a wide variety of disclosures and social reporting (e.g., the triple bottom line—social, environmental, and financial; Council on Economic Priorities, 1998; Hess, 2008). The kinds of voluntary disclosures made by corporations under the banner of CSR overlap considerably with both the compliance and governance functions. Voluntary initiatives typically require a kind of transparency and disclosure that invites the scrutiny, review, and oversight of both state and nonstate regulators, for example, government and nongovernmental organizations (see, e.g., Pistoni and Songini, 2009). Once again, this effectively compromises the desire for the kind of opacity and concealment that supports secrecy and silence.

9. The likelihood of lasting reforms from these governance initiatives is tempered, at least in part, by a history of overlapping and conflicting interests of familiar bedfellows—from auditors, senior management, and boards of directors to underwriters, lenders, lawyers, analysts, and credit rating services. These interests are expressed in a complex and often opaque political environment that preserves the status quo, if not special interests.

The Prospects for Reforming the "Private Nature" of Corporations

Reforms for more than 20 years have sought ways of opening the "private nature" of corporations. Attempts to ensure that deviance is exposed in a timely, if not proactive, manner dominate compliance and governance measures. The challenge, it seems, is how to make these measures effective without a strong constituency that advocates a brand of self-regulation and self-governance backed by the threat of escalating sanctions for noncompliance.[10] In the absence of such a constituency, and with increasing concerns about "over criminalization" and the externalities of formal social controls, the prospects of any serious reform are dim (Husak, 2008).

Elsewhere, I concluded similarly that optimism for meaningful legislative and regulatory corporate crime reform must be tempered by the reception given to corporate criminal liability by the courts, legislatures, and business community (Laufer, 2006). This reception has to change, I believe, for van de Bunt (2010) to see consistently both inquisitiveness and disclosure from existing or new regulatory reforms. That said, it would not take that much of a change to break conspiracies of silence, counter concerted ignorance, and prompt disclosure. It simply requires one of the primary stakeholders embracing the idea of corporate criminal liability so that others believe that it is a genuine—and not merely symbolic—threat.

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10. For a discussion of how this might be accomplished with firms that have an incentive to engage in corruption, see Petkoski, Warren, and Laufer (2009).

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Silent or invisible?

Governments and corporate financial crimes

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This essay makes a case for clearer and firmer policy toward misconduct by corporations. The research article by van de Bunt (2010, this issue) comments on how successful concealment presents a barrier to dealing with such misconduct, and it advocates breaking down this silence by encouraging inquisitiveness and whistle-blowing. Although such initiatives doubtless would have some impact, it is argued here that the problem of silence goes far beyond the immediate actors in each instance and that the fundamental need is for governments to act consistently and to reduce the broader invisibility of corporate misconduct.

van de Bunt (2010) draws on two case studies—Bernie Madoff's Ponzi scheme and a major price-fixing scandal in the Dutch construction industry—in which regulatory failure has been blamed widely for not stopping the offenses earlier. However, van de Bunt argues that this issue was not the only reason the crimes could continue for years; another important reason was the successful concealment of their activities behind a wall of silence maintained by their social environments. van de Bunt uses Simmel's concept of "secret societies" (Simmel and Wolff, 1950: 345), which succeed not because their members are isolated from society but precisely the opposite: They are socially embedded, "their general demeanor inspires trust, they can rise above all suspicion" (van de Bunt, 2010). Thus, Bernie Madoff's status as a well-known public figure and philanthropist led people to assume he was trustworthy; Madoff himself believed that his reputation even deterred investigators from the Securities Exchange Commission (SEC). Doubts about him also might have been discounted because of "cognitive dissonance" (a reluctance to credit evidence that goes against established beliefs). The same happened in the Netherlands, where public prosecutors ignored a whistle-blower's concrete evidence and allowed widespread price-fixing to continue for years.

It is true that the SEC failed to stop Madoff because of a litany of organizational shortcomings, and thus, the immediate sequel to the case has been calls for better and stronger supervi-

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sion. This reaction is logical, but van de Bunt (2010) states that the underlying problem is the length of time these cases take to come to light, and he draws the conclusion that "financial misconduct is best dealt with by breaking the conspiracies of silence." This can be done in the following ways: to encourage insiders to be inquisitive and to provide support for whistle-blowers. Controversially—at least for Western European readers—van de Bunt argues that this encouragement should include rewards or, most productively, immunity from prosecution. Ultimately, then, the research article is not so much about how to prevent corporate misconduct as about how to ensure that it comes to light; so the problem is not how to deal with offenders but how to find out about their offending in the first place.

The research article discusses the silence surrounding corporate financial crimes, but it is more commonly described as being invisible—or at least less visible than conventional crimes. This invisibility is partly a result of the nature of such crimes: They are harder to detect for several reasons; for example, because they often involve complex financial manipulations, because they take place behind closed doors, because their impact is often diffuse, and because individual victims might lose very little and indeed be unaware that they have been affected. Corporate financial crimes also might be cloaked in ambiguity; at least one of those indicted in the American heavy electric equipment price-fixing case of 1961 described his actions as "illegal but not criminal" (Geis, 1967), and the defendants in the Guinness case in England in the 1980s might have believed that the share support operation in which they participated was within the law (Gobert and Punch, 2007; Robinson, 2009). But these crimes also are relatively less visible in policy terms. In the past, criminal justice policy has focused almost exclusively on conventional property crimes such as burglary and street robbery. It is only in response to scandals such as the collapse of Enron, Worldcom, and several other major American companies in 2001 as well as the credit crunch in 2008 that the spotlight has been thrown on the misdeeds of capitalist corporations. But even in the wake of tough criminal legislation such as the Sarbanes-Oxley Act (2002), Snider (2007) argued that—in practice—many cases still are resolved by settlement agreements, which are quicker but involve no admissions of guilt, and in some sectors, investor protection has been resisted with arguments about market efficiency. She also drew attention to the cyclical nature of government intervention: Once the scandal ceases to be newsworthy, the pressure is off, and it is business as usual. Political interest in controlling financial misconduct also is motivated largely by the need to maintain public confidence in business and, indeed, in the capitalist system. The regulation of health and safety, for example, is far less rigorous, despite the toll of injuries and deaths of workers and consumers (Tombs and Whyte, 2007). So what is needed is not just encouragement for those directly involved to ask questions and to blow the whistle; the failure to *see* extends to government and policy makers, and this problem is what must be remedied.

First, though, it is important to comment on the potential of whistle-blowing. This strategy inevitably is limited by the following factors: the ethical dilemmas faced by whistle-blowers and, if they can overcome these issues, the risks they take. Ethical dilemmas develop when whistle-blowers experience conflict between their own moral beliefs and organizational pressure to conform; faced with deviant behavior in the organization for which they work, they might have to make a difficult choice between "loyalty" to the organization and their perceived responsibility to society as a whole (Glazer, 1983).

As for risks, whistle-blowers might be treated like pariahs; van de Bunt (2010) notes that they are badly perceived even by bystanders: The Dutch whistle-blower *and his son* never could find work in the construction industry again. Stanley Adams was arrested for industrial espionage and lost his liberty, his wife, and all his money after blowing the whistle on Hoffman-La Roche's breaches of competition regulations in pharmaceutical products (Punch, 1996), and it is widely believed that Karen Silkwood lost her life after publicizing her concerns about safety at the plutonium processing plant at which she worked (Myers, 2000). Glazer (1983) interviewed 10 whistle-blowers and found that most of them had suffered adverse consequences (although they had overcome them in the long run) and Glazer and Glazer's later research (cited by Green, 1997) involved 64 whistle-blowers, who again mostly had endured considerable difficulties. Although these cases occurred before measures to protect whistle-blowers were included in the Major Fraud Act (1990), it should not be ignored that whistle-blowers risk vilification and ostracism as well as financial and employment problems, and thus, the reliance on whistle-blowers, whatever legal protection is made available, demands great courage from these individuals.

An argument also is made against rewarding whistle-blowers, especially with immunity from prosecution. Geis and Dimento (1993) suggested that doing so might diminish the deterrent effect of potential individual sanctions. Corporate executives and employees who are considering participating in illegal activities might reason that they are not at risk because, if caught, then they can escape prosecution by giving evidence against their employers. However, no evidence indicates that this behavior happens in practice.

Whistle-blowing is and will remain a contentious and difficult issue. The main aim of this essay, however, is to suggest that the problem with policy on corporate financial crimes goes deeper. Governments have been reluctant to legislate to control business behavior since the 19th century (Robb, 1992) partly because government members often have close links with business leaders but also because the health of capitalist economies depends on thriving industries—and governments, therefore, have to balance controls over business activities with the need to promote and support them. And, of course, powerful businesses lobby governments to create a favorable legislative environment state: "[T]he corporate sector seeks to bring the law into conformity with its aims, rather than the other way round" (Gobert and Punch, 2007: 98–99).

Snider (1993) argued that the roots of recent policy lie in the neoliberal ideas that have dominated government policy since the end of the 1970s, insisting that market forces would regulate companies more effectively and cheaply than criminal law. Consequently, the 1980s was an era of deregulation in the United States and the United Kingdom, especially in financial matters, but there were budget cuts for other regulatory agencies, such as pollution and health and safety. For example, in the United States during the Reagan Administration, the SEC was subjected to continual reductions in staffing, and the Savings and Loan regulations were repealed with disastrous effect (Calavita and Pontell, 1990). Similarly, in Canada, downsizing and reductions occurred in budgets for regulatory agencies (Snider, 1993), along with a very low level of enforcement in environmental protection.

In some respects, policy in the United States has become more punitive since the 1980s. The Environmental Protection Agency has moved toward more use of criminal law, the Department of Justice has focused on health-care fraud since 1992 (and convictions trebled), and prosecutions for price-fixing and antitrust peaked in the 1980s (but then fell away); furthermore, the Enron and Worldcom scandals led to tougher legislation in the form of the Sarbanes-Oxley Act. Baldwin (2004) likewise perceived a tougher approach in the United Kingdom. But as noted, Snider (2007) suggested that this policy goes in cycles: Big scandals draw a dramatic response from governments concerned with the credibility of business, but then the pressure is relaxed until the next scandal forces them into action again. So the prerequisite for policy in this area is recognition by policy makers that corporate misconduct is ever present and that—however important thriving industries are to the economy—their interests might be at odds with the wider public interest. This recognition is apparent in the admission by Gordon Brown that, during his tenure as British Chancellor of the Exchequer in the years preceding the credit crunch, mistakes were made in the regulation of banks: "The truth is that globally and nationally we should have been regulating them more. . . . So I've learnt from that. So you don't listen to the industry when they say, 'This is good for us.' You've got to talk about the whole public interest" (BBC News, 2010). But controversy also persists as to *how* to regulate business; in particular, should we adopt a coercion model that emphasizes enforcement and deterrence by way of severe sanctions, or a compliance model in which business is encouraged to behave properly and the emphasis is on education and persuasion?

The argument for deterrent policies is based on the economic model of the corporation as a rational (and amoral) calculator (see, e.g., *Harvard Law Review*, 1979). According to this position, corporations can be deterred because they have carefully planned strategies and can take into account the potential costs as well as the perceived benefits of illegal actions. All that is needed is to increase the likely penalties to the point where they outweigh the benefits. Punitive sanctions also are advocated by radical writers, who emphasize the immorality of corporate behavior and want to see punishments comparable with those imposed on conventional offenders (e.g., Slapper and Tombs, 1999). However, Simpson's (2002) research on deterrence and corporations suggests that this simple model of corporate decision making is not accurate. Studies based on objective deterrence (which assess whether changes in the level of punishment lead to changes in the level of offending) show that the firm's economic climate is more important than the severity of sanctions, and studies of perceptual deterrence (which takes into account how potential offenders view sanctions) show even less support. Baldwin (2004: 382) suggested that deterrent policies might fail because companies simply do not know how to manage the risk of regulatory penalties: "'punitive,' 'command' or 'deterrence' approaches to regulation and enforcement are severely limited in potential since even top companies think in very confused, frequently very different, and very irrational ways about how to manage regulatory risks."

Simpson's (2002) own research has focused on decision making by individuals within corporations and suggests that their reasoning is complex and mostly personal (based on a consideration of morals, shame, and personal gain), but they also take into account the organizational context—for example, whether they are following instructions or any risks to the organization's reputation. She proposed that insufficient thought has been given to whether deterrent policies should be aimed at individuals or at the corporation as a whole. But in doubting the efficacy of deterrence, she also referred to the nature of organizations and the complexities of group decision-making processes, and it is clear that policy on how to control the behavior of corporations needs to be based on a realistic model of how they actually work (cf. Punch, 1996; Wells, 2001). This change requires that policy makers familiarize themselves with the work of, for example, Jackall (1988), whose interviews with and observations of senior managers in American companies shows how complex their motivations can be and how different they are from the simple picture of all decisions being influenced solely by profit maximization. In particular, Jackall (1988) emphasized the importance to managers of impressing their superiors. In this sense, the culture of an organization and the qualities of its leaders can be crucial in setting the tone and in determining whether it conducts its business with integrity (cf. Clinard, 1983). Thus, crime prevention might be achieved better by influencing the ethical behavior of corporations rather than by threatening severe sanctions for misconduct.

John Braithwaite has argued in several books and articles for a "pyramid of enforcement" (e.g., Fisse and Braithwaite, 1993). Most infractions can be dealt with by negotiation and advice, and only the most serious or persistent offenders should face severe penalties. Linked to this point is the idea of self-regulation: Corporations able to demonstrate that they have sound policies to ensure compliance with the law might be offered "light-touch" supervision by regulatory agencies. Clearly, this status is most likely to be earned by corporations that adopt socially responsible and ethical policies. Some reservations have to persist about the simplicity of this approach; Baldwin (2004) for example, pointed to the difficulties presented by the differing world views of managers and regulators, but Simpson characterized self-regulation as "an idea whose time has come" (2002: 102).

A growing body of evidence tends to support this position and is against the "just deserts" argument and the more ideologically founded arguments that criticize capitalism per se and see little hope of restraining the activities of powerful multinational corporations. But in policy terms, a clear case exists for reversing the trend of cutting the resources of regulatory agencies so that, for example, decisions about whether to prosecute can be made more consistently on the grounds of effectiveness and appropriateness rather than on the resource implications: The personal liability of senior decision makers can be extended, as in the Sarbanes-Oxley Act (which prevents top executives from denying responsibility by claiming that they did not know what was happening); while keeping open the possibility of convicting the corporation itself, especially where responsibility is too diffuse for individuals to be convicted (Wells, 2001); and greater democracy and participation can be encouraged in corporate decision making (Glasbeek, 2001).

In summary, policy in relation to corporate financial crimes does need to encourage those involved and those with important information to come forward and break the silence that enables these crimes to continue. But more broadly, governments and policy makers need to follow Gordon Brown's lead and recognize that what is good for business is not always good for the public or even the economy, as well as acknowledge that business misconduct occurs and must be responded to constantly rather than sporadically. But in the absence of evidence to support simple punitive policies, attention also must be focused on encouraging corporations to adopt socially responsible and legal ways of conducting their business.

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How to effectively get crooks like Bernie Madoff in Dutch[1]

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Two distinctive case studies constitute the core of van de Bunt's (2010, this issue) inquiry into recent notorious episodes of white-collar crime. The first concerns a Ponzi scheme that was based in the United States but had tentacles that extended deep into overseas markets. The second, a domestic scandal in the Netherlands, would be designated in the United States as an antitrust conspiracy and in Canada as an anticombines crime.

van de Bunt (2010) believes that the same interpretative analysis and policy recommendations apply equally well to both of these white-collar offenses. The core similarity that is said to render them congruent is the essential need for secrecy if they are to prevail. It is pointed out that in both instances, the episodes went undiscovered for considerable periods of time. A large number of people were involved in the Ponzi scheme as customers with a rather tight in-group as perpetrators. Numerous individuals participated in the Dutch cartel; some of them backed out because of moral concerns and then returned to law breaking when they found it preferable as the path to better earnings. In neither case did any of this corps of conspirators or customers uncover the wrongdoing, although in both instances, a concerned outsider sought valiantly to stir the authorities to action.

The analytic downside with the twinning of the two cases is that policy recommendations that apply to both inevitably have to ignore significant distinctions. We have noted already that the perpetrators of the two kinds of criminal activity were different. In the Dutch scheme, unlike

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1. The term, referring to a person in trouble or disfavor, was coined in the 1850s, allegedly in regard to "Dutch uncles" who rather than being caring and avuncular were claimed to be stern and harsh taskmasters given to reprimands and scolding (Hunt, 1998).

the Ponzi scam, the perpetrators were a group of persons who worked for different companies. The victims also were dissimilar: The Dutch cartel injured public bodies and others engaged in construction projects, whereas the Madoff Ponzi scheme harmed a large number of investors, although unlike the Dutch enterprise, it rewarded some who, on the basis of need, knowledge, or luck, had harvested their lucrative "earnings" before the business collapsed. To simplify and pinpoint our analysis and to rely on information with which we are more familiar, we will focus on the Ponzi scheme in our commentary.

Bernard L. Madoff Investments Securities

van de Bunt (2010) deserves high praise for trawling the official documents associated with the Bernie Madoff case—the Congressional hearings and the regulatory agency reports. These excellent sources often are deemed too tedious or too inaccessible and are likely to remain beyond the ken of criminologists. These sources can offer responses to questions by persons closely associated with the issue under review and often by witnesses who testified under oath.

At the same time, these hearings and reports, by the nature of their mission, often do not delve into matters that are key to criminological scholarship and that can be significant in testing theory and formulating policy. Besides, in the Madoff case, the key figure did not appear before legislative committees because to do so would have interfered with the pending criminal adjudication. We will turn to the considerable array of trade books to flesh out van de Bunt's (2010) portrait of the Madoff scheme (see, e.g., Arvedlund, 2009; Kintzman, 2008; Oppenheimer, 2009; Ross, 2009; Sander, 2009; Strober and Strober, 2009).

For 40 years, Bernie Madoff, an affable crook who mingled with the country club set, operated a Ponzi scheme that defrauded investors of $65 billion. Madoff enticed the careless, the greedy, and the gullible with a campaign maintaining that his company used sophisticated computer systems "to monitor prices" and to "identify trading opportunities around the world." A host of domestic and foreign investment funds put all the money entrusted them into Madoff's scam operation, pocketing the fees they charged their customers to handle their money. René-Thierry Magon de la Villehuchet, after losing $1.4 billion of his own and his clients' money, committed suicide 2 weeks after Madoff's ruse became public knowledge.

Madoff pled guilty on March 3, 2009 to 11 criminal charges. On June 29, federal district court judge Denny Chin imposed the maximum possible sentence of 150 years on Madoff, declaring that the defendant was "extraordinarily evil." He granted that the sentence was symbolic, an overkill, but he wanted it to convey a lesson to other actual or potential white-collar criminals. The Madoff prison term was far from a record for perpetrators of financial fraud. During the last decade, there have been sentences as high as 350 and 845 years (Frank and Efrati, 2009).

During the Madoff presentence sessions, there were wrenching presentations to the court by victims of his scheme. One said that the fraud depleted money that had been saved for the care of his mentally disabled brother. "I hope Madoff's jail cell will be his coffin," the victim declared. One woman told the judge, "I now live on food stamps. I scavenge the dumpsters at the end of the month." Others labeled Madoff a "monster" (Lattman and Lobb, 2009: A12).

For some, there was scant satisfaction in seeing Madoff get his due, while those who directly contributed to the economic meltdown not only escaped untouched by the criminal justice system but also were raking in even more exorbitant incomes. At the firm of Goldman Sachs, the average employee salary had risen to $700,000 a year, which is higher than before the meltdown. For Frank Rich, a *New York Times* columnist, Madoff's offenses were small potatoes compared with "the esoteric (and often legal) heists by banks and bankers. They gamed the entire system, then took the money and ran before the bubble burst, sticking the rest of us with fear, panic and loss" (Rich, 2009: 8).

Policy Considerations

van de Bunt (2010) joins the large chorus of commentators on the Madoff case that severely faults the Securities and Exchange Commission (SEC) for its failure to carry out its regulatory duties despite more than ample warning that something was seriously amiss (Markopolos, 2010). He nonetheless finds it less than fully satisfactory to call only for an overhaul of SEC procedures, the recruiting of additional and more competent investigators, and the implementation of other agency upgrades. He includes in his policy recommendation the less common admonition that attempts must be made to energize participants, investors, and others so that they root out and report wrongdoing. This policy dictate is highlighted in the abstract (van de Bunt, 2010)—"The strengthening of supervision is unlikely to be effective without simultaneous efforts to encourage people to speak out and to give them incentives to want to know and to tell the truth." The word "simplistic" is employed in the abstract to challenge the common suggestion that better oversight is the core condition essential for better detection of Ponzi schemes and antitrust violations. The author's reservation about that tactic is understandable, but it seems to us to be somewhat off the mark. There was a shameful failure at the SEC in the Madoff case, but the Commission's investigatory weapons remain the most formidable and apt control mechanism. The SEC, of course, under a new administrator, pledged to be tougher and more diligent, but this time, there had to be a strong mea culpa added into the mix. A *New York Times* news story waggishly caught the mood at the SEC with a subhead that read: "Bernard L. Madoff Haunts the Corridors Like the He-Who-Must-Not-Be-Named of Wall Street" (Anderson and Kouwe, 2010).

van de Bunt's (2010) admonition that individual responsibility and alertness have to become a key ingredient of attempts at effective discovery of serious wrongdoing, such as large-scale Ponzi schemes, assuredly is well taken and unarguable. And it is buttressed by the discussion of incentives for a greater degree of due diligence and subsequent reporting of criminal activity. Mention is made, for instance, of financial rewards for providing prosecutable leads, but such money, unless it were to come from government funds (an unlikely prospect), would have to be paid out at the expense of those who were cheated and who hope to be reimbursed as well as possible from recaptured assets of the perpetrator. We might note, too, that the Madoff fraud was uncovered by his two sons who allegedly were informed by their father about what he had been up to and who conveyed that information to their lawyer who reported it to the authorities. They do not seem suitable candidates to receive reward money. The original short-lived but wildly flamboyant scheme of Charles Ponzi was primarily brought to earth by the investigative reporting of the *Boston Globe*, aided by its recruitment of economic analysts who discovered quickly that Ponzi's claims were contrived almost totally out of thin air. The paper's circulation soared as it focused on Ponzi's peccadilloes (Dunn, 2004; Zuckoff, 2005). Should the newspaper have been given a monetary reward? We think not.

We believe that it is a sound idea to educate and to alert the public about tell-tale signs and dangers associated with fraud, but we are less persuaded that the consequences will contribute significantly to a decline in such behavior. Rather, we would stress the need to make substantial structural changes in the conditions under which such schemes and other white-collar crime have flourished. Three recommendations are as follows:

1. Change the way outside accountants are employed by companies
2. Charter corporate entities federally rather than under state law
3. Rewrite the law defining the rights of corporations under the Constitution.

The Auditing of Corporations

The Madoff case further brought home the inadequacy of current arrangements for the auditing of the books and the assets of businesses, which is a matter highlighted in the demise of Arthur Andersen, who once was one of the Big Five of the nation's accounting firms. Arthur Andersen was complicit in the gigantic Enron fraud. It assisted the energy company in cooking its books by endorsing accounting tactics that transferred losses to offshore companies said to be independent entities but that were in fact controlled by Enron, and it otherwise played fast and loose with the law. In return, Arthur Andersen was receiving $52 million a year for performing audits and providing consulting services for Enron (Squires, Smith, and McDougal, 2003; Toffler and Reingold, 2003).

Madoff Investments, for its part, was audited by Horowitz & Friehling, which is a hole-in-the-wall firm located in a village north of New York City, and that was staffed by a secretary and single accountant, David Friehling. Friehling was perfectly aware that Madoff was crooked, and yet year after year he concocted an audaciously phony balance sheet for the firm (Henriques, 2009).

Auditors today operate under unacceptable conflict-of-interest conditions. They become dependent on the high fees they gain from the company that hires them, and they know full well that if they are too demanding or critical, they can readily be replaced. They cannot ask too many embarrassing or possibly incriminating questions. Moreover, they are limited in the range of their inquiry by their fee: The more they take pains to be as thorough as possible, the less profit they will realize because of the additional expense of the probe. A typical instance would be one in which a corporate treasurer shows them a note indicating that another firm owes them several million dollars. Should the auditor check with the other company to verify that the note is not a forgery or a put-up deal? Or, should he or she take the easier path of assuming that all is in order?

An overhaul of the auditing process is needed. A government agency should assign auditors, perhaps randomly, and they should be paid from a fund provided by their clients to an outside oversight group. Auditors should be rotated on a regular basis, probably every 3 years. The oversight agency should be certain that, when wrongdoing is known or suspected, these doubts are resolved satisfactorily.

Federal Incorporation

The variegated assortment of regulation by states of corporate entities should be terminated by enactment of a federal chartering statute that would apply to large businesses engaged in interstate commerce (Nader, Green, and Seligman, 1976). It is common knowledge that corporations seek the least demanding jurisdiction for chartering—often the state of Delaware—and that where they are chartered has little or nothing to do with where they are headquartered and where they do business.

This current situation places pressure on state legislatures and courts to cater to corporations because of their self-interest in maximizing fees and other income that they can secure from the corporations they charter. If you increase the demands on corporations chartered in your state, then you run the risk of watching them depart for more indulgent jurisdictions. Federal chartering would provide considerably more transparency regarding corporate governance and activities, and would introduce homogeneity into the conditions under which a corporate entity is to exist and act.

The Corporation as a Person

American law initially took the sensible position, equivalent to English common law, that a corporation could not be tried criminally. Thus, in 1883, a Maine court decreed, "It is a doctrine that … when a crime of misdemeanor is committed under the color of corporate authority, the individuals acting in the business, and not the corporation should be indicted" (*State v. Great Works Milling and Manufacturing,* 1883). But the Model Penal Code promulgated by the American Law Institute (ALI) adopted the principle that a corporation should be dealt with in the courts anthropomorphically, as if it were a person. This fiction has outlived its value. It is noteworthy that in discussing the ALI proposal, Glanville Williams, who was a British legal luminary, thought it might be the better part of wisdom to reexamine the concept of corporate criminal liability de novo rather than to accept what he saw as the "Topsy-like" development of the idea. "I know that the [ALI] Reporter has told us that the whole trend of [court] decisions is in favor of extending corporate liability, but he has also told us … that the cases are not well reasoned on fundamental policy, and it seems to me that the judges have not always looked where they are going" (Williams, 1956: 179). Similarly, Maria Boss and Barbara George (1992: 57–58) recommended that "legislators ... should focus their efforts on creating laws specific to white collar crime and utilize nontraditional penalties and standards imposing accountability and 'front-end' compliance requirements."

Our policy recommendation is that a wholly distinctive body of law should be established that indicates what is and is not proper in regard to corporations and should not resort to analogies to living human beings to make that determination. After all, corporations cannot vote and are only allowed to live by governmental authority.

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W A L L S O F S E C R E C Y A N D S I L E N C E

Getting our attention

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Henk van de Bunt (2010, this issue) presents two vexing issues in the control of white-collar crime—how to expose the deception and secrecy that lie at the heart of white-collar crime and how to ensure that responsible authorities will listen to the evidence of criminal activity once it surfaces. Two distinct cases—Madoff's Ponzi scheme and the Netherlands price-fixing cartel—are presented to demonstrate the need to break through the "conspiracies of silence" that too often lead to years of ignorance before crimes of this sort are exposed. In both cases, conspiracies of silence were facilitated by the status of the parties, fear of disclosure, and concerted ignorance of third parties who should have known. Thus, despite substantial differences in the structure of these crimes and the regulatory contexts in which they occurred, van de Bunt concludes that they share a similar lesson: Financial misconduct is dealt with best by measures that encourage inquisitiveness; for example, requiring new obligations and due diligence from those who ought to know and devise more powerful incentives to encourage people to come forward. Better supervision is not enough.

In a general way, these loosely defined prescriptions for reform are helpful in focusing our attention on what really matters. As disclosure norms are embedded deeply in organizational and occupational cultures, programs to promote disclosure must certainly attend to the organizational context of deception if they are to be successful. Markets are dynamic, and the opportunities to deceive change with them. So, too, will the relevant victims, insiders, and bystanders who have material information, as well as the pressures they face to "manage" their ignorance. Regulators must be creative and nimble.

A growing literature on the motivations for regulatory compliance might be helpful in thinking about policy reform. "Civic duty"—the moral and instrumental stakes in the success of a particular regulatory regime—must be a foundational element of programs to facilitate the exposure of potentially illegal activities (see the general discussion in May [2005]). Regulation, whatever its form, must be perceived as a central component of markets and not as interference, as it so often is. The big sticks of criminal and civil penalties, when legitimately and consistently

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imposed, might generate pressure to disclose material information, although much research tends to confirm that the deterrent effect of punishment is limited and even might be counterproductive. Even so, "showcase" enforcements can serve as important "reminders" about the obligation to disclose (Thorton, Gunningham, and Kagan, 2005) and as "reassurances" that those who disclose material information are smart to do so (Gunningham, Thorton, and Kagan, 2005). Although enforcement actions can influence actors' sense of obligation, social and peer influences are far more critical. Most regulatory scholars recognize that regulation works when it combines persuasion, fear, and normative duty, although they debate the proper alignment of the mixture. Clearly, any policy to encourage inquisitiveness and to promote whistle blowing must attend to all three and must consider the best way to enlist private systems of governance to encourage those with knowledge of fraud to come forward. For a discussion of how interactive and reflexive regulatory practices construct the meaning of compliance, see Picciotto (2007). Legitimacy issues are key, as Haines, Reichman, and Scott (2008) explain.

The Problem of Attention

Even if we were to get them right, programs and incentives to break the conspiracies of silence by demanding greater inquisitiveness and facilitating whistle blowing, in themselves, do not address what must be the main policy concern of the article: No one listened to those who did come forward with clear evidence of misconduct. Offering incentives adds little if no one with the authority to act wants to listen. The remainder of this essay discusses the role authorities played in the conspiracies of silence, focusing on how the structures of fraud regulation might change with the attention of regulators.

The Madoff Ponzi scheme and the Netherlands construction industry price-fixing cartel exploited different kinds of trust relationships and represented distinctive organizations of secrecy. Madoff's Ponzi scheme manipulated the classic principal–agency relationship in which individuals (principals) invest their resources with other agents to act on their behalf for a future, often uncertain, return. Familiarity, interdependence, and continuity can provide incentives for trustworthy behavior in most cases (Shapiro, 1987). However, it was precisely these kinds of connections that Madoff was able to exploit. Investors were drawn to him by his connections, his location at the center of financial power, and his promise of exclusivity. The promise of exclusivity was the key to his success. He told investors "You must never tell anyone that you're invested with me" (Arvedlund, 2001). And he delivered the goods. Madoff's operation might have been too big to be believed (Markopolos, 2010), but the larger-than-life personal and professional persona he created and the money he "generated" made it difficult not to believe.

As van de Bunt (2010) notes, the Netherlands construction industry case presented a very different story. Hardly a secret society, hundreds of companies met covertly to create their illegal deals. Collusion was widespread across an entire industry. Officials were bribed to ensure their silence. It might be that the Netherlands' case is similar to the Madoff case, although it seems that money and access to markets might have facilitated the two schemes in different ways. And it seems that, in both cases, red flags were available for regulators to see but were ignored.

Unfortunately, neither the article (van de Bunt, 2010) nor more general scholarship available to me has provided enough detail to make sense of why the Netherlands construction price fixing was ignored until an insider blew the whistle on Dutch TV. We know much more about the regulatory failures in the Madoff case. What is most troubling about the Madoff case is that so many victims were sophisticated investors and guardians of people's money who ought to have known better, and that those few "bystanders" who did come forward with information about the frauds were ignored.

Madoff's Ponzi scheme was clearly exceptional. Few Ponzi schemes last as long, and few are as deeply embedded socially and institutionally. To be sure, had someone from the inside turned or had regulators bothered to looked deeply at the evidence provided by competitors and some investors, the Ponzi scheme would have ended sooner. But they did not. Examinations into Madoff went nowhere because the lack of a Securities and Exchange Commission (SEC) follow-up or follow-through lent credibility to Madoff and provided reassurance to investors who might have had their doubts.

Deriving policy from the exceptional case rarely seems wise. However, in this instance, the Madoff scandal was colocated within a period of recklessness and misfeasance, if not malfeasance, in the financial industry that warranted increased scholarly attention by criminologists (Rhee, 2009). Although Madoff's intentional fraud was not linked directly to the relaxation of mortgage lending standards and the use of complex derivative instruments to manage that risk, the solvency problem of big banks, the problem of liquidity in the credit markets, or the use of risky derivatives, the structure of the Madoff scandal—particularly the use of affinity groups (Fairfax, 2001), the interconnectedness, and the failure of multiple forms of social control to respond—offer important lessons for our understanding of the current financial crisis. In both the Madoff fraud and the global financial crisis, professionals acted without understanding the underlying logic of the transactions they made, and those who knew better ignored the signs of impending disaster. And in both cases, agencies failed to exercise oversight delegated to them as "guardians of trust."

In part, the failure to look is grounded in the ideology of free markets and relates to a "fundamental tension between the philosophy of securities regulation and the necessities of anti-fraud market enforcement" (Rhee, 2009: 115). Regulatory design often assumes that if honest disclosure is made, then free markets will ensure a fair market. The lack of political will to regulate became manifest in the underfunding of the SEC and in the "pervasive belief that in the power of markets to cleanse themselves, and of non-legal forces like reputation, competition, and learning from experience to substitute for aggressive legal intervention" (Langevoort, 2009: 14).

The Failure to Attend

Ideology matters because it can determine what regulatory agents can and choose to pay attention to. Heimer (2008: 31) suggested that the "limited capacity to pay attention poses the challenge for regulation." Understanding the political, social, and actuarial consequences of the lack of attention is critical (Haines, in press). The Office of Inspector General (OIG) investigation of the SEC's actions or inactions in the Madoff case provides different explanations for the lack of attention (see also Langevoort, 2009). Data about the fraud, including six to eight complaints to the SEC and two 2001 journal articles (Arvedlund, 2001; Ocrant, 2001), were there for the taking. Why was this evidence ignored?

Competency Limits

The SEC report repeatedly asserted that the teams assembled to consider the fraud cases were woefully inexperienced. They "failed to appreciate the significance of the analysis in the complaint" (2009: 5) According to an examiner from the Office of Compliance Investigations and Examinations, no training was provided, examiners "weren't familiar with securities laws," and they had no experience with or understanding of the underlying transactions. These knowledge deficits were important factors in their inability to see the fraud.

Tunnel Vision

Related to the issue of competency is the problem of an overly narrow focus on specific rules rather than on the big picture of fraud or fairness. Rhee (2009) suggested that the SEC's "check box" emphasis on the rules of disclosure might have misdirected or distracted regulators from focusing on the substance of the investment, and might have allowed them to miss the Ponzi scheme entirely. The OIG report claimed that the enforcement staff failed to appreciate the significance of the investment analysis in complaints, some as early as 16 years before Madoff confessed, and focused instead on the smaller issues of registration and disclosure. When questioned why investigators focused on "front running" rather than on the more serious issues that were raised in a 2003 Hedge Fund Manager's complaint, the associate director explained that he did so "because that was the area of expertise for his crew" (U.S. SEC, 2009: 10). In a different investigation, "the OIG was that examiners failed to analyze Madoff's returns because portfolio analysis was not a strength of broker-dealer examiners" (U.S. SEC, 2009: 13).

Too Much Data and Too Little Time

The SEC report found that SEC examiners failed to seek out data that could have confirmed the suspicions raised in the complaints because it would have taken too much time to examine. Examiners said they were "hesitant to get audit trail data because it can be tremendously voluminous and difficult to deal with and 'takes a ton of time'" (U.S. SEC, 2009: 11).

Intraorganizational Silos

In a 2004 routine examination by the Northeast Regional Office (NERO), investigators discovered e-mails that raised questions about Madoff's activities, including a step-by-step analysis of why Madoff was misrepresenting his trades and suspicions that he might not be trading at all. NERO examiners did not solicit the counsel of investment management examiners who might have been able to do the kind of analysis that NERO examiners could not because "they almost never work together" (U.S. SEC, 2009: 13). The OIG faulted the enforcement staff for not consulting the SEC's experts in the Division of Trading and Office of International Affairs. Not only did they have useful expertise, but also they could have facilitated inquires with independent third parties.

Madoff's Con-fidence

Although resource constraints (e.g., time, money, and expertise) explain some of the regulatory agencies' lack of attention to information that would have blown Madoff's Ponzi scheme out of the water, regulatory examiners clearly were enraptured by Madoff—a testament to the success of his confidence game. Although the OIG report did not consider this a factor, it seems possible that some of the rapture might be connected to the euphoria in the market more generally. Most, but not all, complaints came during periods of prosperity. Regulators were not immune to euphoria in the marketplace.

Distrust of Third-Party (Bystander) Data

The SEC report is replete with examples of the SEC's apparent unwillingness to "trust" data coming from third parties. Markopolos, a potential market competitor, discovered the fraud when he tried to replicate the transactions. Although providing a "blue print" of Madoff's fraud, the OIG report indicated that the relationship between Markopolos and NERO enforcement was "adversarial from the start" (U.S. SEC, 2009: 18). Even more significantly, SEC examiners never requested independent third-party verification of trades even though that information was available; for example, the Depository Trust Company (DTC) was responsible for clearing and settling transactions. When examiners asked Madoff for his DTC account number, Madoff thought it was "game over." But the SEC never followed up to examine those accounts. Had they done so, they would have discovered that Madoff held substantially fewer equities than he claimed. Although this oversight might be a product of sheer laziness or incompetence, it also might reflect a mindset unwilling to consider data collected and owned by others.

Rethinking Regulatory Attention

The analysis of what went wrong in the Madoff investigation sheds some light on what we might need from broader regulatory reforms. After all, the failure to attend to clear signs of overly risky behavior lies at the heart of both. Some proposed reforms (e.g., changes in capital requirements) clearly focus on protecting assets and market stability. Others are linked more directly to the need to improve our assessment of the overall health of the market *and* to improve our capabilities to prevent and ferret out fraud. To avoid the mistakes of the past, we must creatively rethink regulation. We cannot simply reconfigure the current structures of financial regulation without also addressing ways to refocus the attention of those who guard our trust. Although some blame for the current global financial crisis surely lies at the feet of systems of self-regulation, we should not retreat to state-centered systems of command and control that were problematic in the past. Instead, we must consider creative ways to strengthen state power for investigating fraud that work in strategic collaboration with the self-regulatory systems so that both can "steer and row" (Braithwaite, 2000). A regulatory system that can embrace successfully a diversity of perspectives (Dorn, 2010), and be accountable to the public, might be able to promote the kind of inquisitiveness that van de Bunt (2010) aptly notes needs to be encouraged. (Managing conflicts of interest offer additional threads of reform not discussed here. These might include clear separation between advisory and custodial functions of investment services. Similar structural reforms such as bringing hedge funds and private equity into SEC jurisdiction are beyond the scope of the article.)

Specific regulatory reforms are well beyond the scope of this essay and my personal expertise. Still, some broad principles gleaned from the SEC's failure to investigate the Madoff Ponzi scheme and informed by scholarly discussions of new governance might help influence the architecture of regulatory reform. These principles recognize that regulation, even the enforcement function, works better when grounded in an iterative process of information sharing among regulators, the regulated, and the public; the latter too often being excluded.

Increase Competency

Before we insist on finding new incentives for whistle blowing or other forms of disclosure and exposure, we ought to consider promoting finance literacy for those whose job it is to guard our trust. In both the Madoff scandal and the most recent financial crisis, it is clear that regulators did not have the needed expertise to assess the transactions they were charged with monitoring (see also Rhee, 2009). On-the-job training is no longer sufficient for the regulation of the market. Lawyers responsible for the investigation of market-based fraud must have sufficient levels of finance literacy, at least enough to assemble a team with the requisite skills. Career tracks within regulatory agencies must be developed that encourage the best and the brightest to stay around long enough to accumulate the judgment that so often is necessary to ferret out complicated frauds. Because investment officers at large foundations and not-for-profits seemed to be largely ignorant about the ways they put their assets at risk, we should consider new certification programs for those who manage other people's money.

Audits for Learning

Audits have become an increasingly relied-on regulatory strategy of forcing regulated entities to "account" for their activities (Powers, 1999). A 2003 special issue of *Law & Policy* critically examined how regulatory agencies, nongovernmental organizations, and other public-sector actors used outside and independent audits to facilitate compliance with regulatory rules. Audits rarely lived up to their promise for accountability. Like the tunnel vision that limited the SEC's investigation of Madoff, Parker (2003) found that the audit methodology used by Australia's two biggest regulators tended to focus on the management system at the expense of the harm that might be done by business practices. Does that make the audit useless? Perhaps not. Parker introduced the possibility of changing the stance of the audit to be a more critical analysis and constructive evaluation rather than a blanket assurance of rule following. In another contribution in this same volume, Scott (2003: 214) argued for the potential value of auditing as a form or meta-regulation that helps to "achieve structural coupling, to find an alignment between the normative structures of regulating and regulated systems." The challenge of finding alignment in the flow of contemporary markets is daunting. And, of course, all obvious caveats of regulatory capture apply. Still, they should not dissuade us from using audits in new and creative ways.

Auditing for learning raises the possibility of greater understandings and adaptations by both the regulator and the regulatee that are grounded in experiential learning and regulatory principles rather than strictly by rules. Along with the explosion of new financial instruments has come a plethora of new rules to regulate them. Those charged with monitoring compliance, whether public or private, too often miss the forest for the trees. Although a place for the more traditional audit remains, audits for learning that use principles rather than rules as their guide might lead regulation in new directions to uncover fraud that is masked by complex systems of rules.

The Political Will

As this essay was being written, the Financial Industry Inquiry Commission is holding hearings to increase our understanding of what led to the financial meltdown. Testimonies from former Chairman of the Federal Reserve, Alan Greenspan, that he did not do anything wrong and from former Treasury Secretary and Citigroup chairman, Robert Rubin, that he did not know were predictable. The inability of the commissioners to probe beneath the surface and to ask hard questions is disturbing. In her *Wall Street Journal* commentary, Peggy Noonan (2010: A13) chided the witnesses for their boringness and "opacity of language so thick that following them is actually impossible," and reminding her of Michael Lewis's (2010) observation that "the subprime market had a special talent for obscuring what needed to be clarified."

To cut through the obfuscation of the markets, we need the political will to investigate and learn from our mistakes. This kind of analytic exercise falls in the valley between the twin peaks (Coffee and Sale, 2009) of consumer protection and prudential regulation. In his provocative testimony before the U.S. House of Representatives Committee on Oversight and Government Reform, Andrew Lo (2009) proposed an independent agency like the National Transportation Highway Safety Board be established. His "Capital Markets Safety Board" would be "dedicated to investigating, reporting, and archiving the 'accidents' of the financial industry . . . teams of experienced professionals… work together on a regular basis over the course of many cases to investigate every single financial disaster, a number of new insights, common threads, and key issues would emerge from their analysis" (p. 20). As part of their charge, institutionally embedded and systemic fraud like that undertaken by Madoff should be included as part of the list of "accidents" that require this level of inquiry.

The political will and the funding to investigate deeply through independent investigation surely will help to encourage cultures of inquisitiveness of public agencies. Fraud might be hard to prevent, but certainly lessons can be learned from the past. Investing in comprehensive and independent analysis of market "accidents" might help structure our attention to the possibility of future fraud.

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Serious tax fraud and noncompliance

A review of evidence on the differential impact of criminal and noncriminal proceedings

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Research Summary
This article reviews what international evidence exists on the impact of civil and criminal sanctions upon serious tax noncompliance by individuals. This construct lacks sharp definitional boundaries but includes large tax fraud and large-scale evasion that are not dealt with as fraud. Although substantial research and theory have been developed on general tax evasion and compliance, their conclusions might not apply to large-scale intentional fraudsters. No scientifically defensible studies directly compared civil and criminal sanctions for tax fraud, although one U.S. study reported that significantly enhanced criminal sanctions have more effects than enhanced audit levels. Prosecution is public, whereas administrative penalties are confidential, and this fact encourages those caught to pay heavy penalties to avoid publicity, a criminal record, and imprisonment.

Policy Implications
Although it has yet to be proven that prosecution has a greater or lesser impact on these offenders, increased prosecution might be justified for purposes of moral retribution as well as perceived social fairness.

Keywords
serious tax noncompliance, criminal penalties, civil penalties, fraud, white-collar crime, tax evasion, deterrence, shame

This research has been carried out under the ESRC Professorial Fellowship RES-051-27-0208. I am grateful to the U.K. tax authorities (HMRC) for stimulating and facilitating the work, and to Peter Grabosky and the anonymous reviewers for their comments and editorial assistance on earlier drafts. Direct correspondence to Michael Levi, School of Social Sciences, Cardiff University, Cardiff, Wales, U.K. CF10 3XQ (e-mail: levi@cf.ac.uk).

Tax fraud has been largely neglected by criminologists. Although the boundaries between criminology and regulatory research have been elided in recent years, high-end tax evasion has not played a prominent role in white-collar or corporate crime literature.[1] The purpose of the study described in this research article was not to fill that large gap; rather, this study's purpose was to determine the effect on general and on specific deterrence when individuals deemed by the revenue authorities to be "seriously noncompliant" with their legal tax obligations are (a) publicly prosecuted or (b) dealt with by civil penalties, away from the gaze of the media and the public.[2] This study also considered the broader public policy aspects of this decision, such as fairness and legitimacy, which influence the decision to declare earnings honestly or not among the general public.

Serious noncompliance (SNC) is a behavioral and administrative label, not a legal one. It includes major frauds that are prosecuted and "serious" evasion cases that might meet *prima facie* criteria for fraud but actually are dealt with by negotiation or, when this fails, by civil or administrative law mechanisms.[3] "Seriousness" is undefined intentionally by revenue departments but can relate to the size of losses (harm) and to perceived intentions (blameworthiness). It also can reflect the taxpayers' position of trust (e.g., tax advisers), their celebrity status (e.g., leading sports or movie stars), and the perceived high level of evasion in the public sector. In the latter three cases, prosecutors will consider strategic prosecutions or other publicity strategies to leverage the effects of their interventions and to produce general deterrence. Thus, U.K. doctors recently have been targeted for public threats of aggressive enforcement (Houlder, 2010).

Much is at stake in judging deterrence impacts. In the United Kingdom, the indirect taxation "tax gap" is estimated to be £15 billion, mostly in value-added tax fraud, and the direct

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1. Some prominent exceptions to this neglect exist, mostly emanating from the Australian Centre for Tax System Integrity (CTSI; see J. Braithwaite, 2005; V. Braithwaite, 2003, 2009a, 2009b; Braithwaite and Wenzel, 2008; McBarnet, 1991, 2003; McBarnet and Whelan, 1999; Murphy and Harris, 2007). For research that connects tax fraud and conventionally defined organized crime networks, see van Duyne, 1993, 1999; van Duyne and Houtzager, 2005; and Heber, 2009.) Taxation rules are complex—deterring the interest of the inexpert—and confidentiality rules normally would prohibit researcher access to tax files.

2. In the United Kingdom, most people suspected of serious tax noncompliance by individuals (hereafter, SNC) are told that a prosecution is not planned and are given the option of making a full disclosure, following which they might be given a reduced penalty for cooperation (e.g., 10% instead of up to 100% of the tax due). This civil fraud investigation procedure is set out in Code of Practice 9 (2005; available at hmrc.gov.uk/LEAFLETS/cop9-2005.htm#a). In the United States, where the process is similar, civil penalties are commonplace: In the 2008 fiscal year, 40.3 million penalties were assessed involving more than $28 million, abated by $11.9 million. (See irs.gov/taxstats/bustaxstats/article/0,,id=207459,00.html and, for the schemes, irs.gov/irb/2004-12_IRB/pt03.html. For the U.S. tax settlement manual, see Seidman, DiCicco, and Meland, 2009.)

3. Normally, tax fraud cases would receive serious (and expensive) analysis by departmental criminal lawyers before a decision is made to prosecute. However, that is the penultimate stage ***only for those cases that are seriously examined for prosecution.*** Where the default is that most serious cases are not prosecuted; such detailed consideration is given only to a few tax cases that stand out as "appropriate" candidates for prosecution—an unresearched process. It is seldom if ever possible for outsiders to know what plausibly could have been prosecuted but was not. In the United Kingdom and in most countries, tax data are legally confidential (although in Sweden, declared income and taxes more than U.S.$27,500 p.a. on all taxpayers are publically available, as are business debts to the government).

taxation "tax gap" is estimated at £25 billion, of which £8.9 billion relates to corporation taxes (Her Majesty's Revenue and Customs [HMRC], 2009). This amount is approximately 9% of the total tax "take" (Public Accounts Committee, 2009: 3). The 2009 U.S. net tax gap was estimated at $290 billion, based on 2001 figures (U.S. Internal Revenue Service, 2009).

A series of factors have focused analytical and political attention on the hollowing out of state resources and the role of "secrecy havens" in enabling (a) rich individuals and corporations to pay small amounts of tax and (b) white-collar and organized criminals to conceal both their schemes and the proceeds.[4] Recent nongovernmental organization campaigns have been launched against high-end tax avoidance and transnational corruption.[5] In addition, thousands of high net worth Americans and others were assisted by some international banks in holding accounts overseas without informing their tax authorities—which those individuals legally were obliged to do. In the aftermath, approximately 14,700 individuals from approximately 70 different countries "voluntarily" disclosed to the Internal Revenue Service (IRS) secret offshore accounts at UBS (Zurich Switzerland) and other banks to avoid possible criminal prosecution in the United States. The number is almost double the initial amount announced in October 2009 and dwarfs the number of voluntary disclosures in 2008 when there were fewer than 100.[6] A more modest approximately 10,000 people contacted the HM Revenue and Customs (HMRC) in the United Kingdom before the expiration of the reduced penalty deadline to confess about their offshore accounts—more than 1,000 people on the last day ("Last chance saloon," 2010). Currently, it is not possible to deduce whether the fear of prosecution or the fear of significant financial penalties most affected these decisions. However, the fact that these people had underreported income and wealth in the first place suggests that neither sanction alone was a deterrent, and that expected detection rates were low. This low detectability, indeed, has been the promise of "customer confidentiality"—the discreet term for banking secrecy—in recent decades.

Public and governmental tolerance of high-level tax evasion might diminish as smaller corporate and individual taxpaying populations bear the burdens of financing public services and supporting weakened financial sectors. Despite an unannounced fall in the proportion of millionaires facing audit (TracIRS, 2009a), and a relatively unobtrusive auditing risk for finan-

4. These factors include the redistributive (in favor of the rich) policies of the George W. Bush Administration, the "dot.com" bubble of 1998–2001, the collapse of Enron, and the economic crisis of the late "noughties" (2008–2010). U.K. data show that inequalities have risen under the "New Labour" administration 1997–2010 (Hills et al., 2010). Arguably, this reflects the light-touch approach to financial services regulation, including by the tax authorities.

5. See, for example, taxjustice.net/cms/front_content.php?idcat=2 as well as Global Financial Integrity (gfip.org/), Global Witness and Transparency International.

6. See Chung (2009). An HMRC article estimated the tax gap for the very wealthy through an analysis of complex personal returns (CPRs) risk-based enquiries on the 40,000 taxpayers selected by having substantial income or wealth and complex tax affairs. Based on this definition, the tax gap for the very wealthy is estimated to fall within a range of £115 million to £250 million. See hmrc.gov.uk/freedom/tax-gap-very-wealthy.pdf.

cial services corporations,[7] these pressures might have generated some reevaluation of how we respond to suspected tax evaders in the United States, the United Kingdom, and elsewhere.

Historically, in every jurisdiction, most suspected tax evasion has been dealt with through civil and administrative penalty mechanisms or by negotiated settlement rather than through the criminal justice system. In essence, this process means the payment of a percentage of the amount detected as "evaded," in addition to the unpaid tax itself with a scale of penalty reductions for early and full declaration. The "taxpayers" usually have to make a declaration that they have disclosed all assets and income, making it easier to prosecute or to administratively fine them if this declaration is discovered to be a lie. This legislation has been assumed to be a rational way of dealing with people viewed as being "not real criminals" and as amenable to the sort of graduated sanction pyramid developed by John Braithwaite (2002). This tendency does not mean that no prosecutions occur, but that prosecutions are rare and not systematically related to the size of evasion.[8]

Presumably to ensure that taxpayers cannot "game" the system, HMRC public guidance on its discretionary principles does not define SNC or specify beyond the vaguest terms the criteria underlying its prosecution policy. Although substantial research and theory have been conducted on tax evasion and compliance, almost no focus has been directed to the SNC subpopulation. As with criminological theories in general, inferences about susceptibility to sanctions that are drawn from the generally law-abiding might not apply to intensive offenders.

No scientifically defensible studies have been reviewed to date that directly compared civil and criminal sanctions for tax fraud, although some examined the impact of significantly enhanced criminal (but not civil) sanctions compared with enhanced audit levels. The most notable of these studies is a review for the IRS based on state-level cross-sectional analysis for the period 1988–2001 (Dubin, 2007). Dubin took a positive view of the relative impact of

7. Only 15% of which were audited in 2008 compared with 64% of all other large corporations (TracIRS, 2009b).

8. In the United States, tax fraud prosecutions totaled 1,368 in fiscal year 2008, an increase of 8.7% over the 1,259 prosecutions reported for fiscal year 2001. This amount constitutes approximately 8% of the federal white-collar prosecution total. In the United Kingdom, during 2008/09, the Revenue and Customs Prosecution Office completed 1,121 prosecutions involving 1,506 defendants. Asset confiscations constituted a tiny proportion of the "tax gap" estimates (HMRC, 2009; RCPO, 2009).

criminal sanctions—perhaps a slightly more positive view than the evidence warranted.[9] Although corporations ultimately are run by individuals, the alignment of opportunities, risks, and incentives might be different for companies. The policy implications of this notion are examined in the following sections.

Models of Tax Compliance

A proper model of fraud committed in a business or professional context should differentiate among the following (see Levi, 2008a):

1. Preplanned fraudsters have the initial intention of defrauding taxes (although the scale of their ambition might vary, as might their need for active collaborators and skills).
2. Intermediate fraudsters start out honestly but turn to intentional fraud later.
3. Slippery-slope fraudsters might commit offenses of deception (and insolvency fraud), while in their own eyes at least, merely seeking to carry on their previous business; or they might continue incurring debts (including their own living expenses and tax obligations) at a time when they cannot objectively repay.

Such differentiation is absent from the literature on tax fraud and, indeed, on tax compliance generally. A helpful general framework of the potential determinants of tax compliance, against which the relative effectiveness of civil and criminal sanctions might be based, is provided by Kirchler (2007: 3). His components have been modified and rephrased in Figure 1.

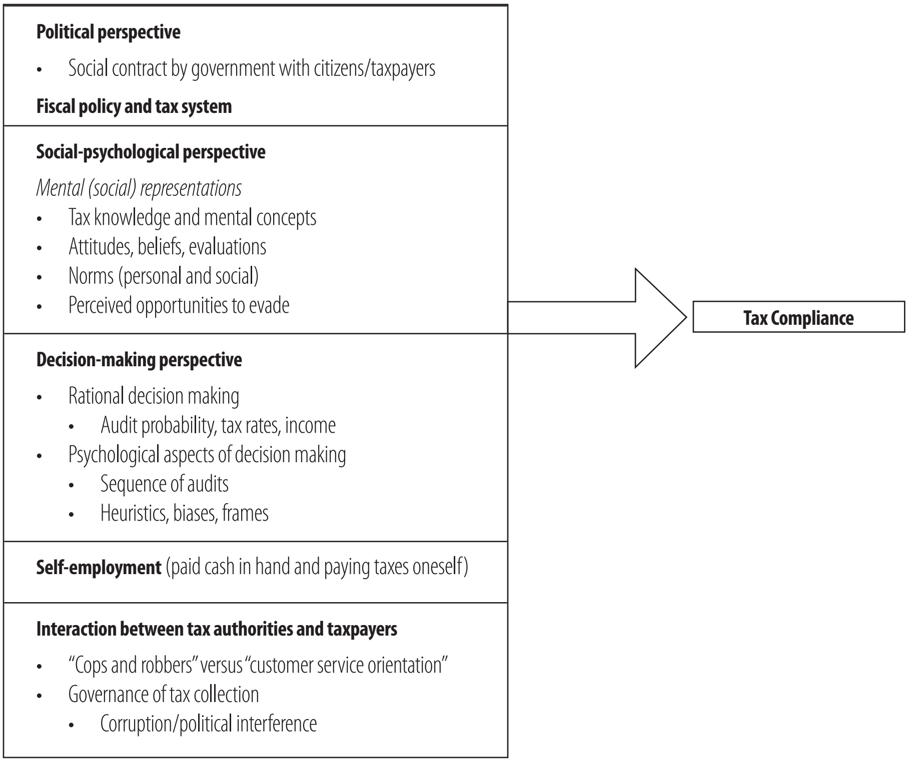
Principal Lines of Literature Review

This analysis begins by distinguishing between (a) the expressive moral component of the use of criminal law and (b) the practical impact of criminal prosecution (compared with other forms of sanction) on SNC behavior. It also considers the implications of a more "criminalizing" orientation for the staffing levels and expertise of tax agencies, prosecution departments, and the already-heavily occupied criminal and civil courts.

9. The significance levels are much lower than would be needed to show definitively that criminal prosecutions made more of a difference than increasing audits. Dubin (2007) concluded that criminal investigation (CI) activities have a measurable and a significant effect on voluntary compliance, that the mixture of sentenced cases (for tax and money laundering violations) is not a significant determinant of tax compliance, and that incarceration and probation have more influence than fines on taxpayers. Simulations using estimated models showed that the direct effect of doubling the audit rate on assessed tax collections (reported amounts and additional taxes and penalties) was $21.7 billion, whereas doubling the CI tax and money laundering sentences might increase assessed collections by $16.0 billion. He estimated the general deterrence, or spillover effects, from either audit or CI activities to be approximately 95%, in other words doubling the impact of direct actions. However, what is important for deterrence are ***perceptions*** of audit probability and forensic competence (as well as a judgment about consequences), not objective audit rates (although changes in the latter should have an effect on the former). An earlier study by Dubin (1990) concluded that self-reported taxes would have been $15.6 billion more in 1986 had audit levels remained at their one third higher 1977 levels, but Long and Burnham (1991) criticized this inference, arguing that because an audit program was in place, other changes in enforcement resources made it difficult to determine the independent effect of varying detection probabilities.

FIGURE 1

A Framework of the Factors Influencing Tax Compliance



No model can sensibly determine in aggregate form the level of *intentional* or *recklessly dishonest* SNC (i.e., tax *crime*). This crime has to be analyzed case by case, perhaps using precedents to predict outcomes in sets of analogous cases. The latter has not been attempted by anyone. Focusing on tax decision making by individuals, compelling evidence suggests that our individual tax decisions are affected by normative influences in our environment and by the extent to which professionals are available to help us evade if we are inclined to do so.

The Taxpayer as a Moral Calculator

The central orientation of the early economic models is that of the taxpayer-as-gambler (TAG), which is similar to the "amoral calculator" type in general business regulatory studies. The TAG model makes the following four propositions (Cowell, 2004):

1. If the rate of return to evasion is positive, then everyone evades tax.
2. People with higher risk aversion tend to evade less.
3. People with higher personal income tend to evade more.

4. Increasing any of the standard tax-enforcement parameters (the probability of audit, the proportional surcharge on evaded tax, or the tax rate) will reduce the amount of concealed income.

However, empirical evidence casts doubt on these propositions. Evidence from the U.S. Taxpayer Compliance Measurement Program (TCMP) suggests that a firm's compliance is associated positively with being publicly traded and belonging to a highly regulated industry. Having low profits relative to the industry median is correlated with higher corporate tax evasion. Cowell (2004: 11) argued that a rational taxpayer's current tax evasion is a decreasing function of evasion in previous periods. If caught, then he will receive penalties for previous years' noncompliance. However, if taxpayers regard themselves as exceptionally sharp, or if they become "addicted" to cheating and believe that varying their tax admissions will arouse the suspicion of tax authorities, then prospective risks of having to make back-payments might not be enough to persuade them to stop. This issue might be even more true for individuals in corporate settings whose annual bonuses and stock prices might receive strong "performance boosts" but against whom tax investigations might occur only years afterward.

Personality abnormalities characteristic of major fraudsters generally might occur at the high end of the SNC population, and commercial sociopathy might be stimulated by aggressive business and professional cultures or by pressures from "organized crime." For example, value-added tax/carousel/excise frauds in Europe carried out by professional teams might create and sustain "markets for tax vice" (J. Braithwaite, 2005).

Expectations of and concerns about stigma also are related to anticipated occupational consequences. Getting a sanction on one's record means more for those who need regulatory authorization as a "fit and proper person" to continue their careers (e.g., as a director of a public company or bank, a money laundering reporting officer, or a lawyer). Conversely, even a criminal record and bad publicity mean comparatively little to people who can operate in the background using "front men" (more rarely, "front women"). A criminal record is likely to do more damage than an administrative "record" to elites and is picked up more readily by foreign authorities.[10] A criminal record or a regulatory penalty mentioned in a newspaper article might be picked up by electronic newsgathering and be detected in the course of due diligence searches, which can affect corporate takeovers and banking licenses. Here, the fact that noncriminal tax penalties are not published significantly reduces the collateral damage to those sanctioned. *If they have the resources to repay* and/or *if they are below the various thresholds for prosecution*, then they buy their way out of the public record as well as out of "justice." A personality dimension is present in regard to the desire for approval or fear of disapproval by others, which can be important

10. Like the former U.K. Prime Minister's son, Sir Mark Thatcher, they might be denied a visa for the United States or might be prohibited from company directorships in countries (such as those in continental Europe) that apply such bars on people with criminal records (although the practical effectiveness of such controls is dependent on easy cross-border data exchange). To her astonishment, in 2008, home-improvement expert, Martha Stewart, was refused entry at a U.K. airport because of her felony conviction and imprisonment in the United States. If they had been dealt with by regulatory sanctions, then their visas would not have been affected.

to decisions to offend. However, some important recent changes in the nature of status and in the ability to insulate oneself from disapproving people have brought extra complexity to the task of social regulation and to deterrence by informal sanctions.

The subjective opportunity cost of any given sanction might vary among individuals, even though the actual sentence might be the same for all (see Bushway and Reuter, 2008; Cook, 1980, 1986; Nagin, 2007). As for *general* deterrence, communication of enhanced risk via highly publicized sanctions might increase the chances of people recalling a "bad event" if they contemplate tax evasion.[11] In the criminological version—rational choice theory—people maximize their utility given the situational opportunities that confront them. This notion has been modified to take account of variations in cognition and creativity in spotting fraudulent opportunities, sometimes in collaboration with professional advisers (Levi, 2008a).

However, it is not self-evident which choices will be seen as "rational." Economic models do not prespecify whether outwitting the tax authorities or other groups, despising conventional bourgeois tax morality, or following industry norms of "tax planning" are utilities to be maximized. Nor do they indicate whether the same characteristics are to be minimized as part of sentiments of social obligation that might vary between countries.[12] In international business circles, competitive pressures might stimulate the "race to the bottom" in tax minimization—legal or illegal. As Shover and Hochstetler (2006: 116) explained, "Choices . . . occur in sequences and change as circumstances develop. Moral reservations and internal inhibitions are subject to situational suspension or inattention." They cited one case involving a physician who did not file a tax return (2006: 113). He stated that postdivorce "I was trying to drink myself to death. I did not care about the government and did not think about the trouble I could get in. It totally did not matter to me."

Simpson (2002) demonstrated that risk perceptions and opportunities for advancement and thrills predicted the *intention* to offend in a variety of business crimes. Other factors influencing the intention to offend included an ethical reasoning scale, anticipated shame, and informal sanctions. Threats of formal sanctions—civil or criminal—were not strong deterrents unless combined with low moral principles. People with high morality and social embeddedness were unaffected by low sanction risks. Hessing, Elffers, Robben, and Webley (1992) noted that some need only a small amount of deterrence to keep them honest, others need none at all, and others

11. (Although guaranteeing such publicity might be hard to implement, unless, for example, sanctioned persons are required to pay for an advertisement about their misconduct.) In prospect theory, this response is called the "availability heuristic" (i.e., something that is available in the mind to assist decision making, in this case, whether or not to evade taxes).

12. John Braithwaite (2005) reviewed variations on aggressive tax shelter and scheme promotion among Australia, the United Kingdom, the United States, and even within different cities in Australia. To date, no studies of any effects have been done of the former KPMG (Sydney, Australia) or of Ernst & Young partners' (London, United Kingdom) prosecution and imprisonment in the United States upon the tax culture there and elsewhere. Because of collateral damage risks, KPMG was given a "deferred prosecution" on the condition that it change its practices—an increasing trend for corporate violators.

still are totally dismissive of threats.[13] Either they are fearless, or they are preoccupied with how to recover their losses. Arrogance might play a part in fearlessness.

Evidence from the United States indicates that taxpayers possess poor knowledge of the audit rules and risks, usually overestimating the probability of audit. Thus, fuller information might increase tax evasion rates (Andreoni, Erard, and Feinstein, 1998: 844, 845). Low awareness of law and detection risks is common among offenders generally and is an important issue in game-theoretical simulations of tax evasion. Rationality is always "bounded," not just by the knowledge of abstract probabilities but also by variable beliefs and concern about the reactions of others to knowledge of one's involvement in "crime." These might vary throughout time and place and are affected by the prospects of migration to places where one is unknown.

Discussing field experiments, Slemrod (2007) concluded that "there has been no compelling empirical evidence addressing how noncompliance is affected by the *penalty* for detected evasion, as distinct from the *probability* that a given act of noncompliance will be subject to punishment" (p. 38). This statement is consistent with evidence from general studies of deterrence. It does not address the civil versus criminal issue in the loose term "punishment." Data indicate that the "amoral calculator," or the TAG model, is simply wrong and that the model requires refinement. Frey (1997) and John Braithwaite (2005) suggested that increasing punitive tax enforcement might reduce compliance resulting from "civic virtue." However, it is questionable whether this finding applies to SNC. Even when people contemplating evasion perceive the costs associated with civil and criminal prosecutions as high, those costs might be viewed as amassing far in the future. One U.K. government economist observed the following:

> Tax evaders see immediate benefits whereas the costs which remain uncertain are unlikely to arise soon after the offence has been committed, if at all where the offence is not detected. This behavior may be particularly visible in risk seekers who are more likely to discount future potential costs. This then implies that we would want to focus on catching evasion quickly and not rely on the fact that we can look back and deal with the consequences of evasion that has occurred in the past (personal communication, 2008).

How does this apply to *business* tax compliance and evasion? Here the research is sparse. In principle, businesses can be either (a) mere fronts for the perpetration of fraud or (b) genuine businesses that evade tax as part of their repertoire of profit making, whether or not in response to declines in profitability. As with the earlier typology of individual involvement, businesses can turn from genuine trading organizations to mere instruments of tax or perhaps other forms of fraud, making ongoing risk monitoring crucial (Levi, 2008a). Control strategies should reflect which of these categories the firm belongs. To align the incentives of the decision makers and the shareholders, the corporation should tie the agent's compensation to observable outcomes

13. Because of personal or socially generated morality (see Wenzel, 2004).

that affect *post-tax* corporate profitability. As with distortions generated by the "bonus culture" responsible for much of the financial crisis of 2008–2010, this analysis would require serious attention by corporate governance and regulation. Crocker and Slemrod (2005) noted that enforcement strategies directed at the tax adviser and those directed at the corporation itself might impact business behavior differently. J. Braithwaite (2005) made the interesting point that Australian taxpayers, whose schemes were disqualified late in the day by the Australian Tax Office (ATO), blamed the ATO rather than their tax advisers.

Stigma, Reintegration, and Deterrence

Tension is always present between (a) frightening people with credible threats of formal and informal sanctions and (b) reducing social exclusion and promoting social reintegration, giving people an incentive to rehabilitate themselves. Part of the subjective evaluation of consequences in the decision to offend is the judging the meaning the potential penalties might offer for them.

For Karpoff and Lott (1993), as perhaps for the theory of reintegrative shaming, fairness vis-à-vis penalties and in satisfying the general public that the authorities are combating "unjust enrichment" is irrelevant (J. Braithwaite, 1989, 2002, 2005). Reintegrative shaming might have to deal with punitive denunciatory sentiments, and this process conceivably might be achieved by persuading victims and the public that the offender has atoned and will sin no more. A longitudinal study of U.S. federal "white-collar" offenders found that imprisonment had no significant effect on recidivism compared with fines or probation (Weisburd and Waring, 2001: 113; although civil or administrative sanctions were not examined in their study—a significant gap). This "no difference" finding applied regardless of timing, frequency, or type of recidivism.

High-level tax evaders, especially if unindicted, might find it comparatively easy to migrate to a "flight haven" jurisdiction where tolerance is high, at least as long as they retain their money. Consider the itinerant career of the late Robert Vesco, who lived, worked, and invested serially with senior public officials and their relatives in Costa Rica, the Bahamas, Antigua, Nicaragua, and Cuba while evading the U.S. authorities on a variety of fraud charges. Vesco's case is merely one extreme illustration of such toleration. Significant pressures have been placed within the G20 for greater information sharing and cooperation, including the introduction of peer-review mechanisms in 2010 (Organisation for Economic Cooperation and Development [OECD], 2009). However, because transnational tax collection lacks the moral appeal of fighting organized crime or terrorism, tax investigation powers have lagged behind the general trends in "soft law" peer reviews, sharing suspicious activity reports, and mutual legal assistance in criminal matters that have been stimulated by the Financial Action Task Force's anti-money laundering efforts (Levi and Gilmore, 2002; Sharman, 2006).

Legitimacy, Publicity, Awareness, and Tax Evasion

A narrow focus on particular sanctions applied to people or companies who are already seriously noncompliant can neglect the important dimension of *social legitimacy* to behavior. This outcome is true whether the situation involves paying taxes, corruption, or perceptions of the police (see Tyler, 2006, 2009). Alm, Jackson, and McKee (2008) concluded that the tax authority would be served by pre-announcing audit rates and by emphasizing the previous period's audit frequency in the annual reporting of enforcement efforts. Increasing audit levels tend to generate a substantial "ripple effect" among those not audited (Dubin, 2007). However, a "core" group of individuals—for whom general "appeals to conscience" tend to be irrelevant—might not be inclined to pay taxes or might otherwise engage in complex fraud schemes. For example, such appeals do not work on psychopaths (Babiak and Hare, 2007). For them, only system-"designed out" or individualized targeted intervention is likely to be effective.[14]

In common with other more general regulatory analyses, the models in the economic and regulatory literature assume some sort of market viability, rationality, and social embeddedness. These assumptions make it sensible to apply a "pyramid of enforcement" in which sanctions are escalated if people and organizations fail to respond to lower level sanctions and informal advice. Such regulation appears to optimize enforcement costs per (mis)behavioral unit (J. Braithwaite, 2002, see also Macrory, 2006). In economic terms, a blanket criminal justice model would impose resource costs that are unavailable and disproportionate to those who would respond to less costly sanctions. Even higher audit levels impose unnecessary costs on compliant taxpayers.

However, graduated sanction models are destined to fail with preplanned offenders whose businesses are not otherwise viable. They also might delay the identification of intentional organized fraudsters (individual, networked, or corporate) and the prevention of their frauds. However, criminal justice alone cannot put an end to the crimes of intentional organized fraudsters. For prevention, one also must consider the possibilities of disguise of beneficial ownership and shadow directorships, and perhaps also entertain better explanations of decisions that communicate the *moral* difference between categories of SNC. Hypothetical examples include applying the term "theft from the public" to businesses that are or have become mere instruments of fraud, and labeling as "decisions not to meet all their legal and social obligations" those otherwise legitimate corporations who might have invested heavily in their respectable social profiles but have been caught for SNC.[15]

In reviewing costs and benefits of criminal sanctions, an important balance should be struck among (a) *administrative convenience* (i.e., resource costs), (b) *outward-facing demands*

14. To reduce billions of pounds in annual losses, the HMRC has made more onerous the registration of new businesses for value-added tax—one major source of high-value preplanned fraud—although this regulation also negatively impacts honest new businesses. However, the monitoring of existing businesses contains many time lags that facilitate both the opportunity to defraud and the scale of fraud.

15. Pragmatically, one must accept here that the media cannot always be persuaded to publicize tax agencies' attempts to rebut corporate PR—except by paid advertisement—and the public might not always be persuaded to read or listen to the tax agencies' perspectives.

to "satisfy the public" that "justice" has been done and that the bad have been punished, and (c) *behavior-changing sanctions*.[16] In common law countries and even some civil law countries such as the Netherlands and Sweden, prosecution is optional even after the evidential threshold has been reached.[17] But if the case never reaches the police or prosecutor, then it will not be recorded as a crime or considered for punishment. Administrative and civil penalties applied by bodies whose main function is not to deal with "crime" in this sense are preemptive. A choice always has to be made about what is in the "public interest," but many people believe that wrongdoing normally should lead to punishment and to *criminal* justice. To others, the criminal law is just one mechanism among others for achieving a "reasonable" level of compliance. It is arguable that the optimal level is where the marginal benefits of revenue generation exceed the costs of enforcement.

In principle, one might have an approach that distinguishes among the following in sanctions and "control routes":

1. Those who commit large-scale tax fraud *and* are part of more general serious crime networks;
2. Those who evade tax via a substantial nondeclaration of income from crimes other than tax fraud;
3. Those who act more or less in isolation from general crime networks but are involved in a very high level of tax fraud (using corporate or other intermediaries as vehicles); and
4. Those who have "modest" amounts of undeclared income or overdeclared deductions against tax.

In terms of amenability to control, it is also helpful to distinguish between the following kinds of SNC: (a) those that have the *capacity* to pay proper taxes from their assets or profits and (b) those SNCs that would not survive if they had to pay a legitimate level of taxation. The former might be dealt with more slowly. The latter have to be closed down by whatever means—civil or criminal—as early as is ethically, legally, and pragmatically defensible. The goals here are to reduce misallocation, fraud losses, and to satisfy public expectations of legitimate intervention. Setting aside problems of cooperation and transparency in other jurisdictions, no reason exists why such a typology cannot lead to differentiated sanctions. However, one complicating factor in this equation is that tax fraud cannot be treated solely in isolation, for at least the following three reasons:

16. The social definition of "the bad" in tax cases is open to public relations and other pressures, which form part of the internal decision-making process about the consequences of prosecution, (a) in terms of whether juries are likely to share the prosecutor's presentation of harm and dishonesty of the accused (in jurisdictions that have jury trials) and (b) in terms of expected praise or criticism of the tax agency from the media, public, or government. (For discussion of media treatment of white-collar crimes, see Levi, 2006, 2008b.) In the United States, "underground' movements" claim a principled refusal to pay tax. Actor Wesley Snipes claimed membership of one such movement and was acquitted of felony tax evasion charges, although he was convicted of and imprisoned for three misdemeanor counts in 2008.

17. In many continental European countries, the principle of legality applies, and in theory, the prosecutor must prosecute ***all*** cases in which the evidence seems strong enough to merit prosecution. Recent research has noted that the Swedish Economic Crime Bureau less often takes continued action such as prosecution against those on "high incomes" (Kardell and Bergqvist, 2009).

1. Some tax fraudsters who are part of the "professional" or "organized" crime networks might be calculating the costs and benefits of tax fraud relative to other frauds and nonfraud crimes that they have the skills and resources to commit.
2. Some displacement effect might result from arbitrage of perceived detection and punishment probabilities in different jurisdictions.[18]
3. Some *general* demoralization/tax noncompliance effect might be discovered through comparisons of how leniently tax fraudsters are treated compared with social-security fraudsters in particular and "working class/underclass" offenders in general. Nontax and lower-level tax offenders also might seek to justify their conduct as being low in seriousness compared with the unprosecuted crimes (including tax crimes) of elites.[19] Fairness matters.

These observations raise the issue of what counts as "success" in enforcement regimes. A beggar-my-neighboring-department model might generate the aura of success against narrow objectives, but externalities impacting on the public might be considerable. In seeking to develop a dynamic model of "fitness for purpose" of sanctions, a refined problem-oriented policing model of the "triangle of tax crime" comprises the following elements: (a) suitable targets, (b) motivated offenders, and (c) capable guardianship (by tax authorities and other gatekeepers such as national and international employers, neighbors, tax advisors, bankers, lawyers, etc.). Attitudes to tax fraud/evasion are important components of crime in the context of motivation and guardianship. To these we should add that motivation to evade can be activated only where people work devious schemes out for themselves or are advised on *how* to do so. It is worth noting that an important component of the "mix" is interactive impacts between taxpayers based on what they believe (rightly or wrongly) about (a) the levels of evasion and (b) the risks and consequences of sanctions.

Where do people get their knowledge from? In addition to information from professionals, publicity about tax prosecutions might occur in specialist professional publications (tax advisers or construction newspapers), business papers and electronic programs (*Bloomberg*, *Financial Times*, and *Wall Street Journal*), national mass media, and local media. Media coverage in tabloids might have little effect on elites, but it might have significant effects on the popular sense of "justice for all." Coverage in the specialist and professional press might produce stigma and fear of stigma among some or all actual and potential evaders but leave unaffected mass opinion about equality of justice and the legitimacy of tax enforcement. If it is correct that "taxpayers" are willing to pay more in civil penalties than expected criminal penalty levels to avoid conviction and publicity, then the argument might take a different shape from a situa-

18. The role of professional advisers, the media (including professional publications), and social/professional network rumors are important here. Considerable informational asymmetry is likely to occur, and some professionals might keep their extensive knowledge of tax agency practices to themselves as an "asset" to market to clients. Ex-Revenue staff often are recruited precisely for their inside knowledge and to assist in negotiating out of trouble.

19. The *causal* impact of such perceptions is hard to determine, but the moral effect of controls is diminished by their ability to point to tax and other frauds by relatively well-off people.

tion in which 3% of the total tax evasion identified is recovered. The latter was observed by the U.K. Public Accounts Committee (2008), which also noted that no sanction occurred of any kind in half of the cases.

Conclusions

Beginning this year, pressures will increase to extract more taxes from companies and from wealthy individuals. The gloss has been stripped from the "light touch regulation" culture, and public finances need replenishment from the massive bailout of the financial sector. The judgment that noncompliance is "serious" can relate to large individual or linked cases, to the professional and social status of the people involved, or to the *perceived* increasing rate of a form of abuse. This latter perception will trigger alarm at the erosion of a major public income or expenditure scheme. The impact of civil penalties that have been or will be publicized might be very different from the effects of current anonymous civil penalties. Under s94 of the 2009 Finance Act, HMRC can put on its Web site the names of some who are deemed to have deliberately evaded tax of more than £25,000 in total after April 1, 2010, unless the evaders make a full disclosure of any tax wrongdoing without delay. However, the number of people who will be thus "named and shamed" remains obscure.

It is important to differentiate between the impacts of civil and criminal processes on (a) those individual and organizational SNCs that have been identified and (b) the pool of currently unidentified actual and potential SNCs. SNCs here could include the infrastructure of facilitators and inhibitors of SNC behavior—such as the large accounting firms given deferred prosecutions in the United States, allegedly (and plausibly) because of the collateral damage that would be caused by their postconviction liquidation. Interviews with imprisoned Australian tax offenders provide insight into the importance of procedural justice and the relatively greater impact of economic informal sanctions compared with the pains of imprisonment (Roche, 2006). However, those interviewed do not seem to be very high tax-evading offenders or those using the corporation as a tool for fraud; in other words, the interviewees do not appear to be the kinds of taxpayer who might be less susceptible to mass social influences.

The scale of global misconduct by elites might be indicated by the fact that, after revelations of its willingness to sacrifice its clients' secrecy to save itself from a terminal criminal conviction, Swiss-headquartered bank UBS experienced net outflows from its private banking operation of SFr90 billion ($84.4 billion) in 2009 (Simonian, 2010). German officials stated that they had received approximately €200 million by February 2010 from "voluntary" declarations by LGT's (Vaduz, Lichtenstein) German clients—a 40-fold return on investment on the €4.6 million they paid the domestic secrecy law-breaking informant for the data without taking into account income the German government received from Australia, the United Kingdom, and the United States, among others (anonymous personal communication, February 2010). The Germans have announced publicly their willingness to purchase data from other "secrecy havens," mentioning a Swiss informant willing to violate Swiss criminal provisions on bank secrecy ("Secrets and tax," 2010). Other countries such as the United Kingdom have announced publicly that they are willing to purchase such data from the German authorities. It seems likely that such anti-organized crime-type policing methodologies for raising transparency will transform the risks for evaders more than weighing the civil penalties versus the criminal prosecution.

The use of the criminal sanction has a moral component. Governments criminalize acts on the basis that they are morally wrong and *deserve* public sanction—not just as a pragmatic technique for controlling the behavior more effectively. It is intriguing to consider how the prosecutions and penalties regimes would differ from the present ones if the United Kingdom, the United States, or Australia had a unified body prosecuting or sanctioning all frauds against the government—from tax to social security frauds—as Sweden does. For some elite and perhaps nonelite suspects, "the process is the punishment" (Feeley, 1992). To what extent should we take account of the secondary consequences of arrest, charge, and sentence for the particular offenders when deciding what form of action to take?[20] The interagency consistency issue keeps reemerging in tune with the "social fairness" question that cuts across internal bureaucratic rationalities in different countries and might indeed be part of the social fabric that is crucial to tax compliance.

How we handle SNC might *influence* as well as *reflect* how seriously this misconduct is regarded. It might be easier for those with tax evasion opportunities to rationalize serious evasion as "not really harmful" if they see few people like themselves convicted. And those who commit smaller but still significant offences might be able to rationalize their conduct to themselves and to at least some of their peers as "nonserious" by reference to larger, unprosecuted cases (Henry, 1978; Levi, 2008a; Shover and Hochstetler, 2006).

In considering the practical implications of international evidence, one must observe cultural differences when adopting models on the basis that they "work" or "do not work" somewhere else. "What works" is always contingent on context (see also Hasseldine, Hite, James, and Toumi, 2007: 190). Thus, Swedes might be particularly concerned about the demoralizing effects of perceived evasion levels upon the hardworking middle classes; whereas in Germany, the motivation for pursuing tax evaders principally seems to be the search to pay for welfare levels at a time of decreasing state budgets.[21]

Unfortunately, hard evidence of the relative impact of civil and criminal sanctions on tax offenders does not seem to exist, and even absolute impacts of either civil or criminal sanctions are absent. One form of financial sanction is, of course, the confiscation (or asset recovery) order. Although some anecdotal research in the United Kingdom suggests that serious mainstream criminals in particular are upset by the prospect of losing their assets, it falls short of hard evidence of its individual or general deterrent effect (Levi and Osofsky, 1995; Matrix, 2007).

20. The question of how we can calculate properly these secondary effects is difficult to answer. Sociopaths might simulate well-integrated people and incorrectly get sympathy and reduced risks of prosecution and sanctions—that is their tradecraft.

21. I am grateful to the anonymous reviewer for suggesting these points. The two motivations are not, of course, incompatible.

Civil penalties might be cheaper to resource, might be faster, and might be more predictable than criminal jury trials. That is their chief attraction to both enforcement body and "offender." Their disadvantage is the sense of unfairness and social privilege they create, although no one might know. Stigma and the criminal process are more of a deterrent to those "respectables" who consider that they have something to lose (Sherman and Smith, 1992). Recidivist fraudsters and the mobile megarich might *prefer* social approval (or the absence of public disapproval) but are not dependent on it. If you have money, then you will always have "friends."

Given the economic stakes, much thought needs to be given to how we might produce better evidence about the yield of different approaches to dealing with high-level evasion. Given the strategic view taken by tax authorities of the use of prosecution, it might be possible to conduct a long-term randomized controlled trial in which some serious cases were allocated to criminal prosecutions and others were not—a policy that would cause outrage if applied to very serious harms in other spheres of "criminal justice." However, unless they were done at different times, it would be difficult to track the *general* deterrent or preventative effects because it might be too difficult to attribute effects to the particular measure. The "criminal careers" models now familiar in general criminology are largely absent for individual and corporate tax evaders, and data need to be collected systematically on such "careers" subject to errors generated by unknown beneficial ownership and false identities. At present, we know far too little about the "tax careers" of SNCs to form a base rate for such evaluations, and (though there are some unpublished cross-sectoral data-matching exercises in the United Kingdom) we know even less about their involvement in other offending.[22] Other measurable initiatives are available that one might monitor more rigorously. These initiatives include the state-of-belief, expectation and knowledge of the risks, and the consequences of tax sanctions, focused especially on the sorts of elite and risk-taking circles in which serious tax evasion is likely to flourish. Likewise, the impact of publicity campaigns on both tax yields and whistle blowing could be measured (see also Wenzel and Taylor, 2004). It should be possible to examine the effects of threatening taxpayers with publicity on civil settlements if they do not make an accurate declaration and settle early, contrasting future with present rates of early settlement.

Although scientific evidence might bear on some components of the tax control role, some core aspects of the civil versus criminal process debate are really policy questions. How much of a role should the tax agency give to the public display of disapproval of particular tax evasion practices? How much to issues of social fairness—"equal punishment for all serious offenders"—rather than to the (probably) less expensive and quicker civil mechanisms? If actual and potential serious tax evaders *over*estimate the risks and consequences of tax sanctions at present, then publicity might *reduce* deterrence. The present state of evidence does not tell us

22. (Although Heber, 2009, examined unregistered construction workers in Sweden and the relationships between the fixers and criminal entrepreneurs on the basis of data from the Swedish Register of Suspected Offenders.) Sweden takes a sophisticated approach to economic crime prevention, using both administrative and criminal evidence as well as research-scoping studies by the Swedish Crime Prevention Bureau to feed into preventative methods (Korsell, 2005). It should be stressed that media publicity styles vary enormously between countries (for a Swedish study of a corporate financial scandal, see Alalehto, 2007).

how different sets of potential serious tax offenders perceive these trade-offs. Much needs to be done to improve the evidence base for decisions on how to deal with the large-scale end of tax evasion. Perhaps the economic and fiscal crisis might be the stimulus to involve multidisciplinary research, including criminology, in this important area of public policy.

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POLICY ESSAY

SERIOUS TAX FRAUD AND NONCOMPLIANCE

Criminal prosecution within responsive regulatory practice

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In his article, Levi (2010, this issue) makes an argument for why serious tax fraud and noncompliance should be addressed through criminal as opposed to noncriminal proceedings. But will it deter the noncompliant? Context, as he acknowledges, is a central determinant in how sanctions affect subsequent tax noncompliance. Context includes the norms and attitudes of the community to tax evasion. It is also the case, as Levi notes, that a more "criminalizing" orientation has implications for "staffing levels and expertise of tax agencies, prosecution departments, and the already heavily occupied criminal and civil courts." Such factors are bound to intervene between a more aggressive policy that applies criminal sanctions in response to serious tax evasion and the ultimate goal of deterring tax fraud and delivering to the taxpaying public just outcomes in response to serious tax noncompliance. That is not to say that Levi's appeal should fall on deaf ears, just that it needs to be interspersed with a suite of other sanctioning mechanisms that have political support and that are embedded in the public's understanding of how justice can be delivered in the domain of tax noncompliance.

Levi (2010) suggests that an analysis of cases—in particular, analogous cases—is the appropriate methodology for gathering evidence on causes and consequences. In the absence of such data, the policy question is how to progress the argument, begin a systematic scrutiny of cases, and maintain scope for correcting the strategy as evidence accumulates. Research supports Levi's position that serious tax noncompliance needs to be a more costly exercise for taxpayers who intentionally engage in fraud, who drift into such activity through poor business acumen or financial desperation, or who act as opinion leaders and experts, convincingly discounting the risks of prosecution as they market financial products to an unsuspecting public. This policy essay considers how tax authorities might increase the costs of serious tax noncompliance through a

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suite of mechanisms that support rather than detract from criminal prosecution while preserving efficiencies in tax authority budgets and reassuring compliant taxpayers.

Community Norms and Expectations on Serious Tax Noncompliance

Arguably, the time is ripe for seeing serious tax noncompliance as a criminal activity that warrants a response that uses the full force of the law. Although tax evasion, at times, has been dismissed as the sort of thing that everyone would do given half a chance, the evidence suggests a stronger sense of law abidingness around the issue of paying taxes in the broader community. The public are well aware that the benefits offered by governments are dependent on the tax that everyone pays, and although acceptance is widespread that not everyone pays their fair share of tax (in particular, those in positions of privilege and power) and that governments are not immune from wasting taxpayers' money, community support is strong for the principle that it is everyone's responsibility to pay taxes (V. Braithwaite, 2009; Kirchler, 2007).

More recently, the case for governments taking a firm stand against serious tax evasion has been mounting. Few can argue with the costs that serious tax noncompliance places on the public purse. It is now common knowledge that the tax gap of countries in the developed world amounts to billions, if not trillions, of dollars. Any argument that tax defiance on this scale is justified because wealthy individuals do not approve of how the government spends their money or because economic prosperity would falter if corporations paid the tax they truly owed seems trite, if not insincere. If the tax gap could be closed, then money would be available for governments to pay the debts incurred as a consequence of the global financial crisis, and money would be available to spend on quality health care and education as well as on promoting environmental sustainability. Making the argument that tax monies are best placed in the hands of government rather than in private individuals or corporations is probably easier today than it has been for many decades.

Serious tax noncompliance also has assumed greater importance as a crime warranting investigation and for criminal prosecution because of the link that Levi (2010) points to between tax noncompliance and other serious financial crimes. This connection has been reinforced in public consciousness in the last decade with exposure of "secret havens" for purposes of money laundering post-September 11 and with revelations of the array of complex financial arrangements for reducing tax liability in the wake of the global financial crisis. Recent events strengthen arguments that tax noncompliance should not be given special status or be viewed as distinctively different in quality from other financial crimes of wealthy elites and corporations.

Although it seems unlikely that much public sympathy would persist for anyone making the case that serious tax noncompliance deserves the leniency described by Levi (2010), strengthening the government's arm to rein in serious tax noncompliance is not without pitfalls. Three policy challenges raised by Levi will be discussed. The first is putting sufficient resources into the investigation and collection of evidence for criminal prosecution. The second is differentiating between forms of serious noncompliance, bearing in mind that intentionality is not always readily identified in this domain. The third challenge is to manage the financial planning industry that has burgeoned and embraced a range of forms of tax minimization and avoidance without clarity as to which forms are legitimate and which are not.

Resources for Investigation and Prosecution

Levi (2010) makes the point that serious noncompliance is "a behavioral and administrative label, not a legal one." Included are major frauds that are prosecuted and what Levi describes as "serious" evasion cases that might meet *prima facie* criteria for fraud but are dealt with by negotiation and by administrative law and civil penalties. His argument is for pushing more cases through to criminal prosecution, presumably with better guidelines for doing so to enhance accountability and transparency. Levi puts forward the view that serious tax noncompliance will not be reined in through negotiating settlements or by imposing civil penalties "away from the gaze of the media and the public."

In an important sense, Levi's (2010) point is sound. When the government sanctions certain activities and labels them criminal, a message is sent to the community that says, "if you are an honest taxpayer and do not want to join the criminal ranks, then do not venture down this path because we will prosecute you." Messaging about unacceptable conduct strengthens the self-regulatory moral pathway and is a relatively cost-effective way of improving compliance (V. Braithwaite, 2009). Being able to label serious tax noncompliance as a criminal act as opposed to dabbling naïvely on the margins of illegality might be expected to add to the salience of the message for those who value being law abiding. The message harnesses even more regulatory effectiveness if accompanied by steps that should be taken to avoid trouble (e.g., seeking advice from an honest tax adviser; V. Braithwaite, 2009). Tax authorities commonly issue guidance notes to tax practitioners to help them stay on the right side of the tax law and keep their clients out of trouble. This cost-effective strategy is commonly used for building a shared understanding in the tax community for what is expected and what kinds of actions risk prosecution.

Although all of these policies can be implemented without too great a cost to tax authorities, Levi's (2010) point is that messaging is not credible if nothing much is done about noncompliance or, more importantly, if nothing much is observed to be done by authorities to control serious cases of noncompliance. And by and large, nothing much is observed as being done. Public skepticism about law-enforcement efforts has been captured through survey research (Braithwaite, Reinhart, Mearns, and Graham, 2001). Collecting taxes from high-wealth individuals and corporations, for instance, is regarded as a higher priority by Australians than reducing taxes (Braithwaite et al., 2001). It is in this kind of social context that Levi's proposal for more public prosecutions and criminal sanctioning has merit. Otherwise, the cheaper option of messaging about honesty in taxpaying cannot be expected to hold sway. Honest taxpayers, those we might call the converted, might lie awake worrying about doing the right thing—as they always have done—but those engaged in serious tax noncompliance will dismiss the message as nattering or as a bluff because they see no action being taken to increase the risks of being caught. What is worse, no action suggests a covert message—that the authority lacks resources or is hamstrung in some other way and cannot take action. Stern messaging without following through with firm action, in some quarters, will be an invitation to game play—to challenge and compete with the system and beat it through exploiting perceived weaknesses (V. Braithwaite, 2009).

So what is involved in reinforcing messages by increasing public prosecutions, particularly criminal prosecutions? Preparing cases for prosecution invariably will require greater resources. Realistically speaking, it is unlikely that tax authorities in the United States, Europe, Britain, Australia, or New Zealand in the foreseeable future will receive significant boosts in funding to pursue tax prosecutions more aggressively (unless it is part of a special project or task force to address a particular risk to revenue). Most tax authorities have been gearing up to do more to improve compliance with fewer resources, thus the emphasis throughout the Organisation for Economic Cooperation and Development (OECD) on improving voluntary or quasi-voluntary compliance. Where Levi's (2010) analysis, however, has real bite is in the assertion that, as the pendulum has swung in the direction of persuading and educating the public to do the right thing, attention has strayed from effectively dealing with those who were never going to comply voluntarily. Bureaucracies become caught in their own one-size-fits-all policies; the public are uniformly consistent tax cheats, who need to be sanctioned into submission or into uniformly law-abiding citizens waiting for education and persuasion. Policy needs to be more versatile with recognition that good governance means dealing with both groups of taxpayers as well as those Levi identifies as in transition, and staff need to be adept at using such policy to elicit the best outcome given the form of noncompliance they are confronting.

Regulatory pyramids, or as Levi (2010) describes them, "graduated sanction models," ideally are suited to achieve both objectives of recognizing virtue and holding vice to account through criminal sanctioning if need be. The central principle is to give taxpayers the option of recognizing their noncompliance and making amends in the knowledge that if they do not, then the costs of noncompliance will escalate, right up to the point of corporate capital punishment if necessary. As Levi notes, the efficiency of regulatory pyramids is in the fact that not everyone requires maximum escalation. Different amounts of pressure are required in different cases to achieve compliance, and in most cases, this process will be far less than the full force of the law. The full force of the law and associated resources then can be saved for those cases in which it is the last option available to the authorities.

Levi's (2010) objection to graduated sanctions is that the authorities never get to the point of criminal prosecution or that the process is too slow and labored to be effective in preventing more fraud. A negotiated settlement is reached or civil penalties are applied behind closed doors, and fraudsters go back to their fraudulent practices without incurring costs of any significant kind. Levi's point is well taken, but the problem is not with regulatory pyramids; rather it is with the ways in which tax authorities have tried to script particular responses in the form of preprogrammed stages of regulatory intervention. This "game-like" approach of do X if the errant taxpayer does Y and settle as soon as is practicable is not an adequate way of operationalizing the intent of regulatory pyramids, and it certainly does not reflect the ways in which talented investigators use the principles of regulatory pyramids in practice.

Psychologically and socially, regulatory pyramids do three things. In focusing on education and persuasion, regulators are trying to draw out a moral self, with the assumption being that law abidingness, at some level, is part of every person's socialization experience. Evidence shows this concept to be one of the major pathways for reining in tax defiance (V. Braithwaite, 2009). Second, the regulator is trying to connect the errant taxpayer with the norms and standards of his or her community that neither approves of nor benefits from one of their own facing prospects of prosecution, which is why restorative justice conferencing is recommended for use at any, if not all, stages of escalation up the pyramid (Braithwaite, 2002). Third, the regulator is impressing upon the taxpayer that follow-through will occur, right up to criminal prosecution if necessary. Regulatory pyramids have to have tops in practice and in theory if they are to be used to deal with noncompliance (Ayres and Braithwaite, 1992).

The fact that many authorities use regulatory pyramids without tops lies at the heart of Levi's (2010) concerns about the effectiveness of "graduated sanction models." The question of "why no tops" is indeed one for policy makers. Does the law permit the use of the top? Does the authority have political support to use the top? Does the authority have the resources to pursue the case to the top? Do the risks to revenue justify pursuit of the case to the top? For regulatory pyramids to work, tax authorities must follow through on cases in which the answer to all these questions is "yes."

Follow-through would do much to lift the integrity of tax authorities in the eyes of the public. If the problem is that capacity to follow through is too often thwarted, then would the routine use of criminal sanctions guard against administrative complacency in settling cases of tax fraud behind closed doors? Possibly, but if the objective is to use criminal sanctions to deter others, then it is important that the public sees that the most egregious cases are taken to court and that convictions follow in fair and reasonable circumstances.

Roche (2006) looked into patterns of prosecution for tax evasion in Australia in 2005 after the tax commissioner announced a crackdown on cases of tax fraud. Australia has the kind of arrangement that Levi (2010) suggests might be advantageous in ensuring that different kinds of fraud against the government (e.g., welfare and tax) are dealt with in a comparable fashion. The Australian Tax Office refers cases to the Office of the Commonwealth Director of Public Prosecutions (DPP); the tax authority does not have authority to prosecute except for minor cases. The tax office set up a Serious Non-Compliance Unit in 2003, and 600 officers were assigned to work on "active compliance" soon after. Roche (2006: 3) described it as follows: "This new enthusiasm for punishment is borne out by figures showing a steady increase in DPP prosecutions of tax offences, from 121 in 2001–02 (60 of which resulted in prison sentences) to 172 in 2003–04 (81 of which resulted in prison sentences)." With this change came a flood of press releases announcing successful prosecution and jail sentences. The press reported the following: "These sentences, of up to six-and-a-half years, are finally burying a widely held myth that the worst that can happen for tax offences is a heavy fine" (Roche, 2006: 4).

The effectiveness of a tougher prosecution policy in making the public think more seriously about the consequences of tax fraud was not subject to rigorous evaluation, although as noted by Roche (2006, citing Braithwaite, 2005: 29), during this period, corporate tax collections increased at a rate that was greater than growth in the economy. This phenomenon occurred at a time when corporate tax collection rates in OECD countries—already low—continued to fall. But Roche's interviews with a sample of those who had been prosecuted suggest that some undesirable consequences were incurred for tax office credibility during this period. Most importantly, the targets for prosecution were biased toward lower to middle classes (some cases involved welfare as well as tax fraud) and did not include wealthy elites and corporations—a fact that did not escape the notice of those who were prosecuted. It is likely that the DPP did not have the specialist knowledge necessary for prosecuting anything more than the more open-and-shut cases of tax evasion. Second, delays in prosecution were inordinately long. In the most extreme case, 5 years had elapsed between admitting the offense to an Australian Taxation Office officer and receiving a formal summons to attend court. As Roche (2006: 11) noted, "from a legal perspective, delay undermines the right to a fair trial" and breaches the spirit of the Taxpayers' Charter that promises procedural justice to all taxpayers.

Five years later, the Australian Taxation Office is working in partnership with five agencies with support from another two to investigate tax fraud at the top end of town. Project Wickenby has a budget of $A305 million for 7 years. As of February 2010, Project Wickenby investigations have resulted in 57 people charged on indictable offenses, 26 criminal investigations, 1,167 audits with 665 under way, more than $A573 million raised in tax liabilities, more than $A174 million in tax collected, and almost $A76 million in assets restrained (crimecommission.gov.au/media/faq/wickenby.htm.) The success of the project will be evaluated undoubtedly after its completion. In the meantime, these figures provide an indication of how resource-intensive criminal prosecution of serious tax fraud is, although it also should be noted that the taxes owing in the wake of the project are significant.

The purpose of this section is to concur with Levi (2010) that criminal prosecution is an important part of the sanctioning tool kit of tax authorities, but also to make the point that its feasibility is dependent on having policies that encourage the deployment of a suite of strategies to lessen the need for prosecution and to make sure that when it is used, the resources are available to optimize its effectiveness. The suite of strategies that have their own psychological, social, or economic deterrence value to a greater or lesser degree include queries directed to taxpayers and their advisers, desk audits, full audits with the intention of detecting fraud, skilled questioning to unpack the story of offenders, conversation to canvass future scenarios, conferencing to identify harms, and civil penalties to nudge people toward compliance—right up to criminal sanctions, seizing of assets, and reputational losses to prevent more fraudulent activities.

Differentiating Forms of Serious Noncompliance

Levi (2010) differentiates forms of serious noncompliance not only in terms of the size of lost revenue but also in terms of intentionality. Levi makes much of the planful fraudster, who sets out purposefully to defraud tax revenues—the "amoral calculator" or the "commercial sociopath." This "type" is differentiated from "intermediate fraudsters," who start out honestly but turn to intentional fraud later, and "slippery-slope fraudsters," who commit offenses of deception (and insolvency fraud) in an attempt to carry on their businesses and hopefully trade their way out of difficulty. Levi expects that criminal prosecution will affect fraudsters differently, depending on their intentionality, and he is attracted to a distinction between "theft from the public" and a more sympathetic version that might be described as "decisions not to meet all their legal and social obligations."

Regulatory pyramids give investigators options for taking account of intentionality as they learn more about the case. Differences in intentionality as well as differences in the willingness to accept responsibility are important factors in determining how tax authorities respond to instances of tax fraud. When tax authorities select a case for closer scrutiny, establishing the degree of planning and purposefulness is part of the investigative process. As Waller (2007) reported after having interviewed car dealers subjected to visits from the tax office, people expect the tax authority to act on the knowledge that they have and to not waste time pretending to collect information that is already in its database. Waller's study showed that it made no sense for scripts to be prepared for using regulatory pyramids, starting at the bottom, regardless of circumstance. If investigators have evidence of intentional and well-planned fraud, then they might adopt a highly intrusive approach, fairly high up on the regulatory pyramid, compared with how they might begin an investigation in which tax fraud is intertwined with incompetence and business failure. The practical utility of regulatory pyramids, however, is not so much where one begins but where one ends. The objective is always to keep the door open for cooperation of a genuine kind and to save resources for the cases in which tougher enforcement is necessary to elicit compliance.

Intention is an aspect of fraud relating to the past that investigators try to uncover. However, willingness to cooperate with the tax authority and to accept responsibility for fraudulent activity is a more dynamic quality, shaped by how the investigating officers conduct themselves, both in terms of their skill and competence and their adherence to principles of procedural justice. Regulatory pyramids allow tax officials to differentiate noncompliers in terms of their willingness to cooperate. Where fraud has been committed, and where the offender is prepared to acknowledge and accept responsibility for the crime, a case can be made for streamlining the process so that a person can pay their dues there and then, as opposed to waiting, sometimes for years among Roche's (2006) sample, for a court date to air the same information. Obviously, the seriousness of the offense will frame what can and cannot be done procedurally. Given this constraint, however, merit exists in rewarding the moral self when it surfaces and strengthening its influence on future behavior. By contrast, little can be gained through prolonging punishment unfairly and, in the process, sowing seeds for resentment and defiance.

Managing Tax Avoidance

Adopting tougher enforcement policies on serious tax noncompliance requires support not only from the population at large but also from those involved in the tax and financial planning industries. As serious noncompliance is dealt with through criminal sanctions, it is necessary to keep open channels of communication with the financial planning industry as to where the line is being drawn between unacceptable and acceptable tax behavior. As Levi (2010) and others acknowledge, it is not always clear when tax minimization strategies serve legitimate business purposes and when they have no other purpose than to avoid tax. Tax authorities use the courts to test the law and to clarify interpretation, but this process invariably lags behind the development of new financial products for reducing tax liabilities. At the high end of the market, the beneficiaries of such products are wealthy elites and corporations who can stay ahead of the law. It is when the more complex and elaborate schemes are packaged for mass consumption that the holes emerge, and tax authorities swoop to close them down (Braithwaite, 2005).

The danger of an overreliance on criminal sanctioning in such cases is a delay in authorities taking action to reduce risk to revenue and minimize harm. As tax minimization schemes of dubious legitimacy are rolled out and marketed aggressively to the public, tax authorities need to issue warnings quickly and turn the stampede of investors around quickly. Having the capacity to prosecute scheme promoters and use criminal sanctions strengthens the hand of tax authorities considerably. By the same token, having such power is not much use if authorities are cut off and fail to gather intelligence of newly emerging schemes and how they are being marketed. For this reason, tax authorities need respectful, cooperative relationships with the financial sector along with a clear understanding of the kinds of activities that will be prosecuted with the full force of the law if necessary.

Within this environment, where the power of the tax authority can be matched by the power of the financial sector, Levi (2010) is critical of the way in which the fraudulent activities of large accounting firms can be swept under the carpet for fear of the collateral damage that might follow from public exposure. The timidity of regulators and their reluctance to ask questions and demand explanations played no small part in the unravelling of the financial system and the global financial crisis. But the policy lesson here is that regulators did not have to choose between looking the other way or preparing for a high-profile court case (see J. Braithwaite, 2009). Many steps could have been taken in between and been set in motion before problems were out of control, which involve investigative diligence and the opportunity for such firms to acknowledge misconduct and take steps to put their own house in order. In Levi's terms, would criminal prosecution be relevant in such a scenario? Most definitely. Criminal prosecution is the default. With this certainty in mind, the opportunity to acknowledge mistakes and to learn from them is the rational way forward for the accounting firm and for the regulator.

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POLICY ESSAY

SERIOUS TAX FRAUD AND NONCOMPLIANCE

Fairness matters—more than deterrence

Class bias and the limits of deterrence

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The recent financial crisis aggravated problems with an already troublingly high national debt because government has both bailed out reckless financial institutions and spent money to stimulate an economy wrecked by the "wilding" of financial institutions. Thus, the context for "Serious tax fraud and noncompliance" (Levi, 2010, this issue) is strategizing about how to reduce the "tax gap"—the difference between what is owed to the government under existing tax laws and what is collected (General Accounting Office [GAO], 2008a; Her Majesty's Revenue and Customs [HMRC], 2009, 2010). In the absence of literature on high-end tax evasion specifically, Levi examines general findings about the impact of increased sanctions and publicity from the greater use of criminal, as opposed to civil, sanctions.

Although increased exemplary prosecutions would be an inefficient way to secure increased compliance among major tax cheats, strategies focusing on increased publicity have promise, especially when combined with numerous enforcement options that could have a high return on investment. Indeed, the problem is not a lack of criminal prosecutions but a widespread anti-tax and anti-Internal Revenue Service (IRS) sentiment that emboldens politicians—even ones who "spout law and order"—to "handcuff the tax police" (Johnson, 2005: 4) and hobble enforcement. Ultimately, anti-tax and anti-IRS vilification can lead to backlash and security issues that need to be weighed against the benefits of deterrence. At the same time, an increased use of criminal sanctions might be justified because "fairness matters" (Levi, 2010) for securing widespread voluntary taxpayer compliance and for reducing rampant class bias (Barak, Leighton, and Flavin, 2011; Reiman and Leighton, 2010). But fairness is not well defined in relation to voluntary compliance, and it raises questions about the importance of the legitimacy of the tax system—questions that go beyond tax administration to activities of government,

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such as bailing out reckless financial institutions and redistributing taxpayer money to them (and their executives).

Given that a celebrated tax protest—the Boston Tea Party—led to America's independence, anti-tax sentiment has a cultural resonance that can be coupled with a tendency to see "the government" as a "catch-all phrase for the oppressor, the deceiver, the denier of dreams" (Barry, 2010). So, tax fraud should not be perceived as a crime against "the government" but as an improper transfer of money to tax cheats from the current and future American public. The public suffers higher taxes and fewer public services; future generations also are harmed because frauds increase the national debt (government expenditures minus tax collection revenue), which is financed through bonds for which the interest rate compounds the original amount of the fraud. Finally, financing our national debt requires bond purchases by foreign governments, especially China. Thus, although the fraud is not solely responsible for the national debt, it contributes to our country becoming increasingly dependent on China and beholden to its good will—a harm outside the traditional view of victimization but still significant for our posterity.[1]

Exemplary Prosecutions, Adverse Publicity, and Anti-IRS Backlash

The IRS uses substantial resources to prosecute tax resisters who challenge the legitimacy of government taxation. Some of these cases—like the prosecution of actor Wesley Snipes—involve substantial sums of money, but more typically, the legal precedent is the main concern.[2] Outside of "idiot legal arguments" about why tax collection is illegal (Sussman, 1999), major tax fraud is the province of wealthy individuals, small businesses, and corporations bilking the government out of tax revenue by failing to file a tax return, under-reporting income, and not remitting payroll taxes (GAO, 2008a, 2008b). However, "tax administrations will never be able to collect every dollar of tax due. In fact, it can be argued that this should not be the goal since the measures required to do this would be so intrusive as to lead taxpayers to revolt" (HMRC, 2009: 16). Thus, the question is about the role of deterrence in closing the tax gap while being mindful of backlash against tax collection.

Review of the efficacy of deterrence leads to findings that serious violent criminals do not seem to be deterred by increased penalties (Donohue, 2009), so it is unclear to what

1. Because of the serious harm from major tax fraud, having "noncompliance" enter popular usage would be a form of class bias given that no "serious welfare non-compliance" label exists for the poor; popular and political discourse angrily refers to welfare cheats and frauds. In both cases, people fail to perform legal duties to disclose information truthfully so they can transfer money improperly from the public.

2. Snipes was sentenced to 3 years in prison for three misdemeanor counts of failing to file tax returns but was acquitted of felony charges of tax fraud because he relied on the advice of an accountant for an anti-tax organization. The decision follows Cheek v United States (498 U.S. 192 [1991]) that a good-faith misunderstanding of the law, even if not objectively reasonable, negates the required statutory element of willfulness. In dissent, Justice Blackmun noted: "[I]t is incomprehensible to me how, in this day, more than 70 years after the institution of our present federal income tax system . . . any taxpayer of competent mentality can assert as his defense to charges of statutory willfulness the proposition that the wage he receives for his labor is not income, irrespective of a cult that says otherwise" (498 U. S. at 210). Buchanan (2010) added that "Congress has passed laws requiring the IRS not to use disparaging language to describe" tax protesters and what others call their "idiot legal arguments" (Sussman, 1999).

extent serious tax fraud can be deterred. As an economic crime, major tax fraud—especially by corporations—is probably closer to rational choice assumptions than violent crime is, in which case increasing the *certainty* of detection is more powerful than increasing the severity of penalties. Thus, the cost-effective strategy for reducing the tax gap would involve increasing the reporting and matching of financial information, more audits, more timely filing of tax liens for businesses delinquent in paying payroll taxes, and more resources for the IRS to "immediately begin collection actions against all of its high-priority cases" (GAO, 2008b: 8). Several states have had success with publicizing the names of individuals and corporations that have the largest unpaid tax bills (GAO, 2008a), which is a strategy that might substitute for the publicity of the criminal prosecution noted by Levi (2010).

More generally, the GAO (2008a) identified numerous strategies in which minimal enforcement efforts could generate substantial revenue. Their analysis frequently notes "limited resources," and the larger context is that "politicians know a good applause line when they see it, and pledges to reduce taxes too easily slide into efforts to reduce the enforcement powers of the IRS" or its operating budget (Buchanan, 2010). Although this issue might seem political, Levi's model (2010: Figure 1, bottom box), includes both the governance of tax collection and political interference.

The contemporary anti-tax and anti-IRS vilification suggests that any benefits from increased deterrence need to be weighed against the costs of backlash, a point especially salient because earlier this year a man flew an airplane into an IRS building in Austin, Texas, killing himself, one IRS employee, and injuring 13 others. Like 9-11 and McVeigh's bombing of the federal building in Oklahoma City, people condemned the violence; but unlike the other events, the attack on the IRS triggered an outpouring of anti-government, anti-tax, and anti-IRS sentiment (Buchanan, 2010). Disturbingly, the sentiment is not just talk, as evidenced by a post-Austin tragedy headline, "Attacks on IRS and its employees are all too common" (O'Keefe, 2010). Although rule enforcers are frequently not popular, people who are anti-IRS are not necessarily anti-police, so coming to a better understanding of the relationship among anti-IRS, anti-government, and law-and-order sentiments could help with IRS security and with making sense of political interference with a vital government function.

Class Bias/Fairness Matters

Levi (2010) notes that "fairness matters," and a federal joint forum on tax compliance has elaborated on this: "[S]ome enforcement actions may have low returns on investment, such as many criminal prosecutions, but nevertheless be necessary both for fairness and to encourage voluntary compliance" (GAO, 2008a: 12). Although this formulation minimizes the connection between fairness and voluntary compliance, others see a direct, causal impact: "Tax evasion can create unfairness and can fuel perceptions of rampant cheating that undermine respect for government. Left unchecked over time, these perceptions would tend to snowball as more people conclude that cheating is common, normal, and inviting" (Jrank.org, 2010: para 2).

The GAO itself noted that failure to enforce payroll tax laws quickly gives "the non-compliant business an unfair competitive advantage. . . . Businesses that fail to remit payroll taxes may also under bid tax-compliant businesses, causing them to lose business and encouraging them to also become non-compliant" (2008b: 26). Moreover, "allowing businesses to continue to not remit payroll taxes affects the general public's perception regarding the fairness of the tax system, a perception that may result in lower overall compliance" (2008b: 26). A recent GAO (2009a: i) report noted that "fairness is believed to undergird voluntary compliance," and it recommends a comprehensive evaluation of the administration of civil tax penalties on voluntary compliance—a suggestion that also should apply to criminal penalties. Such research is overdue and could help ensure that penalties are set appropriately and administered consistently.

However, implementing a policy based on fairness should require no specific outcome, such as increased voluntary compliance. Our conceptions of the rule of law and constitutional requirements of equality do not allow for class bias, and the substantial evidence of class bias in the criminal justice system (Barak et al., 2011; Reiman and Leighton, 2010) supports a presumption of bias in applying criminal sanctions in tax administration. Indeed, as Braithwaite noted (2003: 14), "just deserts theorists worked hard at refusing to confront the implications of applying a just deserts philosophy to tax and consumer fraud where tens of millions of offenses are detected each year of frauds involving much greater amounts of money than the average blue collar theft". He added that retributivists and the sociologists of punishment tend to be "only really interested in the punishment of the poor, so both failed to play any critical role in exposing hypocrisy with respect to the crimes of the powerful" (2003: 14), especially corporations. Policy makers generally have followed suit, mostly increasing punishments for white-collar crimes at times—like the economic collapse surrounding Enron—when the crisis threatens the legitimacy of the state. If fairness requires an increased use of criminal sanctions for the wealthy and businesses (or a decreased use of criminal sanctions for the poor), then we should embrace the actions necessary for justice simply because they are necessary for justice.

Because policy makers are likely to be more interested in outcomes like increased voluntary compliance than equality, future analysis should start with the assumption that fairness is not merely a matter of whether the overall administration of tax collection involves class bias. The broader question of the legitimacy of tax collection also depends on whether tax collection supports a government that is perceived as working in the interests of all.[3] More pointedly, the question would be how voluntary compliance will be affected by the bailout of the financial sector (Ritholtz, 2009a; Smith, 2010) and by the redistribution of wealth from taxpayers to

3. This analysis connects with the cultural resonance surrounding the airplane flying into the IRS building. Kooistra (1989: 11) suggested that hero status is bestowed on a criminal when people find "some symbolic meaning in his criminality," and support for the symbolic meaning happens "when substantial segments of the public feel themselves to be 'outside the law' because the law is no longer seen as an instrument of justice but as a tool of oppression wielded by favored interests."

executives of companies receiving taxpayer money through the Troubled Asset Relief Program (TARP).[4]

Conclusion and Recommendations

The discussion so far has attempted to explore some important threads in Levi's (2010) article, and the final task is to focus the analysis into policy recommendations. Although I am skeptical about the cost-effectiveness of a deterrence strategy for closing the tax gap, increased prosecutions are necessary for fairness and have the added benefit of a positive impact on voluntary compliance. Increased enforcement for either deterrence or fairness has the potential for increased backlash and anti-IRS sentiment, but enforcement for the sake of deterrence—a "scared straight" program for tax cheats—is different from promoting equality in tax administration and criminal justice. Having tax collection be but one example of a multifaceted plan to heighten equality before the law would reduce some (but not all) of the negative consequences. Any necessary increase in IRS security would be a small price to pay for a substantively fairer society and increased voluntary compliance; it would be a drop in the proverbial bucket compared with the resources the United States spends to defend—and impose—its ideas around the world.

Exemplary Prosecution and Adverse Publicity

Exemplary prosecutions are likely to be an inefficient way to secure compliance. Better goals would involve increasing the certainty of apprehension combined with the tools to make it "easier for people to be good" (Tifft and Sullivan, 2001: 180). For example, sending information and worksheets and offering the opportunity to redo portions of taxes to those who are out of compliance is both productive (GAO, 2008a) and humane—especially for those cheating because of economic difficulties; it also might help to identify those who are willfully cheating. In addition to many GAO recommendations that can be culled easily for high return-on-investment strategies (GAO, 2008a, 2008b), the IRS code should be changed so that it can follow the 19 states that publicize the names of those with delinquent tax bills. The GAO (2008b: 19) noted that "just threatening to publish the names of tax offenders can bring some into compliance, while actually appearing on a tax offender list can bring about societal pressure to comply." And it "may also encourage greater tax compliance among the general population of taxpayers to avoid potentially being on the list" (2008b: 19).

4. New York Attorney General Andrew Cuomo reported that Citigroup and Merrill Lynch together "lost $54 billion, paid out nearly $9 billion in bonuses and then received TARP bailouts totaling $55 billion" (Cuomo, 2009: 1). Other companies did not lose money but paid out more in bonuses than they made in income. Goldman Sachs, Morgan Stanley, and J.P. Morgan Chase together "earned $9.6 billion, paid bonuses of nearly $18 billion, and received TARP taxpayer funds worth $45 bil1ion" (Cuomo, 2009: 2).

Greater Investment in Research

The political reality of high deficits and President Obama's increased budget request for the IRS (GAO, 2009b) mean increased enforcement is coming, and the head of the office of the Treasury Inspector General for Tax Administration (which handles threat and assault case referrals) said, "There is a direct correlation between increased IRS enforcement efforts and the number of threats made against IRS employees" (O'Keefe, 2010). In this environment, research is important for a better understanding of the constellations of beliefs that are anti-tax, anti-IRS, and anti-government. Research findings should be of a nature that they can be applied to strengthen IRS security (and provide a basis for evaluating the applicability of research and strategies from other countries to the United States). The nature of *Criminology & Public Policy* is to advance policy and not simply to provide the standard academic call for more research, but where key research is lacking, an important policy goal can be to stimulate it, and anti-government beliefs are part of right-wing extremism that was largely ignored under the Bush presidency.

Furthermore, the existing effort to evaluate the effect of civil tax sanctions should be expanded to include criminal sanctions. The "IRS said that such a plan was important in understanding the relationship between penalty administration and voluntary compliance and in identifying priorities and potential resource needs" (GAO, 2009a: 16). Because "developing a comprehensive plan may take time" (2009a: 16), it is not too late to add an evaluation of criminal penalties and achieve some economies of scale by undertaking both evaluations simultaneously. Both projects must include, even focus on, high-end tax evasion by individuals and corporations.

Legitimacy and Voluntary Compliance

Equalizing civil and criminal sanctions is important but not enough to increase the legitimacy of tax collection. Given huge deficits from bailing out a reckless financial sector and the redistribution of public money to the wealthy, serious financial reform is necessary to increase voluntary compliance by demonstrating that the government is working in the public interest rather than for special favored interests. Indeed, preventing (or at least mitigating the impact of) economic crises is better for the national debt than bailouts and stimulus spending. Unfortunately, popular anger has dissipated, and financial firms have poured hundreds of millions into Congress to stop meaningful reform. Because the outcome of this opportunity for major financial reform is questionable (Ritholtz, 2009b, 2010), future reform efforts could benefit by studying Finland, which made a "decision of principle to fight economic crime" in 1996 and has had a series of action plans that have renewed this initiative for a decade (Alvesalo, Tombs, Virta, and Whyte, 2006). "Raising economic crime as an economic, social and crime problem, one which causes damage to the material and moral fabric of Finnish society, the Action Plans consist of a series of reforms in legislation, regulatory organisation, enforcement practice, and research activities" (Alvesalo et al., 2006: 9).

These action plans included tax evasion as part of a systemic package to deal with economic crime. Interestingly, the "'triggering event' was the recession at the start of the 1990s, known in Finland as 'the Great Depression'":

> Unemployment rose from 3% in 1990 to 20% by 1994, real wages fell, and, from a balanced budget in 1990, the Finnish central government budget was in deficit by . . . over 12% of GDP. In terms of causes, amongst other reasons mismanagement on the part of both Government and the Bank of Finland was perceived as crucial, as were a series of bank failures—with some of the latter being popularly attributed to crime and illegality on the part of owners, directors, and managers of banks and other private companies. . . . At the same time, the Government committed enormous expenditures to rescuing the banking industry from near-collapse. Further, the legacy of depression was an enduring one—for example, it has left unprecedented, high levels of unemployment (Alvesalo et al., 2006: 10).

When the next major financial crisis happens, concerned citizens and policy makers should be ready to move with something along the lines of the Finnish Action Plan. The time to start assembling the policy pieces is now, and hopefully *Criminology & Public Policy* can be a significant forum for such efforts.

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POLICY ESSAY

SERIOUS TAX FRAUD AND NONCOMPLIANCE

Serious tax noncompliance

Motivation and guardianship

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Questions about tax evasion are as old as taxes themselves and will remain an area of discovery as long as taxes exist. To understand the impact of a tax system, it is important to know who complies with the tax law as well as who does not. Tax evasion is a large and growing problem in almost all countries. Alm (1999) reported the annual growth rate of unpaid U.S. federal individual and corporate income taxes since 1973. Reliable estimates by the Internal Revenue Service suggest a tax gap of some $257–$298 billion in 2001 (for the federal income tax), which equals a noncompliance rate of about 15.5% to 16.6%. The exploration of tax noncompliance is relevant for many reasons. Tax noncompliance reduces tax collection and the tax performance within a country. It also might lead to externalities such as the increase of alternative taxes, which adds to the tax burden of compliant taxpayers. Such externalities are particularly relevant when focusing on serious noncompliance (SNC), a topic that Levi (2010, this issue) discusses. Levi (2010) correctly points out that public and government tolerance of SNC might decrease as other firms or individual taxpayers bear the burden of financing public services. Tax noncompliance creates several areas of misallocation in resource use. First, individuals might devote considerable energy to cheating on their taxes, and second, taxpayers might make behavioral changes (e.g., choosing how many hours to work). In addition, the presence of tax fraud also requires the government to invest in resources to deter noncompliance.

However, much in the field of tax compliance remains unexplained, and empirical evidence is essential to address the lack of insights. In their overview, Andreoni, Erard, and Feinstein (1998: 835–836) stated: "Although many empirical studies of noncompliance have been conducted during the past decade, we believe that the empirical literature is still in its youth, with many of the most important behavioral hypotheses and policy questions yet to be adequately investigated." A key limitation is the lack of knowledge regarding how to deal with SNC.

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Therefore, the article by Levi (2010) is a timely contribution to the literature, as it promotes the reevaluation of policy strategies. I will start with public prosecution and media

In this essay, I will identify and discuss specific and potential actionable policies to deal with SNC, such as public prosecution, tax amnesties, rewarding honest taxpayers, and good governance based on the current research findings and current state of knowledge. I will start by discussing whether public prosecution and increased media can help deal with SNC. Such a policy tool is discussed by Levi (2010), and I will stress that this policy not only affects the opportunity costs of compliance but also is related to motivation considerations, social interactions, and the visibility of noncompliance. Moreover, the efficiency of such an instrument is driven by the effectiveness of the deterrence system. In a next step, I will go beyond Levi to discuss additional specific policies. First, I will analyze whether tax amnesties can help reduce SNC. Many governments have implemented tax amnesties with the hope of reducing SNC. Next, I will focus on rewards, a relatively novel policy that might influence individuals' and firms' compliance behavior. Instead of increasing the relative cost of not paying taxes, the instrument of rewards raises the benefits of paying taxes (a "carrot" rather than a "stick" policy). This policy essay then ends by stressing the importance of governance quality to tackle tax noncompliance.

There are several aspects that I will not address in detail but that are worth discussing briefly as they might interact with the policies that I highlight in this essay. It is highly unlikely that SNC happens unintentionally or because of a "mistake." Thus, focusing on SNC also requires the analysis of the actions of a whole range of actors. For example, tax practitioners might play a key role in understanding SNC, as McBarnet (1992: 343) explained:

> Noncompliance raises many major issues for policy and for theory. But there is a real danger: in concentrating attention on noncompliance, the constructed and problematic nature of compliance will be overlooked, and wider issues – the role of tax practitioners in undermining declared tax policy; the different routes available to rich and poor, individuals and corporations, for escaping tax; the possible limits of the law – will be ignored. Legal tax avoidance, taking us into just these issues, should therefore be recognized as a key topic for research and analysis too.

Several studies show that the average level of noncompliance is higher for returns prepared with paid assistance. Erard (1993) found that the use of a tax practitioner significantly increases tax cheating. Generally, taxpayers with professional help tend to have more complex tax forms, which opens the possibility to cheat or avoid payment. And some studies have reported that the tax practitioner's penalty and the importance of the client will influence the practitioner's willingness to recommend aggressive positions (see, e.g., Reckers, Sanders, and Wyndels, 1991).

An investigation of SNC also requires a better understanding of business noncompliance, an area in which limited evidence is available. In most studies on tax evasion, the research has focused on personal income tax, with business tax evasions having received little attention. This finding is surprising when one takes into account the economic importance of the business sector and the revenue importance of business taxation for tax administrations. New work in this area is relevant and will build on existing evidence. For example, there is some evidence in regard to value-added tax (VAT) evasion. Agha and Haughton (1996) analyzed French audits in 1984 and reported that two thirds of those audited had understated the value of taxable sales, and a quarter of them reported taxable sales fraudulently. Two fifths of those audited had overstated the value of taxable inputs. They also provided a summary for VAT tax evasion in different countries. For example, in the late 1970s, 40% of the VAT revenues went uncollected in Italy and in the Netherlands, and one third of all firms had evaded some VAT. In addition, examining SNC also might instigate an ambition to improve on existing knowledge about tax avoidance.

Public Prosecution and the Media

Levi's (2010) research article in this special issue stresses that a criminal record for SNC is likely to generate more damage than an administrative record and is picked up faster by foreign authorities. Media releases on criminal records and regulatory penalties affect the reputation of a company and might even affect corporate takeovers and banking licenses. This point is important: Increasing (media) scrutiny and transparency can help increase the expected punishment and the opportunity cost of SNC. It provides an additional channel of external punishment and control; the stigma of SNC is substantially larger. Reputation is a key factor in the legal business world, and many firms conducting SNC are active in the legal sector. The media has an incentive to report SNC activities, as they generate attention. Several studies in the area of illegal activities, such as corruption, have shown that "sunlight is a good disinfectant" (see, e.g., Brunetti and Weder, 2003; Duggan and Levitt, 2002). Subjective opportunity costs and subjective estimated risk will alter as transparency increases. Empirical findings indicate that the subjective risk of getting caught is related more closely to the perceived duty to comply than to objective risk factors (Scholz and Pinney, 1995).

However, research also has stressed that increased monitoring and penalties for noncompliance might enhance extrinsic motivations to comply with the law, but conversely, it might crowd out the intrinsic motivation to comply with taxes. On the one hand, the risk is that honest taxpayers (individuals or firms) might perceive the increased monitoring as a sign that their intrinsic motivation is not recognized, which might result in opportunistic behavior from previously compliant agents (Frey, 1997). On the other hand, it is possible to argue that interventions to prevent SNC are unlikely to damage the intrinsic motivation. Tax morale—the intrinsic motivation to pay taxes—is not expected to be crowded out if public prosecution, as a policy, is directed against large-scale dishonest taxpayers.

In addition, social interactions might influence the effect of public prosecution. Discussions on social interactions can be found in the crime literature or, more specifically, in the literature on information cascades, fads, herd behavior, and bandwagon effects. Contagion effects have been observed in other illegal activities, such as assassinations, hijackings, kidnappings, and serial murders (Bikhchandani, Hirshleifer, and Welch, 1998). The relevance of social interaction and crime is explored by Glaeser and Saks (2006), who focused on the United States in their analysis across both cities and precincts in New York. The results indicate that social interaction models provide a framework for understanding variances of cross-city crime rates. Individuals are more likely to commit crimes when those around them are doing so. We can expect that the willingness be commit tax noncompliance depends on the tax noncompliance level of other individuals and firms in a society and that current tax fraud levels are affected by the past levels. The willingness to commit tax fraud is influenced by the perceived activities of peers and other individuals. Thus, a person's willingness to engage in noncompliance depends on the lack of prosocial behavior of others. The more others are perceived to be noncompliant, the higher the willingness to be noncompliant. Frey and Torgler (2007) found empirical evidence of conditional cooperation by focusing on tax morale. Public prosecution will enhance the visibility of tax noncompliance and will, therefore, influence the perceived level of tax fraud activities. It might generate not only externalities in respect to SNC but also noncompliance in general. If prosecution is still perceived to be inefficient, then tax compliance might be crowded out by such an increase in visibility. Kahan (1998: 394), for example, stressed: "When they perceive that many of their peers are committing crimes, individuals infer that the odds of escaping punishment are high and the stigma of criminality is low. To the extent that many persons simultaneously draw these inferences and act on them, moreover, their perceptions become a self-fulfilling reality."

Can Tax Amnesties Help?

Tax amnesties are a major issue on the political agenda. In times when many governments are confronted with budget deficits, tax reforms gain importance. One strategy is to implement a tax amnesty as part of fiscal reform, the main purpose being to increase governments' revenues. It offers tax evaders the possibility of returning to the tax system without the normal imposition of penalties and fines. The government is particularly keen to reduce SNC to generate larger tax revenues. Therewith, an amnesty is perceived as a possible vehicle to increase not only present but also future voluntary compliance, in the hope that tax evaders are ready to become honest in the future and assuming that the delinquents will be less likely to fall back into noncompliance. However, the final success of a tax amnesty depends on the long-run revenue effects. It is debated whether tax amnesties, in the long run, undermine the motivation to pay taxes. For example, honest taxpayers might feel upset by an amnesty. If most taxpayers voluntarily comply with tax laws, the option of an amnesty given to a small group of (large) tax evaders can be understood as a violation of equity by most taxpayers. Thus, it also is possible that an amnesty results in a lower ex post level of tax compliance.

It is reasonable to assume that governments invest in short-term political advantages in order to be reelected. The political motivation lays in the immediately affordable advantages of a tax amnesty (see, e.g., the recent tendencies in Italy), so that—not surprisingly—many countries have more than one amnesty per generation. Unfortunately, regardless of the short-run political motivation, multiple tax amnesties within a short interval reduce the efficiency of such a program. Government's credibility is reduced, and individuals' tax compliance is crowded out because honesty is not honored, which also lowers the opportunity costs of tax noncompliance, SNC in particular. An amnesty can be interpreted as a signal that tax evasion is forgivable. The psychological costs of not complying are reduced when observing others' opportunistic behavior. An amnesty might induce the anticipatory behavior of taxpayers. After an amnesty, previously honest taxpayers might anticipate subsequent amnesties by reducing their tax honesty.

Tax amnesties around the world have shown that most revenue collected generally comes from those with relatively small amounts of previously unreported taxes. Hard-core evaders typically do not participate in an amnesty. This explains why amnesties rarely generate significant amounts of additional revenue (Torgler and Schaltegger, 2005).

Rewarding: An Alternative?

It is relatively novel to investigate the impact of rewards on tax compliance; however, there is some anecdotal evidence about the implementation of rewards to reduce tax fraud, especially in Asian countries. For example, Japan offers audited taxpayers the opportunity to have a photo taken with the Emperor if they are found to be honest. In the Philippines, the names of audited taxpayers go into a lottery if they are found to be compliant with the VAT. South Korea provides access to airport VIP rooms, issues certificates and awards, and is considering the possibility of free parking in public parking facilities as rewards for honest taxpayers.

Rewards could be relevant for eliminating undesired behavior or for motivating desired behavior because it is perceived as supportive (see, e.g., Nuttin and Greenwald, 1968). Indeed, the role of rewards in shaping both human and animal behavior has long been a subject among social psychologists (see, e.g., Nuttin and Greenwald, 1968; Skinner, 1953; Thorndike, 1911). However, only a few studies have analyzed the possibility of pecuniary rewards as an incentive for taxpayers to be honest. As Levi (2010) writes, public prosecution might increase the subjective opportunity cost, and rewards also might increase the opportunity costs of noncompliance.

Yet, it is interesting to consider how actors potentially involved in SNC react to rewards. Different subject groups might react differently to a reward system. Levi (2010) stresses that the alignment of opportunities, risks, and incentives might be different for companies compared with individual taxpayers. So the question becomes whether a (large) firm will react to rewards. Firms are subject to important additional constraints because of the competitive environment in which they operate, which produces incentives among the individual decision makers to discount a monetary reward quickly into total tax liability. In such a case, only the relative price of rewards would work. Nevertheless, nonmonetary rewards also might be highly attractive to (large) firms. One useful form of reward would be the tax office issuing a *certificate* indicating that the taxes, to the best of their knowledge, have been declared correctly, that the firm has been cooperative, and that the taxes due have been paid on time. Such a certificate demonstrates that the firm acts as a "good" taxpayer, which is an attractive reward for large firms as their reputation and image are improved. Shareholders might respond in a positive way by raising share prices, the firm might access more favorable conditions on the capital market, and the customers' trust in the firm's products might increase. Comparative advantages are generated, which also increases the opportunity costs of noncompliance. Two studies have investigated the impact of rewards on tax compliance, both of which allow (to a certain extent) an analysis of the impact of positive rewards in relation to other tax policy strategies. Both studies found that rewards are a strong policy instrument to enhance tax compliance (Alm, Jackson, and McKee, 1992; Torgler, 2003).

Governance Matters

Recent studies have shown that governance also affects tax noncompliance, and the outcome in many countries might be explained by underlying political conditions. Countries might tend to achieve an equilibrium positioning with regard to the size and nature of their fiscal systems. This equilibrium largely reflects the balance of political forces and institutions. Sustainable changes are generated only when the system is "shocked" to a new equilibrium (Bird, Martinez-Vazquez, and Torgler, 2006). If taxpayers perceive that their interests (preferences) are represented properly in political institutions and that they receive an adequate supply of public goods, then their identification with the state and their willingness to contribute increases. However, in an inefficient state where corruption is rampant, the citizens will have little trust in authority and, thus, little incentive to cooperate. A more encompassing and legitimate state reduces the willingness to commit tax fraud. Generally, tax evasion can be viewed as an "exit" option, a signal through which taxpayers can express their disagreement. Tax evasion restricts the government's ability to act as a Leviathan. Thus, tax evasion might reduce the tax revenues and, therefore, the size of government, which serves as a sign that governance is not working well.

A sustainable tax system is based on a fair tax system and responsive government, which is achieved with a strong connection between tax payments and the supply of public goods (Bird et al., 2006). The level of SNC also might be affected by governance quality, reducing the opportunity costs of being compliant. Friedman, Johnson, Kaufmann, and Zoido-Lobaton (2000) as well as Torgler and Schneider (2009) showed that institutions affect the size of the shadow economy. Furthermore, there might be a crowding-out effect of morality among the tax administrators when there are many corrupt colleagues. On the one hand, if individuals and businesses believe neither that contracts will be enforced nor that productive efforts will be protected, then their incentive to be active in the shadow economy and tax evasion activities increases, which strengthens the incentive to commit SNC. On the other hand, rules attained through active involvement enhance the level of rule obedience and the willingness to cooperate and act in line with those decided rules. The more people and companies are involved in establishing rules, the stronger will be their sense of obligation (Cialdini, 1989; McEwen and Maiman, 1986). The way taxpayers are treated by the authorities affects their evaluations of authorities and their willingness to cooperate (see, e.g., Tyler, Casper, and Fisher, 1989). Tyler (1997) argued that understanding what people and companies want in a legal procedure helps to explain public dissatisfaction with the law and points toward directions for building public support for the law in the future.

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Transnational white-collar crime and risk

Lessons from the global trade in electronic waste

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Research Summary
Business transactions have increasingly been crossing national borders, thereby presenting greater opportunities for white-collar crime and for the externalization of risk. The global economic crisis, resulting in part from the subprime mortgage scandal, is a prime example of this potential. To develop theoretical perspectives and practical interventions to prevent and respond to the global financial crisis, we consider similar issues of risk and white-collar crime associated with global transactions in electronic waste (E-waste).

Policy Implications
Smart (or responsive) regulation is a promising approach for addressing both E-waste and the current economic crisis. This response includes crime prevention, third-party- and self-regulation, and the threat of strong state intervention. Future research should explore the extent to which smart regulation reduces specific forms of white-collar crime and risk, as well as whether these interventions generalize to other transnational problems.

This project was supported in part by the Michigan State University Sustainable Endowment Project and the Regulatory Network visiting scholar program. Appreciation is extended to Jennifer Melvin for her assistance with data collection. Special thanks are also extended to Neal Shover (University of Tennessee), Peter Grabosky (Australian National University), and three anonymous reviewers for their helpful comments on earlier drafts of this article. Direct correspondence to Carole Gibbs, School of Criminal Justice, Department of Fisheries and Wildlife, Michigan State University, 508 Baker Hall, East Lansing, MI 48808 (e-mail: gibbsca1@msu.edu); Edmund F. McGarrell, School of Criminal Justice, 560 Baker Hall, East Lansing, MI 48808 (e-mail: mcgarrel@msu.edu); Mark Axelrod, James Madison College, Department of Fisheries and Wildlife, 362 North Case Hall, East Lansing, MI 48825 (e-mail: axelrod3@msu.edu).

Keywords
transnational crime, white-collar crime, risk, electronic waste, E-waste

Business transactions have increasingly been occurring across national borders, thereby resulting in greater opportunities for white-collar crime and the externalization of risk (Passas, 2002). In addition, the global marketplace intensifies the impact of white-collar crime and risky transactions. "When nations fail to curb emergent forms of white-collar crime the effects ripple throughout the world. This happens, for example, when unrestrained business and trading practices cause international catastrophes" (Shover and Hochstetler, 2006: 45). The global economic crisis, resulting in part from the subprime mortgage scandal, is a prime example of this potential—one that is replicated in the harm associated with the growing trade in electronic waste (E-waste).

In both cases, the harms result from white-collar crime and legal-but-risky business transactions that cross borders. Globalization has allowed these risks to be disassociated from the people accountable for them. Environmental impacts associated with E-waste, for example, have been shifted to developing nations and financial losses have been spread around the world. In other words, the risks have become externalized. In addition, trade in E-waste is fueled by a similar set of factors; namely, lure and lack of oversight. Finally, reducing the opportunities for both types of illicit and risky market transactions is a challenging regulatory and enforcement issue.

This article begins with brief comments on the global financial crisis before moving to a discussion of the problems caused by E-waste. Data are presented on the scope and destination of U.S. exports of E-waste trade and on indicators of risk and white-collar crime associated with the trade. Next considered are theoretical frameworks suitable for interpreting E-waste and the global economic crisis, which is followed by a discussion of the challenge of regulating these global business transactions. The article concludes with an overview of potential interventions to reduce the harm associated both with E-waste and with regulation and enforcement in global financial markets.

The Global Economic Crisis

Problems in the United States mortgage markets began to surface in 2007 and grew significantly thereafter, which led to historic financial failures and a credit crisis across much of the globe (Shiller, 2008). Despite disagreement about the explanation for this crisis, little doubt exists that pro-homeownership policies, global financial imbalances, and "overly aggressive" mortgage lenders were significant contributors. Inadequate oversight also played a major role (Jickling, 2009; Shiller, 2008).

During the previous decade, U.S. policy promoted the dissemination of financial tools (i.e., home ownership) to the general population (Shiller, 2008). Specifically, federal policies designed to provide assistance to lower income borrowers, such as the Community Reinvestment Act (1977), permitted banks to lend to riskier borrowers (Jickling, 2009). In addition, global financial imbalances from increasing U.S. debt and greater investment in U.S. assets by developing countries kept interest rates low (Carmassi, Gros, and Micossi, 2009; Jickling, 2009; Yifu Lin, 2008). Opportunities to profit from the housing market grew significantly. As such, home building and ownership skyrocketed, fueled by profit-seeking mortgage lenders as well as inexperienced and fraudulent appraisers and borrowers (Schmidt, 2008; Shiller, 2008). Potential homeowners, for example, were encouraged to borrow the full value of their property with little consideration of repayment risk. Financial innovation to reduce risks and increase profits among the major players followed, as the use of derivatives, securitization, and the packaging and sale of mortgages to other investors were used to hedge or transfer risks (Carmassi et al., 2009; Shiller, 2008). These financial innovations proliferated absent any significant revamping or creation of new financial institutions for oversight (Shiller, 2008). Many analysts argue that huge Wall Street profits led regulators to look the other way and to ignore the impending crisis (Frean, 2010). The Gramm-Leach-Bliley Act (1999) and the Commodity Futures Modernization Act (2000) allowed companies to continue engaging in unregulated and risky financial transactions (Faiola, Nakashima, and Drew, 2008; Jickling, 2009).

Eventually the large supply of new homes reduced overall housing prices, and borrowers began to default on loans because of higher mortgage rates after the initial low-rate period. The housing bubble burst, and financial institutions that relied on repayment of loans and continued growth in the market began to fail. This crisis quickly spread across borders and caused the failure of financial institutions in several countries. Subsequently, the problems fed back into the United States in the form of the declining value of the dollar, fluctuations in the stock market, and additional financial failures (Shiller, 2008). Discussions of how to address the problem highlighted the significant challenges for the oversight of risky and illegal international business transactions (Carmassi et al., 2009; Jickling, 2009; Shiller, 2008).

Challenges for Oversight

Although global regulation of business has increased significantly since the 1970s, most remain at the local level (Braithwaite and Drahos, 2000). Attempts at global regulation, moreover, are plagued by inconsistencies in legal requirements across jurisdictions, while international treaties designed to harmonize regulation generally are voluntary in nature (Passas, 2002). Countries can choose whether to ratify relevant treaties, and many countries choose not to do so, whereas some ratifying countries lack the requisite resources to enforce their regulations (Chayes, Chayes, and Mitchell, 1998). This variability increases the pool of potential victims and opportunities for white-collar crime and risky transactions with actors in other countries (Shover and Hochstetler, 2006).

The scale and complexity of global transactions challenge good-faith attempts at monitoring and enforcement. The quality and origin of goods, materials, and wastes easily can be misrepresented when they cross borders. The scale of trade, the number of actors, and the complexity of financial transactions make this issue difficult to detect (Elliott, 2009; Hill, 2005). The increased anonymity associated with technology and globalization also hinders the investigation of known cases of fraud, and applicable law—whether "home" or "host" country—is often unclear (Putnam, 2009). Consequently, those who are predisposed or easily tempted to violate the law can do so with the reasonable expectation of impunity (Passas, 2002; Shover and Hochstetler, 2006). As a result of the global financial crisis, the challenge of controlling international markets has come under heightened scrutiny.

The Problem of E-waste

Electronics is the world's largest and fastest growing manufacturing industry (Grossman, 2006; Puckett, et al., 2002). Yet, each year, nearly 7 million tons of high-tech electronics become obsolete, and the result is E-waste (Grossman, 2006). E-waste refers to used electronics destined for disposal, reuse, or recycling, and includes "obsolete, broken, or irreparable electronic equipment such as televisions, computers and computer monitors, laptops, printers, cell phones, VCRs, DVD players, copiers, fax machines, stereos, and video gaming systems" (Luther, 2007: 1). This technological refuse becomes a significant social problem when discarded, as electronic products contain numerous toxic substances (Jackson, Shuman, and Dayaneni, 2006; Pellow, 2007; Scanlon, 2004; Silicon Valley Toxics Coalition, 2008).

Most U.S. E-waste simply is disposed of in landfills or is incinerated, but a considerable portion of it is gathered for recycling and is exported to developing nations for remanufacture or refurbishment (Environmental Protection Agency [EPA], 2007). Many recycling facilities in developing nations, however, are not equipped to handle E-waste properly, and much of it is not processed but is instead dumped in local villages near people and water sources (Pellow, 2007). Illegal dump sites have been documented in Nigeria, Ghana, China, the Philippines, Indonesia, Pakistan, and India (Greenpeace, 2008; Iles, 2004), and they pose severe threats to both human health and the natural environment.

Computer and television displays contain an average of 4–8 pounds of lead each, which means that "the 315 million computers that came obsolete between 1997 and 2004 contained more than 1.2 billion pounds of lead" (Pellow, 2007: 187). In addition to lead, high-tech electronics contain other toxic substances such as mercury and hexavalent chromium (Jackson et al., 2006). Health and environmental impacts include developmental damage to humans, organ damage and cancer, groundwater contamination, and ozone depletion (Grossman, 2006; Huo et al., 2007; Jackson et al., 2006; Puckett et al., 2002; Scanlon, 2004; Silicon Valley Toxics Coalition, 2008). Despite the severity of the consequences, little is known about this global issue because of legal variation and ambiguity in terms of the definition of criminal behavior across states and countries, the hidden nature of the harmful or criminal behavior, and the inattention of enforcement agencies.

In response to this knowledge gap, we assembled a variety of data to describe the problem of E-waste. We began by reviewing academic, nongovernmental organization (NGO), and governmental documents, as well as data collected by the U.S. EPA. Recent legislation requires U.S. exporters to notify the EPA of their intent to export specific types of E-waste. We compiled these notifications along with several preexisting sources of data on the scope and destination of

U.S. exports. Finally, we conducted 20–25 informational interviews (ranging from 30 minutes to 2 hours in length) with business and agency personnel responsible for their organizations' electronic disposal programs, with NGO advocates familiar with E-waste, and with regulatory and law-enforcement officials involved in Interpol's Environmental Crime Program.

U.S. Trade in E-waste

The movement of E-waste across the globe generates benefits (e.g., profits for exporters and recycling of precious metals for use in developing countries). Nevertheless, it also creates harms (e.g., waste dumps and improper disposal and harvesting) and risks (e.g., health risks for recyclers and the import of toys and jewelry containing lead). However, only *some* of these harms and risks occur as the result of noncompliance. Currently, much of the global transport of E-waste is legal (although this transport varies by country and by the status of the E-waste material being shipped). Particularly, in the case of the United States, efforts to regulate domestic and international disposal and recycling of E-waste are relatively weak.

In the United States, most electronic devices (or parts of electronic devices) are either exempt or excluded from the Resource Conservation and Recovery Act (RCRA, 1976) legislation on hazardous waste and are classified as "products" or "commodities" rather than as "waste" (Tonetti, 2007a). Regulations covering the export of cathode ray tubes (CRTs)—the glass video display component in computers and televisions—represent the only explicit regulation of E-waste. U.S. firms exporting CRTs incur liability only under specific and limited conditions related to reporting requirements (e.g., failure to maintain paperwork, failure to notify the EPA, failure to wait 60 days before export of CRTs, and exporting broken, intact equipment). Enforcement of these regulations has been weak (Government Accountability Office [GAO], 2008a, 2008b).

U.S. efforts are a stark contrast to international regulation and enforcement of the trade in hazardous waste. The Basel Ban, an amendment to the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, prohibits the export of hazardous waste from developed countries that belong to the Organization for Economic Cooperation and Development (OECD) to non-OECD countries. Although the Ban is not yet in force, the European Union and other developed countries have ratified it, passed domestic legislation to implement it, and extended its provisions to specific forms of E-waste (Ford, 2009; Zonneveld, 2007). Australia and the United Kingdom also have developed new methods for increasing enforcement. To date, the United States has not ratified the Basel Convention or strengthened enforcement through domestic legislation. Instead, the United States continues to generate significant amounts of E-waste and to externalize the risk by exporting it to developing nations.

Industry experts estimate that, in 2005, nearly 90% of CRT-containing products collected in the United States for recycling primarily were exported to developing countries (EPA, 2007). Nations that placed the highest number of requests to purchase U.S. E-waste on trading Web sites include China, Malaysia, India, Vietnam, Hong Kong, Taiwan, Pakistan, Egypt, and Sri Lanka (GAO, 2008a). Data on U.S. exporter notifications to the EPA of intent to export broken and used CRTs—as well as data from the California Department of Toxic Substances Control—show a similar pattern (see Table 1). In 2007, the largest *volume* of E-waste (72%) was exported to Malaysia (for additional details on estimate construction, see Gibbs, Melvin, McGarrell, and Axelrod, 2008). Malaysia also emerged as the largest export destination for California E-waste. Brazil, South Korea, China, and Mexico are the next most common sites.

TABLE 1

2007 Estimated E-waste Export by Designated Country

	California Department of Toxic Substances Control KGs (in Thousands)	**EPA Notifications of Broken CRT Export** KGs (in Thousands)
Malaysia	3,583	50,699
Canada	NR	11,175–11,689
Brazil	1,633	3,428–1,099
South Korea	1,588	7,103
China	1,043	NR
Mexico	816	NR
Vietnam	318	NR
India	91	NR

Note. NR = not reported. CRT = Cathode Ray Tube.
Source. California Department of Toxic Substances Control, as cited in Lee, Mike, "Some U.S. trading partners not supposed to accept it," *San Diego Union-Tribune,* June 19, 2007; EPA notification reports.

The EPA and California data likely underestimate the magnitude of E-waste exports; both rely on self-reporting, and the California data exclude E-waste that might be shipped to other U.S. states before being exported abroad. These data, moreover, probably represent exports by more compliant businesses. Because neither the EPA nor the California data include nations such as Ghana, Nigeria, and Pakistan—where exposés by journalists and NGOs have documented clearly harmful E-waste dumpsites, including E-waste originating in the United States—they assuredly underreport the volume of risky U.S. exports to developing countries (Carroll, 2008; Greenpeace, 2008; Iles, 2004; Pellow, 2007). Indications of noncompliance with minimal U.S. regulations are an additional cause for concern.

Several destinations listed in the California notification data, several countries seeking U.S. exports in the GAO investigation, and several countries with known illegal E-waste dump sites were *not* included in the EPA data. In addition, exports to China may indicate a violation of federal rules that require importers to give consent prior to shipment. China banned the import of E-waste and is therefore unlikely to have consented. More direct evidence of noncompliance also exists. In a recent GAO study, 43 businesses indicated willingness to export in response to requests for illegal exports of E-waste (e.g., export without notification and export of broken, intact electronics), often after acknowledging illegalities in the transactions. Finally, the GAO worked with the Hong Kong Environmental Department to identify 26 shipments illegally sent to Hong Kong by U.S. businesses without the former's consent (GAO, 2008a).

Theoretical Explanations

Transnational and white-collar crimes are products of choice. Recognition of this fact draws attention to conditions that encourage or permit decisions to engage in risky and criminal transactions. The distribution of lure, "arrangements or situations that turn heads," is one such condition (Shover and Hochstetler, 2006: 27). Most markets for reusable and recyclable electronics are export driven. The foreign demand for raw materials is strong, and importers profit by selling extracted metals and by selling working equipment mixed occasionally in with scrap (Tonetti, 2007b). The large pool of individuals willing to remove metals from E-waste with virtually no worker protection also creates lure for actors at lower levels of the E-waste trade. Middle men profit by exploiting these labor pools to extract metals from E-waste in exchange for extremely low pay (CBS News, 2008).

In addition, E-waste trade is appealing to exporters. Recycling a personal computer in the United States costs approximately $20, while importers will pay up to $15 for each unit, creating an estimated net gain of $35 per computer (India, the E-Wasteland, 2006). Moreover, export allows businesses to avoid the costs and the responsibility associated with health and environmental regulations governing E-waste recycling and disposal within the United States. In addition to the difference in recycling costs, the trade imbalance with China creates opportunities for inexpensive transport of E-waste overseas. Shipping lines offer lower prices on return trips to China rather than allowing cargo ships to leave the United States empty (Fuller, 2006). Thus, international trade in E-waste creates lure for many actors.

Lure includes financial profit but is not limited to profit. In the case of the harmful or illicit disposal of E-waste, one lure is the numerous impoverished villages and the vast expanse of land in developing countries, where E-waste can be dumped free from notice and from state intervention. Parties predisposed or easily tempted can do so with ease. The absence of self-restraint and credible oversight that creates another lure into criminal opportunity (Shover and Hochstetler, 2006).

In the United States, disposing of E-waste criminally is made easy by weak oversight. In other words, non-credible domestic and transnational oversight is criminogenic. Structural asymmetries and inequalities in the law (as well as in politics and culture) increase motivation and opportunity and decrease the ability to control transnational activities (Passas, 1999, 2002). More specifically, symmetries are criminogenic because "they generate or strengthen the demand for illegal goods and services; they generate incentives for particular actors to participate in illegal transactions; and they reduce the ability of authorities to control illegal activities" (Passas, 2002: 26).

Perceptional variations of lure and willingness to exploit opportunities are another consideration. Individuals and organizations—be they predisposed or tempted—have taken advantage of the criminal opportunities associated with E-waste, as evidenced by the previous description of risky transactions and white-collar crimes. In contrast, several recyclers we contacted for interview took pride in being "zero-waste stream" recyclers: They erase all memory in computers and electronics, prevent hazardous waste from moving to landfills, do not export, and do not use prison labor for disassembly. Thus, perceptions of opportunities created by lure and lack of oversight contribute to variations in white-collar criminality.

Such variations in lure, oversight, and predisposition contributed likewise to the current financial crisis. The lure of potential profits from the housing market partially drove the crisis. Indeed, profits associated with the use of derivatives, securitization, and the packaging and sale of mortgages to other investors might have led regulators to ignore the impending problem (Frean, 2010). They not only failed to address emerging risky transactions, but also regulations encouraged banks to take on riskier borrowers. Oversight did not adapt to market developments. In the presence of lure, risky and perhaps fraudulent transactions proliferated. Nevertheless, banks varied in their level of participation in the riskiest financial practices (Theil, 2009). Thus, differences in predisposition and temptation appear relevant to both forms of transnational crime and risk. In sum, E-waste trade and the business transactions leading to the financial crisis point to similar theoretical origins: lure, predisposition, and temptation and non-credible oversight. These conditions—combined with the nature of international transactions—pose significant challenges for regulation and enforcement.

The Challenge of Regulating Transnational Commerce

The nature of global business transactions is a significant barrier to effective regulation and enforcement. Technology has increased the speed and anonymity with which individuals and organizations can engage in risky and illegal transactions (Felsen and Kalaitzidis, 2005; Passas, 2002; Shover and Hochstetler, 2006). These transactions are complex and difficult to track. Business transactions, for instance, occur through multiple financial and banking systems linked across the globe (Elliott, 2009). Also, many transnational crimes occur via several smaller criminal activities, which requires intelligence analysis to disentangle the activities of internationally interconnected individuals and organizations (Hill, 2005).

The actions of nation states likewise can hamper the regulation of risky transactions. For example, asymmetries in the law that facilitate transnational crime often occur because states are unwilling to intervene to address a particular problem (Passas, 2001, 2002). Powerful nations hold more sway over the content of international treaties and can resist the criminalization of their activities or can refuse to ratify treaties that do so (Michalowski and Bitten, 2005). In addition, these countries might fail to enforce domestic legislation adequately (GAO, 2008a, 2008b). Many would argue that this kind of inaction makes countries complicit in facilitating the continued movement of illegal goods and services (Passas, 2002).

Powerful countries are not alone in their failure to act. Developing countries often lack the infrastructure and resources necessary to prevent illegal activities (Shover and Hochstetler, 2006). In some cases, government officials facilitate illegal and risky transactions to generate personal or government capital. "Grand" and "petty" corruption, for example, have fueled the illegal timber trade in Indonesia and have led to illegal exports of fish and lobster in South Africa (Hauck and Kroese, 2006; Palmer, 2001). Similarly, corruption coupled with unregulated markets and war explain nation-level variation in the effectiveness of regulations to reduce elephant poaching

(Lemieux and Clarke, 2009). In some countries banning the import of E-waste, officials have neglected its domestic dismantling and burning (CBS News, 2008).

Overall, these conditions associated with globalization create a significant incentive for individuals and organizations to engage in illicit transactions and externalize risk. The ease of these transactions and the lack of oversight make the activities appealing. It is also cheaper to externalize risks. In fact, differential compliance costs, as well as product and resource values, make illicit transactions profitable (Brack, 2004).

It is necessary to devise interventions that more adequately address transnational white-collar crimes and risks represented by E-waste and global financial transactions. Similar to the need to balance financial innovation with consumer protection, interventions are needed that encourage recycling and reuse in the name of economic development while reducing the risks and harms of E-waste. Rather than the mere promulgation of rules, the use of a "smart" or "responsive" regulation might promote more effective practices (Ayres and Braithwaite, 1992; Gunningham and Grabosky, 1998).

Prevention, Compliance Promotion, and Threat

Smart regulation is "a regulatory approach that is responsive to people's conduct rather than rigid in its response" (Foley, 2004: 2). It requires an assessment of the range of interventions and actors that might be used effectively, efficiently, and fairly to reduce environmental degradation (Gunningham and Grabosky, 1998). Flexibility is the key. Smart regulators must be willing to tailor their responses to specific groups of actors and to implement a range of interventions. Smart regulation recognizes that webs of constraint already exist and potentially are more effective than relying exclusively on government intervention. In this way, smart regulation resembles the concept of nodal governance (Wood and Shearing, 2007). Research on global business regulation supports this notion:

> The globalization of regulation never occurs on the basis of a single mechanism, no matter how powerful. . . . Dense webs of influence are needed to pull off an accomplishment as difficult as establishing a global regulatory regime that secures the compliance of relevant actors in business and the state. Such webs are dense in the sense of involving many types of actors mobilizing many types of mechanisms (Braithwaite and Drahos, 2000: 13).

The use of "webs of actors" or "third-party regulators" does not preclude the need for significant formal sanction threats. The threat of punishment serves as a constant threat to all and as a reality for violators who are unresponsive to other (less severe) interventions (Ayres and Braithwaite, 1992). Evidence of the effectiveness of criminal sanctions alone, however, is limited. Few studies have examined the effectiveness of criminal penalties in reducing white-collar and corporate crime. When legislatively available, harsh sanctions often are not used in practice either for street crime or environmental offenses (O'Hear, 2004; Tonry, 1992). The inclusion of criminal sanctions in new legislation invariably meets with resistance by industry.

NGO respondents interviewed for this study indicated that the International Scrap Recycling Institute and other powerful business interests have resisted federal E-waste legislation. (In part for these reasons, the GAO recommends that shipping codes be modified to identify clearly E-waste shipments that are currently categorized as scrap metals and mixed plastics. Such efforts would allow at least for statistical tracking, international customs cooperation, and additional insight into this largely hidden area of high-risk global trade [GAO, 2008b].)

Coupled with strong foreign demand for raw materials and the lack of recycling infrastructure in the United States for certain types of E-waste, an effective ban on U.S. exports is unlikely (Tonetti, 2007b). Furthermore, the E-waste trade might not be, in and of itself, the problem. In fact, the E-waste trade has positive effects. The trade is considered by some to be a mechanism for addressing the digital divide between developed and developing economies, and some periphery nations have developed state-of-the-art E-waste recycling as a method for economic development (GAO, 2008a; Iles, 2004; Tonetti, 2007b). Finally, even with additional legislation, shipping codes, and innovative enforcement, the detection and apprehension of illegal shipments of E-waste at ports will be extremely challenging. The scope of the problem is too large, and the number of actors is too high to rely on enforcement alone. Instead, the combined use of crime prevention, third-party- and self-regulation, and state intervention will be needed.

Prevention

Criminologists long have emphasized the importance of crime prevention, and preventive initiatives that can be used to reduce the risks associated with E-waste (Tonry and Farrington, 1995; Wood and Shearing, 2007). First, the United States is in serious need of a recycling infrastructure. To support this infrastructure, several states have passed state-, producer-, or purchaser-funded recycling programs (Luther, 2007). Although little analysis has been conducted on the costs of national versus state programs, currently the electronics industry is pushing for a national recycling management program that could be introduced via federal legislation (NCER, 2006, 2008). In addition to end-of-life strategies, the design process needs to be addressed (Iles, 2004), as the European Union requires through its legislation on waste electrical and electronic equipment (Directive 2002/96/EC). Consumers should be able to update electronics easily rather than purchasing new systems, and toxic materials should be phased out of production (Iles, 2004). Waste reduction and recycling infrastructure strategies might represent what Gunningham and Grabosky (1998) called “complementary” strategies. If manufacturers are required to pay for recycling, then it might encourage them to advance waste-reduction techniques voluntarily.

Given the ever-growing production of E-waste, failure to develop a corresponding recycling and waste-reduction process is criminogenic in the sense of generating the conditions for transnational crime. However, relying exclusively on industry to make these changes voluntarily absent of any financial incentive may be naïve. Some companies might change practices voluntarily and invest in producing less waste, but in the absence of a credible threat and profit incentive, many will continue with business as usual. The use of alternative interventions and "third-party regulators" might facilitate this type of transformation of business practices (Gunningham and Grabosky, 1998).

Self- and Third-Party Regulation

Consumer and government purchasing power can be used to persuade companies to change current practices. For example, the Clinton Administration indicated that it was in the market for energy-saving products prior to purchasing a significant number of computers. Such signals sent to the market by large prospective customers can achieve significant positive results (Grabosky, 1994). Similarly, knowledge of business practices allows general consumers to factor company record into purchasing decisions. Standards and certification programs for legitimate recyclers could enable the general public to exercise power by choosing higher-performing businesses (Gunningham and Grabosky, 1998). In fact, although the agency itself will not issue certifications (indicating the need for third-party involvement), the EPA supports recycler certification as an alternative to regulation (Tonetti, 2007b). Public awards for zero-waste recyclers are another option for using third parties to improve performance. Directing consumers to legitimate recyclers can create a financial incentive for unethical companies to self-regulate.

In addition to encouraging positive change, large and small consumers alike can provide informal sanctions, which is often a more powerful influence on individual and company behavior than formal sanctions (Paternoster, Saltzman, Waldo and Chiricos, 1983; Simpson, 2002; Vandenbergh, 2007). Government regulators can facilitate this process through information dissemination (Cohen, 2001). In addition to the potential for fines or other sanctions, negative publicity regarding E-waste can be used publicly to shame repeat "offenders" through the association of their brand with export and improper disposal of E-waste. General risk communications to consumers might help the public act as a control on company behavior. Currently, many consumers take strides to dispose of E-waste appropriately with little knowledge of the potential for improper disposal by illegitimate "recyclers" (CBS News, 2008). Communication campaigns might increase public knowledge of the problem.

Oversight

The effective use of "webs of actors" or "third-party regulators" does not preclude the need for significant formal sanction threats; strong legislation is the backstop of smart and responsive regulation (Ayres and Braithwaite, 1992). One option is to amend current RCRA regulations to include E-waste. For example, the EPA definition of "hazardous" could be expanded to be consistent with the international standards of the Basel Convention. Ratifying the Convention also would require U.S. action when nations that restrict or prohibit E-waste imports receive illegal shipments from U.S. recyclers (GAO, 2008b). If these changes occurred, then increased criminal liability might be necessary. The threat of harsh penalties might deter reasoning offenders, particularly owing to the tendency for white-collar offenders to have more to lose than street offenders (Shover and Hochstetler, 2006). Thus, threatened criminal sanctions might suffice in some cases to prevent abuses associated with E-waste.

Without new regulations, innovations in enforcement are the key to disentangling the actors and methods involved in transnational criminal and risky transactions (Hill, 2005). Methods developed in other nations provide models for increasing U.S. efforts. Officials from the Australian Department of Environment, Water and Heritage, for example, visited importing recyclers in developing countries to verify the legitimacy of the operations. Permits to export Australian E-waste are approved only if it is sent to verified recyclers. The United Kingdom uses intelligence-based enforcement to prevent illegal hazardous waste exports. Information gathered using traditional investigative methods is cross-referenced with public and secure databases to establish targets (individuals, companies, and shipments) for more in-depth investigation. Interventions are matched to the actor and nature of the activity to maximize crime prevention and deterrence (Chris Smith, Environment Agency, personal communication, October 2009). Emerging track and trace technologies also might enable authorities to link illegal exports to specific recyclers and thereby increase the likelihood of detection (Wyld, 2005). Such efforts might be advanced through "joined up" enforcement efforts via organizations such as Interpol's Environmental Crime Program (Elliott, 2009).

Risk assessment can be used to define the probability and potential consequence of certain behaviors or actors and target enforcement resources (Kennedy and Van Brunschot, 2009; Renn, 1998). Companies have demonstrated a range of behavior related to E-waste. Some companies willingly violate U.S. regulations, and importing countries have intercepted and returned illegal shipments to the United States (GAO, 2008a, 2008b). Prioritization of E-waste and cooperation among international customs organizations could help identify companies involved in this illegal trade. Other companies, however, engage in extremely prosocial, environmentally responsible behaviors without any legal requirement to do so. Thus, the level of risk might be assessed by examining prior behavior. Additional research might uncover other risk factors that can enhance control of disposal and export practices, perhaps by informing patterns of regulatory review and development of surveillance or early indicator systems. Such methods also might be used to determine whether the EPA's current educational strategies will be effective for specific companies; in some cases, more severe sanctions "higher" in the responsive regulation enforcement pyramid might be necessary (Ayres and Braithwaite, 1992; GAO, 2008a, 2008b). Relying on the enforcement pyramid to use more punitive punishments selectively when necessary might reserve resources for the most egregious and repetitive offenders.

Absent the general and political will to make these large-scale changes, analysis of growth in global business regulation provides a reason for optimism. "Modeling" is a regulation tool that has been used effectively to address other international business transactions, even by actors that have less power in the global arena (Braithwaite and Drahos, 2000). "Rules or principles do not have to be incorporated into state law or international law to have significance. Modelling of self-regulatory principles and the rules of the private justice systems of corporations are crucial to understanding how the globalization of regulation happens" (Braithwaite and Drahos, 2000: 10).

Smart regulation also could be used to police financial transactions. Additional legislation and innovative enforcement will be necessary to prevent the riskiest financial transactions. However, as with E-waste, a complete ban on these transactions might not provide the optimal solution. Financial innovations are important to fuel economic growth (Shiller, 2008). In addition, a complete ban will be met with industry resistance. Rather than promulgating extensive rules that prohibit these transactions, regulatory agencies need to evolve to provide credible oversight of this economic activity. In other words, risk-management institutions must be updated (Shiller, 2008). As with E-waste, a coordinated regulatory and enforcement effort would facilitate oversight of global financial exchanges. In addition, systemic risk regulation has been proposed by the Obama Administration to prevent future financial crises. Specifically, companies will be designated a specific level of monitoring and oversight according to the level of risk posed to the national economic system (Roth, 2009).

Even with innovation, relying exclusively on enforcement efforts will doubtless be insufficient, if only due to the scope and nature of global financial transactions—many occur in cyberspace. Enhanced prevention is needed. Improved information infrastructure is the key to prevent future financial crises (Shiller, 2008). To address the knowledge gap among low-income individuals victimized by subprime mortgages, the U.S. government could subsidize financial assistance. In fact, dissemination of financial advice to the general public could improve their capacity to act as third-party regulators. Coupled with standards and certification programs for approved financial advisors, opportunities for unethical lenders and brokers to swindle consumers could be reduced. Publicizing the performance record of lenders also would allow the public to sanction unethical firms informally. The will of the general public can encourage legitimate practices. Public awards for firms with outstanding financial records, for example, might create a financial incentive for other companies to improve performance voluntarily.

Conclusion

Risky and fraudulent business transactions resulted in a global financial crisis with profound global repercussions. Lure combined with noncredible oversight created significant opportunities for predisposed and tempted individuals and organizations alike to engage in white-collar crime and the externalization of risk. The scale of these transactions and the resulting harm demand innovative responses and present opportunities to learn about the challenges posed by E-waste and other harmful commercial transactions. Smart regulation is a promising approach to intervene in global business transactions. Specifically, drawing on multiple interventions, targeting multiple actors, and advertising the threat of punishment almost certainly will be more effective than primarily relying on state intervention.

Future research should explore the extent to which various mixtures of policies and "regulators" successfully address specific white-collar crimes and risks as well as the extent to which these interventions can be applied to other transnational problems. In addition, explorations of the contexts in which these interventions are effective would inform evidence-based approaches to crime control and prevention. Regardless of the specific set of interventions that ultimately works best to address these issues, the global financial crisis and the harms and risks associated with E-waste demonstrate the need to be more proactive so these threats do not create preventable "international catastrophes."

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POLICY ESSAY

TRANSNATIONAL WHITE-COLLAR CRIME AND RISK

Global E-waste trade

The need for formal regulation and accountability beyond the organization

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For several decades, scholars of white-collar crime, particularly those focusing on organizational crime, have noted the many challenges of regulating domestic corporations, transnational corporations, and state behaviors.[1] At the state level, such regulations are poised between a host of political concerns and economic interests. Attempting to regulate transnational organizations presents the same challenges noted as well as other complexities, including inconsistencies across jurisdictions, the complementary nature of international treaties, and the overall lack of oversight entities by transnational agencies (Passas, 2002; Ross and Rothe, 2008; Rothe, 2009; Whyte 2003). To use a term from Michalowski and Kramer (1987), "transnational loopholes" exist, within which these organizations operate.

Yet, as noted by Gibbs, McGarrell, and Axelrod (2010, this issue), not all transnational corporations are criminogenic in nature; they do not act immorally, unethically, or illegitimately. However, specific criminal activity is more likely to occur under some common conditions. Gibbs et al. suggest that the likelihood that a corporation will engage in criminal activity is increased in the presence of tempting arrangements or situations, organizational predisposition, insufficient self-restraint, and belief that the certainty and severity of aversive consequences, whether originating from within the organization or from external monitors, is low. Based on the propositional links between these variables and the practices and empirical evidence pre-

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1. Illustrative studies focusing on domestic corporations include Clinard and Yeager (1980); Grabosky and Braithwaite (1986); Kramer (1982, 1992) and Vaughn (1983). For transnational corporations, see Friedrichs (2007); Green, Ward, and McConnachie (2007); Michalowski and Bitten (2004); Michalowski and Kramer (2006); and Rothe and Ross (2009). And for state behaviors, refer to Green and Ward (2004); Kramer and Michalowski (2005); Ross (1995); Ross and Rothe (2008); Rothe (2009); and Rothe, Kramer, and Mullins (2009).

sented in the case of the E-waste industry, Gibbs et al. state that policies should reflect "smart" or "responsive" regulation in the form of crime prevention, third-party and self-regulation, and the threat of strong state intervention. However, I suggest that for these policy recommendations to occur, a directly focused policy must be enacted that addresses individuals as well as the organizational entity within which they are embedded.

Expanding the Discussion of Policies to Control the Illicit E-waste Trade

Policies aimed at reducing organizational crime, especially those that cross borders and involve multiple layers of actors, should not focus simply on "the" corporation. Instead, policies must target individuals (those making the decisions that result in policies that violate E-waste standards), the organizations (as entities), and the broader "system" within which they are embedded—which in this case is the "global" market, the overemphasis on profit, and the exploitation of less empowered and resourceful states.

Gibbs et al. (2010) suggest that a "strong threat of sanction" could serve as a deterrent. However, this ignores the issue of selective enforcement that operates within the current geopolitical structure of international economic relations, often referred to as *realpolitik,* and the current complementary nature of international legal norms and laws.

Furthermore, the deterrence literature indicates that the "threat of sanctions" would be highly problematic. First and foremost, the threat of sanctions is limited conceptually by Gibbs et al. (2010) to the organization and does not include the individual level of accountability. Second, such a policy might not go far enough. Although it is true that social location and position strongly influence deterrence, the literature locates the real general deterrent function of law and potential punishment not at the macrolevel of society or an organization but at the microlevel of *perception* (Nagin and Pogarsky, 2003; Paternoster, 1986; Rothe and Mullins, 2010). Furthermore, individual perception, which shapes the deterrent value of law, includes the perceived legitimacy of the law or regulation (Tyler, 2007; Sutherland, 1947). If law and regulatory frameworks are not viewed as legitimate, then the potential of general deterrence becomes significantly less forceful.

This point then brings us to certainty. A mere threat of punishment without certainty of accountability is highly unlikely to serve as a deterrent and, accordingly, is not an effective control mechanism. Empirical research has established that the main factor producing a general deterrent effect—on street-crime offenders and white-collar offenders alike—is certainty (Hollingier and Clark, 1983; Keppler and Nagin, 2006; Rothe and Mullins, 2010). Not surprisingly, when offenders do not perceive a punishment as likely to be imposed, little disincentive will be present toward offending, regardless of the celerity or the proportionality of the punishment in question (Rothe and Mullins, 2010). To perceive the threat of potential punishment, one must have certainty of its application on the individual level. Likewise, certainty then lends to an individual-adjusted perception of the threat. Ultimately, it is individual decision making that results in criminality.

Nevertheless, there is the need to address the organization within which individuals operate given the complexities of organizational culture and its impact on the individual decision-making process. Therefore, accountability should focus on both actors—not simply the individual or the organization. This concept is no different than holding an individual head of state and high-ranking official accountable for war crimes and genocide (e.g., the Nazis through the Nuremburg Tribunals) in addition to the state (e.g., Germany through the International Court of Justice [ICJ]).

Consequentially, the "threat of strong state intervention" alone will not serve as a deterrent. Self-regulation, drawing from traditional criminological literature, is far more likely to succeed when a powerful deterrent effect is at play, as Gibbs et al. (2010) note. What is needed are solid formal responses that have unity in application and consistent enforcement. After all, one of the most significant barriers to ending impunity has been the selective application of law and the lack of enforcement.

Although I agree with Gibbs et al. (2010) that relying exclusively on enforcement will be insufficient, I suggest that it is the first step that must be taken to encourage the involvement of third parties, self-regulation, identified shaming to reduce the "lure" opportunity and to enhance guardianship. Therefore, if we are committed seriously to reducing these types of organizational crimes, from the E-waste industry to crimes committed in the context of the global economic crisis, then the policies must be expanded and move beyond general principles to include multiple layers of accountability. Here I suggest that the creation of an empowered arbitration council could serve as a deterrent and as a postcontrol mechanism to address victims and perpetrators.

A Globalized Arbitration Council

An arbitration council with the power to sanction verbally and financially—as well as the power to forward a formal complaint for prosecution in states of origin of the corporation or that of the harmed state—could be formed to address these types of behaviors. Specifically, given the issues discussed previously and by Gibbs et al. (2010), a global oversight agency comprising rotating equal numbers of representatives from each global region of the world would sit on an ad hoc basis to hear complaints and cases brought forward by governments, nongovernmental organizations, civil groups, whistleblowers, and other corporations regarding violations of what are referred to in international public law as customary norms (i.e., identified common acceptances of proper behavior that are practiced by most corporations).

This solution would move beyond the problems of selective enforcement, the issues associated with the complementary nature of the ICJ and the International Criminal Court, and would empower victims and victim states to have redress.[2] Additionally, it would address both the corporate entity and the individual-level decision makers. As noted, specific formal controls must be available at the individual level to generate perceived certainty of accountability. Outside of an international court, which is neither desired nor probable for these types of offenses, such control must occur at the state level and should include collaboration with any state that the corporation actively employs, operates, or commits a criminal action within. It is through only this type of approach that any real deterrence can be achieved at the level of individual decision making.

An arbitration council would provide less politically and economically empowered states—which are all too often the "victim" of the E-waste—with recourse. It also would provide the opportunity for the "accused" corporation to respond to allegations. This process would provide a balance of power that is currently absent in international relations and, particularly, in transnational crimes involving victims (states and individuals) who are not empowered to respond to or to penalize corporate entities that are backed by highly empowered countries (such as the United States).

Additionally, a standard of "proof" similar to that applied in the U.S. civil court system could be adopted, because this is less stringent than a criminal case standard of proof. As is well known, the burden of proof in a criminal case is at the level of "beyond a reasonable doubt"; whereas, the burden of proof in a tort case or a civil litigation case is lower: a "preponderance of evidence," or roughly more than 50% probability that the defendant was either negligent or "guilty."

An arbitration court would provide the means of screening unnecessary cases from entering into overburdened criminal justice systems. Such a council could help reduce the selective enforcement, could serve as a basis to support public awareness campaigns, could provide a source for documenting complaints, and could forward potential individual-level criminal cases. It also could serve as a stronger oversight agency for identifying and sanctioning formally and informally those corporations that are in violation of waste trade laws or are below moral and ethical business standards.

As the literature on organizational crime has shown, third-party regulation can serve as a semi-effective constraint (Green and Ward, 2004; Ross, 1995, 2000; Rothe, 2009). This regulation can include other governments, nongovernmental organizations, media, civil groups, and social movements. Here, it is proposed that a formal third-party regulation be implemented in

2. The ICJ (an arbitration court for states) and the International Criminal Court (ICC; a criminal court for individuals that commit genocide, crimes against humanity, or war crimes) are complementary courts, meaning states must sign and ratify their treaty, thus accepting jurisdiction. Furthermore, they remain unempowered to enforce rulings (ICJ) and arrest warrants (ICC) without states' willingness to abide by decisions and/or aid in securing defendants once an arrest warrant has been issued. Consequentially, the broader system within which the E-waste trade industry is situated is grounded within the recognition of sovereignty and states' rights to accept jurisdiction and subsequent rulings. Additionally, neither of these courts is situated to address corporations.

the form of an empowered council that then could serve to complement state-level third-party regulations, as suggested by Gibbs et al. (2010). After all, expecting third-party regulation, conceptualized as consumers or the general citizenry, is problematic by itself. At issue are the assumptions that (a) the consumers would want to be or have the time to be educated regarding these corporations, and (b) the media and state would support campaigns to not purchase products associated with corporations that have been active in the illicit E-waste trade. Although this issue could be a factor for some consumers, one must consider that many consumer decisions are not based on ethical or moral choices but are instead based on affordability or name-brand recognition. Consequentially, to expect third-party regulation to work, one must introduce a framework for an empowered and representative regulatory system—what is referred to here as an ad hoc arbitration council.

With certainty of accountability and a balance of power, I suggest that the other policies suggested by Gibbs et al. (2010) potentially could emerge. In other words, from a strong regulatory and oversight system that moves beyond selectivity and complementarity, a foundation could be created from which Gibbs et al.'s proposed policies could emerge; namely, crime-preventative and self-regulation policies. After all, self-regulation is a valid policy and can be effective for those organizations without the "propensity" to commit illegal acts and those that are already highly committed to conforming to standards and ethical guidelines. However, for those organizations that are more criminogenic in their structure, culture, and business ethos, a policy reliant on self-regulation (as a sole mechanism) to reduce or control criminality is bound to fail—if not first being grounded in a system of certainty and accountability for the corporation and for the individual decision makers. This point is especially salient because, more often than not, rationalizations and neutralizations are employed that remove moral or ethical inhibitions or dissonance one might have. Likewise, effective policies need to be implemented that provide the frame for a preventive ideology and associated practices to follow.

Conclusion

Effective policy suggestions are difficult to conceptualize and to implement for any form of criminality. This issue is especially relevant for forms of organizational crime, including transnational criminality. The latter prove most challenging given the overall political lack of will; the influence of the corporations on political decision making; and the lack of resources to implement needed regulation, formal controls, enforcement, and support to instill public awareness and involvement in curtailing crimes such as E-waste. Consequently, it is difficult to be truly optimistic regarding the implementation of policies broad enough and complex enough to reduce significantly the "lure" and opportunity structures associated with the E-waste industry. Nonetheless, if we accept the etiological conditions identified by Gibbs et al. (2010)—the supply of lure, the size of the pool of predisposed organizations and tempted individuals, and the absence of credible oversight—then policies must reflect and specifically address them. Thus, strong regulation coupled with certainty of accountability at the individual and organizational levels would initiate the processes needed to reduce the harmful practices of E-waste.

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TRANSNATIONAL WHITE-COLLAR CRIME AND RISK

Framing E-waste regulation

The obfuscating role of power

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The research article by Gibbs, McGarrell, and Axelrod (2010, this issue) on electronic or E-waste—which is defined as "used electronics" including obsolete, broken, or irreparable equipment such as televisions, computers, laptops, monitors, printers, video gaming systems, cell phones, and so on—offers a fascinating perspective on the problem of E-waste. The developed world apparently generates 7 million tons of obsolete electronics per year, which contains a potentially deadly cocktail of lead, mercury, and hexavalent chromium that causes cancers, groundwater contamination, and even ozone depletion. In the United States, much of the E-waste is dumped in landfills or exported to the developing world. The authors position this problem in the framework of globalization that, they argue, has increased opportunities for many kinds of white-collar crime, including this one, and has decreased risks of detection. They draw a parallel between the problem of regulating E-waste and the most recent global economic crisis: both are enabled, facilitated, and made more profitable by "inadequate oversight" and decreased visibility, which allows those responsible for high-risk transactions to be "dissociated" from them.

Although several European Union countries have ratified international regulations such as the United Nations-supported Basel Ban, which prohibits the export of E-waste to developing countries, U.S. efforts to regulate E-waste are "relatively weak" (Gibbs et al., 2010). The combination of huge profits, opportunity, and the lack of "credible oversight" has produced "criminogenic asymmetries." Similar factors, the authors claim, have caused the global financial crisis: Technology has increased the speed and anonymity of transactions, states vary in their abilities and desires to regulate transnational commerce, and incentives abound (in the form of massive, easy profits).

The recommended policy solutions are based on an approach Gibbs et al. (2010) call "Smart Regulation" (Gunningham and Grabosky, 1998/2004), which is defined as "a regulatory

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approach that is responsive to people's conduct rather than rigid in its response" (Foley, 2004: 2). Building on the broad, unsupported claim that [all?] "government intervention is too rigid," the authors advocate "dense webs of influence" using a wide range of formal and informal tools of both carrot and stick persuasion. The proposed remedies fall under the general headings of crime prevention, self- and third-party regulation, and state intervention.

At the prevention level, industrialized nations need to develop a "recycling infrastructure" (Gibbs et al., 2010). Laws should be passed that require the manufacturer, consumer, state, or a combination of all three, to internalize recycling costs by building the price of responsible, safe disposal into taxes, manufacturing costs, or the asking price of every E-product. With such economic incentives and disincentives in place, E-product designers and engineers would be motivated to innovate, to develop different designs, and to find ways to phase out toxic materials. At the other end of the supply chain, a viable updating and repair industry would reduce the volume of E-waste and change the built-in obsolescence policies that govern electronics (and most other) industries today. (As one of the editors pointed out, such measures will do little to affect the totally unplanned obsolescence generated by the fast pace of technological change.) At the self-regulation level, the authors want governments to use their enormous purchasing power to buy only those products that conform to strict recycling standards. Existing standards should be toughened, and new organizations should be created to develop and monitor stronger ones. Greater transparency also must be developed to enable consumers to purchase from responsible manufacturers if they want. Awards should be given to the "best" companies, and publicity should be used to shame the reprobates.

The state should back up all these measures through "strong legislation" and continual "oversight" (Gibbs et al., 2010). Industrialized nations should adopt the international standards of the Basel Convention Regulations and expand its legal definitions of "hazardous" accordingly. State oversight should be backed by the *threat* of harsh penalties—the emphasis is on the threat rather than on the delivery. "Innovations" in enforcement are recommended, such as those practiced by the Australian Department of the Environment, which monitors recycling operations overseas and bans shipping E-waste to companies and countries not on the list, or by the United Kingdom, which uses track and trace technologies to monitor E-waste. The authors also suggest that regulatory agencies track companies' records of lawful waste disposal and employ risk-assessment tools to determine appropriate levels of monitoring. For both E-waste and global finance sectors, it is argued, "risk management institutions must be updated." "Additional legislation" is necessary in both domains, but because "financial innovations fuel economic growth," regulation and enforcement must be "innovative"—regulators should improve the information infrastructure, educate consumers of financial products (and E-waste, presumably), give financial assistance and advice to low-income buyers, encourage the development of standard-setting and certification bodies, and publicize the lending records of "responsible" and "irresponsible" companies. The authors (mistakenly, I would argue) believe that state regulatory regimes never adopted such approaches in the past.

Who would argue with these remedies and policy suggestions? They all make sense; many could and should have been implemented long ago. The key question is: Why weren't they? Why have states around the world not acted to prevent recurring stock market crises, to encourage recycling infrastructures, and to control the production and disposal of E-waste? The system of buying and selling stocks and the institution of stock exchanges has been around and generating regular financial crises, bubbles, and bankruptcies for some 500 years (Arvedlund, 2009; Kirtzman, 2009; McDonald and Robinson, 2009; Oppenheimer, 2009; Shiller, 2008). Developed countries have had national or state/provincial agencies charged with regulating stock market players since the 19th century (Condon, 1998; Snider, 2009). The environmental agencies that regulate toxic waste are relative latecomers; most owe their existence to the environmental movements of the early 1970s (Day, Girard, and Snider, 2010; Snider, 1993). But even they have had several decades to address these issues. Why, then, have the deplorable conditions described in this article not been addressed? Why do we still have regular disastrous financial meltdowns and crises? Why is obsolescence still the basis of manufacturing? This article by Gibbs et al. (2010) is missing an analysis of power, its sources, how it is distributed and used, and how it shapes the policy solutions that are *envisioned, adopted*, and *enforced.*

The obfuscating role of differential power has obsessed those who study the harmful acts of corporations from the time of Sutherland on. The famous dialogue between Sutherland and legal scholar Paul Tappan revolved around whether *all* harmful illegal acts or only those prohibited under *criminal* statutes should be included in the definition and study of white-collar and corporate crime (see Clinard and Yeager, 1980). The former, broader definition, which has dominated the field since that time, came from an explicit recognition that it was the power of corporate and white-collar offenders, not the fact that they caused less harm (indeed evidence abounds that the reverse is true), that prevented their harmful acts from criminalization. Since then, many have pointed out that the thefts, assaults, and deaths caused by white-collar and corporate criminals are not policed, enforced, or sanctioned as assiduously or as punitively as their counterparts, the traditional noncorporate offender (Michalowski and Bitten, 2005; Pearce and Tombs, 1998; Rosoff, Pontell, and Tillman, 2006; Slapper and Tombs, 1999; Snider, 1993, 2009).

Explanations for the massive contrast in laws and sanctions have revolved around concepts such as regulatory "capture." But this simply avoids the role of power—for why would those who regulate business offenders be "captured" when police handling traditional offenses so seldom are? And it cannot be blamed on a dearth of good ideas for reform or on a failure to understand the complexities of governing the intricate, multilayered, geographically dispersed corporation (Braithwaite, 2005; Gunningham, Kagan, and Thornton, 2003; Haines and Sutton, 2003; Parker, 2002; Shapiro, 1984; Shearing, 1993). The key factor that explains the state reluctance to address corporate offenses lies in the social credibility of capital, as well as in its immense economic, political, and ideological power. Business actors shape the laws that sanction, monitor, and control them in ways blue-collar criminals cannot (Reichman, 1992). In both financial and environmental regulation, representatives of the largest and most powerful businesses in their respective sector are legitimized as "stakeholders." These prospective "offenders" (as they would be viewed in traditional police parlance) are invited inside the policy tent and literally are asked to shape whatever regulations are envisaged or passed (Condon, 1998; Snider, 2009). Is it any surprise, then, that the "strong legislation" and "continual oversight" the authors recommend have been missing in action?

The power imbalance between the regulators and the targets of regulation explains why enforcement of all types of corporate criminality has been notoriously cyclical. Each disaster, each mine explosion (Glasbeek, 2002; Tucker, 1988), factory fire (Haines and Sutton, 2003), chemical leak (Pearce and Tombs, 1998), and financial meltdown (Calavita, Pontell, and Tillman, 1997) has bequeathed a short-term "license" to regulators to pass new laws and to toughen existing ones. All such disasters have spurred regulators to announce "get tough" measures that, if passed, left "regulatory legacies" and intensified "juridification" (Haines and Sutton, 2003). But when the media spotlight shifts, agencies backtrack and regulatory budgets are savaged. In the financial sector, tax lawyers and accountants begin anew their well-remunerated search for ever more novel ways to evade, avoid, or nullify the latest set of regulations (Braithwaite, 2005; McBarnet, 2004). Indeed, this is the history of the hedge funds and derivative trading practices that produced the 2008–2009 market fiasco (Shiller, 2008). Differential power is also why compliance, not "strong legislation" and "continual oversight," has been the dominant rationale of regulatory agencies. As Coleman, Sim, Tombs, and Whyte (2009: 9) pointed out, "this normative position … is based upon a recognition and acceptance of the constraints upon state resources required to regulate corporations more punitively; a recognition of the power of business vis a vis regulators; and … a concern not to provoke counter-productive tendencies through punitive enforcement" (see also Snider, 2009: 185, 191).

A case in point: The bursting of the stock market "bubble" in 2000–2001 revealed systemic, routinized corporate fraud and generated state-sponsored "crackdowns" in law, the professions, standard-setting organizations, and self-regulatory organizations. The United States quickly passed the pivotal Sarbanes–Oxley Act, which increased reporting requirements, penalties, and oversight over audits, financial reports, corporate counsels, senior executives, and Boards of Directors. By the time the 2008–2009 crisis struck, many of these initiatives had been rolled back: The reform-minded William Donaldson, who was the appointed Chair of the U.S. Securities and Exchange Commission in 2002, had been replaced by Christopher Cox, who was a Wall Street insider more sympathetic to industry concerns, and the pivotal Independent Public Company Accounting Oversight Board had "revisited" its rules to "lessen the auditing burden." These "burdensome" and "unnecessary" rules had in fact forced more than 8% of all listed companies, in 2005 fiscal year alone, to issue "revised" statements correcting the (false) earnings statements they had released previously (Holstein, 2007; McKenna, 2007; Schwartz, 2007).

Indeed, government reluctance to control and sanction the harmful acts of business is rooted deeply in the culture and belief systems of capitalist societies. When the first Factory Acts were debated in 19th-century England, the *idea* that any of the profit-seeking activities of business could be considered immoral or criminal was revolutionary. The business classes insisted that the state had no right to oversee any element of business practice. In their view, this was an abrogation of the near-sovereign rights of ownership enshrined in English common law, where those who owned the factories and machines assumed their God-given right to control everything in that workplace (Carson, 1970, 1980; Paulus, 1974). A hundred years later, environmental laws faced a similar uphill battle (Day et al., 2010). This reluctance to regulate has been compromised in the financial sector because a healthy stock market is the basis of capitalist financial systems, and it depends on investors having confidence in the sanctity of markets. Investors want to know that their money is in good hands, and that regulators are watching and will weed out and punish fraudsters. However, powerful institutions and corporate actors know that huge, probably untraceable profits can be realized through insider trading, Ponzi schemes, churning the market, and so on. Thus, the cycles of punishment and neglect in this sector have been particularly steep: draconian solutions such as sentencing Ponzi scheme maestro Bernie Madoff to a 150-year prison sentence alternating with underregulation and inattention.

Recognizing the realities of differential power does not mean "nothing can be done." Policy reform depends, first and foremost, on the creation of countervailing power. Because states, outside crisis periods, have shown themselves unable or unwilling to contain corporate harm, social movements that generate a continual swell of protest play an essential role in creating a culture in which certain business activities, methods, and practices become culturally unacceptable, publicly shamed, and shunned by all self-declared "responsible" organizations and actors. John Braithwaite's (1994) article on the potential of models and model mongers illustrates how good ideas can be—and have been—deployed to increase the clout of relatively powerless groups seeking change. Braithwaite argued that, despite the reality that subordinate groups generally ape superordinates, "model mongering" can benefit the powerless more than the powerful (1994: 445). "Model mongers float a variety of models until they find one that … [succeeds in] striking a resonant appeal to the sense of identity of a people" (Braithwaite, 1994: 445). Thus, dominant interests—multinational corporations, for example—do not always "win." Social change is ubiquitous, and processes of mutual constitution are constant. As different groups and networks form and interact, they act on each other in detectable, empirically visible ways, which are seldom measurable, predictable, or linear (Mosco, 1996). Multiple determination, not strict causality, is the norm.

Applied to the problem of E-waste, this means that developing a "recycling infrastructure" should be a win–win solution. The obstacle is that to enable the benign policy circle to begin, the nation-state must first pass measures that make it illegal and/or unprofitable for electronics companies to continue externalizing disposal costs. Electronics industries have massive power—lobbying power, and economic and social capital. But they also contain people, networks, and groups that can "champion" environmentally friendly models inside the corporation—*if* oppositional social movements successfully publicize the dangers of E-waste, make it visible, and introduce it as a marker of corporate social responsibility. Counterhegemonic social movements can, over time, create a cultural environment in which companies reap social capital for responsible recycling (which they hope translates into increased sales), phasing out toxic materials and developing products that can be repaired. Once repair and recycling are technically and economically feasible, businesses will surface to fill this market niche—and in so doing will constitute new pressure groups promoting environmentally beneficial policies. Such a milieu makes it possible for governments to contemplate favoring responsible companies in their purchasing policies. Globalized communications and investment can be used here to foster progressive social change—witness the recent agreement by Canada's major energy companies, under pressure from Ethical Funds Ltd. and disaffected groups of stockholders, to disclose the risks of the hydraulic fracturing methods they use in a major oil-pipeline project (Milstead, 2010: B8).

Regulating global financial markets, however, is a much greater challenge. It is harder to create mass social movements or moral outrage to support the rights of investors, or to make the complex nature of these transactions visible, given the speed, technological sophistication, and lack of transparency that dominates these markets. As noted, even though market integrity is in the long-term best interests of the dominant players in this sector, the combination of large profits, multiple opportunities, minimal visibility, and minimal or irregular sanctions has created a bull market in "aggressive" tax planning (Braithwaite, 2005), "irregular" accounting procedures—such as those used by Lehman Brothers to hide its toxic investments—and similar practices (de la Merced and Sorkin, 2010). It is difficult to envisage policy solutions in a culture that continues to revere and reward those who build financial castles in the sky. Although the latest crisis has damaged bankers' prestige (if not profits), and model mongers, shareholder rights groups, state regulatory agencies, investigative journalists, as well as electronically based protest sites and blogs regularly "out" particularly egregious corporate offenders, corporate resistance has already blunted proposed legislative reforms in the United States, which is the dominant financial player. Whether countervailing groups, backed by the apparently swelling outrage of the "ordinary Joe," will be sufficient to counter the massive agglomerations of power that dominate financial markets and to secure what Gibbs et al. (2010) have called "strong regulation" is dubious at best.

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POLICY ESSAY

TRANSNATIONAL WHITE-COLLAR CRIME AND RISK

Smart regulation and enforcement of illegal disposal of electronic waste

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How many times have you disposed of a piece of electronic equipment—a refrigerator, computer, mobile phone, television set, hairdryer, or anything else with a plug on it? And how many of these appliances were still working but no longer pleased you? If you are either a European or a U.S. citizen, then the answers to both questions probably do not differ much. We throw away a lot of electronic equipment that is still functioning or could be repaired easily. Luckily, this equipment does not go to waste; it is exported to countries where a market exists for second-hand electronic equipment. Recycling these goods has numerous benefits in terms of efficient use of natural resources, digital access in developing countries, and economic growth resulting from the development of a recycling industry in developing countries.

A major drawback of transporting electronic waste (E-waste) across the world is that it is also a way to make profits by saving on recycling costs, and it transfers environmental and health problems to underdeveloped areas. Equipment that is exported as second-hand goods, in fact, is not functioning at all or breaks during transportation, and thus, it arrives as waste. Developing countries often lack the technology to process these wastes safely. Many electronic devices contain chemicals and heavy metals such as lead, polyvinyl chloride, or dioxins. These products often are dismantled at waste facilities or scrap yards that lack adequate protection for their employees. Children play or even work at these scrap yards. Moreover, instead of being processed, the waste often is dumped in landfills, causing environmental pollution in nearby living areas. A 2008 Greenpeace investigation of soil and water in Ghanese living areas close to

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scrap yards found carcinogenic dioxins, lead, and other toxic chemicals in concentrations that equal the criteria for severe pollution in European countries (Greenpeace, 2008).

Gibbs, McGarrell, and Axelrod (2010, this issue) propose a "smart regulation" approach to the problem of E-waste. This approach consists of a combination of prevention, third-party regulation, and state intervention. This policy essay discusses the potential of smart regulation based on supply-chain regulation by the European Union (EU) and, in particular, on the regulatory enforcement policy of E-waste in the Netherlands. Dutch ports are major export hubs for waste from the EU to West African countries. The oil tanker Probo Koala, which was authorized to depart from Amsterdam and poisoned hundreds of people when it dumped its polluted load in Abidjan, Ivory Coast, is a recent example of the disastrous consequences of failing enforcement at the port of departure. On the issue of E-waste, however, the Dutch Inspectorate of Environment has developed an innovative enforcement approach and plays a leading role within the EU. In this policy essay, we first describe this approach as an example of smart regulation by analyzing (a) how the supply-chain approach aims to prevent illegal export, (b) what effects can be expected of self-regulation and third-party regulation, and (c) how public enforcement is organized. We then broaden our analysis from the E-waste supply chain to the more general issue of the life cycle of metals in electronics to demonstrate that a solution to the problem of E-waste might not be in continuing to criminalize E-waste but in better regulation of the recycling market.

Criminal Enforcement Problems

The regulatory problem with E-waste is how to distinguish between the legal export of second-hand electronic products and the illegal export of hazardous E-waste, and how to ensure that exported waste is recycled safely and not dumped. The European Waste Shipment Regulation (EWSR), which forms the regulatory basis for EU countries, aims to prevent illegal export by licensing exporters, traders, dealers, and brokers. Export of second-hand equipment is only permitted with a test report showing that each piece of equipment works and with proof that the type of equipment has a market. If no market is available, then the goods are defined as waste.

Only Nonhazardous Waste May Be Exported

This system provides many opportunities for fraud by defining hazardous waste as second-hand equipment. The classic answer to fraud has been the detection and sanctioning of illegal exports of E-waste at exporting ports. However, criminal enforcement at the port of departure only can detect a fraction of illegal exports. The detection of illegal export requires time-consuming verification and inspection of the test reports and container loads in the export harbors. Exporting companies often are small companies, and African exports consist of smaller parties of E-waste mixed with other types of waste (cars or furniture; Inspectorate of Housing, Spatial Planning, and the Environment, 2009). Considering the enormous volume of container exports, only a small percentage of the actual export volume can be inspected. An evaluation of EU enforcement actions shows that 19% of the inspected waste shipments were in violation, of which 37% were illegal transport mostly of E-waste to Africa.[1]

The global character of the E-waste trade creates additional problems for criminal enforcement. For example, crucial to the distinction between legal and illegal exports is the assessment of whether a market exists for the exported goods. It is very difficult to prove that a certain product has no market—say, 15-inch monitors—at the designated location and, thus, that exporting a particular load is illegal (Inspectorate of Housing, Spatial Planning, and the Environment, 2008). It also is difficult to assess at the port of export whether the company at the waste destination can process properly the waste according to local environmental regulations, or to verify whether the waste actually reaches the companies where it is destined to go.

The Dutch Environmental Inspectorate tries to overcome these problems by improving cooperation with other enforcement authorities. First, cooperation with enforcement authorities at the port of reception can help answer questions about local regulations, product markets, and recycling facilities. The Dutch Environmental Inspectorate, therefore, tries to improve cooperation with environmental enforcement authorities in E-waste-importing countries (e.g., Ghana and China) that receive a lot of E-waste destined from the ports of Amsterdam and Rotterdam. Thus, international cooperation among law enforcement does not require regulatory harmonization or physical inspections (exchange of information on regulation and enforcement), but also that specific information on offending export companies and traded goods can prevent illegal exports (Bamberger and Guzman, 2009; Coglianese, Finkel, and Zaring, 2009).

Second, coordination between EU countries can contribute to more effective enforcement. The EWSR is enforced by more than 25 old and new EU member states often lacking expertise and capacity. Because of differences in enforcement level among EU countries, several "escape routes" are used as well as port hopping. The European Union Network for the Implementation and Enforcement of Environmental Law (IMPEL), chaired by the Dutch Environmental Inspectorate, therefore, started an "Enforcement Actions" project in which knowledge and expertise were exchanged and joint inspections were carried out. Training and exchange programs for inspectors were set up, for example, on how inspectorates, transport police, and customs can collaborate (IMPEL, 2009: 38).

Despite these efforts, large differences in enforcement levels within the EU remain. Some member states still fail to inspect waste shipments on a regular basis or even lack an enforcement infrastructure in which the responsibility for waste shipment inspections is specified. Greece, Spain, and Italy have large seaports with easy access to African ports but do not participate in the Enforcement Actions project at all. Enforcement of E-waste regulations is still largely a matter of the personal commitment of certain officials (IMPEL, 2009: 68).

Another problem is that the improvements are mainly directed to better detection and verification of illegal waste, but sanctioning regimes still seem weak. From the newsletters of

1. The other violations were administrative. This detection rate does not reflect the crime rate because it is the result of random and selective inspection measures.

the Enforcement Actions project (IMPEL, 2007), it can be concluded that even the Dutch Environmental Inspectorate responds to illegal export with only a warning letter and that the low penalties result in a lack of priority and enforcement capacity at the British enforcement agency. Even if sanctions were higher, then it is more likely that an incentive would form for the displacement of the crimes to more lenient ports than for deterrence of violations.

A more fruitful approach than focusing on the single-shot moment of container exports of E-waste is to consider the E-waste supply chain. In the following section, we first present an analysis of the problem of E-waste in terms of the criminogenic aspects of its supply chain, which will help us to understand better how electronic products come to be (defined as) hazardous E-waste. We then illustrate how the Dutch Inspectorate for the Environment uses a supply-chain approach in its enforcement policy.

Regulating Responsible Supply-Chain Management

The Criminogenics of Supply Chains

Several criminological concepts and theories have been developed to understand the particularities of transnational supply chains and to assess their associated criminogenic vulnerabilities. In this special issue, Gibbs et al. (2010) refer to the "criminogenic asymmetries" introduced by Passas (1999). These "structural disjunctions, mismatches and inequalities in the spheres of politics, culture, the economy and the law" are multiplied, intensified, and activated by the globalization of business (Passas, 1999: 402). Asymmetries are criminogenic by offering illegal opportunities, creating motives to use these opportunities, and making it possible for offenders to get away with it. For instance, globalization created the possibility to transport toxic waste to third-world countries where it could be disposed of at a fraction of the cost and without the threat of law enforcement. Illicit opportunities are produced by the fragmentation of enterprises and transactions across more than one country. Price asymmetries create the incentive to move hazardous waste to other countries. In addition, regulatory asymmetries create the opportunity to cut costs on environmental management and labor conditions by outsourcing risk, whereas law-enforcement asymmetries weaken social controls.

Moreover, globalization has fostered "competitive deregulation." Competition in global markets has driven corporations to a "race to the bottom" to find low-cost services provided through poor environmental standards, low wages, and poor working conditions. Consequently, risky or harmful links in the supply chain are outsourced to developing countries. Criminogenic asymmetries might lie at the root of both the shipment of E-waste to developing countries for illegal disposal and the outsourcing of the recycling of reusable commodities. Developing countries that need regulation protecting their natural resources and the health and safety of their working populations instead try to attract foreign capital and recyclable commodities by regulating less tightly than other countries. Passas and Goodwin (2004) emphasized that the illicit opportunities created by globalization are not counterbalanced by international forms of control of multinational enterprises, creating "crimes-without-law-breaking."

The metaphor of the supply "chain" also draws our attention to the way the various loops link together in a process by which legal commodities are transferred in illegal goods. Again, work by Passas (2003) but elaborated on by Tijhuis (2006) might be of use. They focused on the interfaces of legal and illegal actors in the production of transnational crime. Tijhuis illustrated that individuals, companies, and even jurisdictions can function as interfaces through which the legal status of certain goods, services, and funds are transformed. In research we conducted for the Dutch Environmental Inspectorate, we observed how expeditionaries operated as such interfaces in the transformation of legal reusable commodities to illegal E-waste. From the end users who get rid of reusable parts of electronic goods to these expedition companies, the waste has a legal status. However, when these expeditionaries prepare the goods for export to Africa or Asia and, therefore, provide it with false classifications, these goods transform from the legal status of second-hand electronic products to the illegal status of E-waste. Following crime pattern theory, these interfaces might provide opportunities for situational crime prevention (Benson and Madensen, 2007; Benson, Madensen, and Eck, 2009).

A Supply-Chain Enforcement Approach

Within the broad scope of the globalized supply chain, the role of a national regulatory agency is necessarily limited. However, the Dutch Environmental Inspectorate provides an example of an enforcement practice that does not concentrate on the "interface" (the exporting party) alone but aims to prevent illegal export by starting at the source. In line with smart regulation theory, it extends enforcement along the E-waste supply chain and addresses waste producers and recycling businesses.[2] Selling waste to a buyer or exporter without a license constitutes an offense under the Dutch Environmental Management Act. The supply-chain approach prevents the producers of electronic products who externalize risks and makes them responsible for their own waste. For example, when the Inspectorate detected a container with defect deep-frying pans, water cookers, and other malfunctioning household appliances destined for Ghana, it not only charged the exporting company that had classified these goods as marketable but also the wholesale buyer who traded the goods and the Dutch retail chain that disposed of the broken appliances. The Inspectorate also exerted pressure on the retailer to end the trade and issued a press release stating that it had stopped "a retail chain" from dumping electronic waste.[3] Such enforcement publicity might not deter explicitly calculating exporters from illegal behavior, but it might function as an implicit reminder to retailers of their social and legal duties and as a reassurance that irresponsible companies will be proceeded against (Thornton, Gunningham, and Kagan, 2005). In this way, public enforcement connects with the existing social-license pressure of third parties (Gunningham and Grabosky, 1998; Gunningham, Kagan, and Thornton, 2004).

2. See the Inspectorate of Housing, Spatial Planning, and the Environment (2009) Nazorgactie electronica afval 2008 (Aftercare action electronic waste 2008; on-line at vrom.nl).

3. See the VROM Inspectorate press release, 26-2-2009 (on-line at vrom.nl).

Incentive Mechanisms, Self-Regulation, and Third-Party Regulation

Disposal or recycling of E-waste in a responsible manner is costly. Regulation aims at transferring these costs to producers or consumers. Several mechanisms have been developed to overcome the reversed incentive structure connected to the negative value of waste. Schemes to return costs of recycling at the end of the life cycle to producers have proven to be highly criminogenic, encouraging "sham" recycling and illegal disposal (Scanlon, 2004). A better option could be to internalize the cost of proper waste management into the price of electronic devices at the time of purchase. However, these advance-recovery fees create opportunities for fraud when products are not recycled as prescribed.

A great challenge is to design incentive mechanisms that have a minimum of criminogenic and counterproductive effects. The EU introduced a system of "Extended Producer Responsibility" by adopting directives that require producers of electronics to take responsibility for the recovery and recycling of E-waste, by providing collection schemes in which consumers can return their used E-waste free of charge,[4] as well as by requiring manufacturers to substitute the use of hazardous materials with safer alternatives.[5] Despite such rules on collection and recycling, only one third of electric and electronic waste in the EU is reported as separately collected and appropriately treated (European Commission, 2010).

Self-Regulation

An alternative to the economic approach of creating financial incentives for desired behavior is a normative approach to stimulate corporate social responsibility. The producers of electronics often are large businesses that depend on consumer trust and, therefore, are easier to motivate toward voluntary compliance than traders and exporters of waste, who often are smaller companies that are unknown to the general public.

To facilitate responsible supply-chain management, the manufacturers of electronics created the Electronic Industry Citizenship Coalition (EICC, 2008). This coalition is a nonprofit organization comprising members of the information and communications technology industries collaborating to promote social and environmental responsibility and shared efficiencies in the global electronics supply chain. The EICC created a Code of Conduct that provided guidelines for performance and compliance with critical corporate social responsibility policies. It also provided tools to audit compliance with the code and helped companies report progress. The actual value of such a self-regulatory scheme can be contested, however. The pitfalls of self-regulation are well known. It might serve as a window dressing, and it might be used to prevent obligatory governmental regulation; furthermore, because of its voluntary nature, noncompliance rarely is sanctioned.

4. See Directive 2002/96/EC.
5. See Directive 2002/95/EC.

Third-Party Regulation

A much stronger effect can be expected to develop from pressure from nongovernmental organizations (NGOs) on electronics producers to reduce toxic material in electronic products. In the market for E-waste, Greenpeace's "greener electronics" campaign provides a good example. Greenpeace's "Guide to Greener Electronics" ranks the 18 top manufacturers of personal computers, mobile phones, televisions, and games consoles according to their policies on toxic chemicals, recycling, and climate change (Greenpeace, 2010). Nokia and Ericsson lead and Dell, Microsoft, and Nintendo scored low for the amount of toxic material in their appliances. Perhaps it is illustrative that several companies classified by Greenpeace as the worst performers in preventing E-waste, such as Microsoft and Dell, have adopted the EICC Code of Conduct.

This type of transparency enables consumers to include information that is otherwise unavailable in their product choices and, thus, to become active "coproducers" of market regulation (Gunningham and Grabosky, 1998). The aggregate market pressure from consumers' individual actions can result in third-party enforcement when consumers "punish" offending companies and "reward" firms with a good compliance status (Bardach and Kagan, 1982). However, it is unlikely that transparency about negative external effects will result in a market for green electronics (Vogel, 2005). Generally, third-party enforcement does not derive its strength from its financial implications but from loss of prestige and public humiliation as a result of negative publicity (Braithwaite, 1989; Fisse and Braithwaite, 1983). Greenpeace is well aware of this fact and does not primarily aim to change consumer decision making, but to shame multinational producers by performing public protest actions at their headquarters.

Like all modern regulatory theories, smart regulation advocates a facilitating role of government—organizing and mobilizing capacities of other network members instead of a direct interventionist role (De Búrca and Scott, 2006; Gunningham and Grabosky, 1998; Wood and Shearing 2007). A major challenge for smart regulation is to organize public enforcement in such a way that it facilitates and reinforces existing third-party regulation (Gunningham and Grabosky, 1998). The regulatory pyramid has become the paradigmatic approach for the "sequential" combination of private and public enforcement (Ayres and Braithwaite, 1992; Gunningham and Grabosky, 1998). Although most Dutch enforcement agencies have embraced the pyramid in their enforcement policy documents, in practice, they often are hesitant to cooperate with NGOs because they fear losing control. The Dutch case of E-waste enforcement, however, provides an example of how private and public regulation can be combined in a sequential order. The ascent along the pyramid was in this case initiated by Greenpeace's (2008) publication of its "Poison for Ghana" report that measured the consequences of E-waste dumping in Ghana. The report revealed that the equipment that was dumped originated from Dutch companies. The Dutch Environmental Inspectorate attempted to trace the companies that had disposed of the equipment to sanction them. In this case, the attempts were unsuccessful, but by using Greenpeace's information, the Inspectorate sent a signal that it is willing to cooperate with NGOs and to back up informal third-party enforcement actions with formal sanctions.

The Life Cycle of Metals in Electronics

The search for smart regulatory strategies as well as for their enforcement efforts is motivated by the social and environmental harm generated by E-waste. This harm is the rationale for the criminalization of the shipment or disposal of E-waste. However, a full consideration of the supply chain forces us to look at the total life cycle of the metals used in electronics that cause harm or need to be recycled. The supply chain often is portrayed as having a beginning and an end. The life cycle of electronic products ends when they are (legally or illegally) dumped or incinerated. However, when metals and other substances are recycled, it signals the beginning of a new life cycle. The harms associated with the supply chain of electronics should not be viewed solely as the problem of E-waste at the end of the track but also as originating from the birth of the life cycle. Such a "cradle-to-cradle" approach instead of a "cradle-to-grave" approach puts addressing these problems in another perspective.

A study commissioned by the Global Sustainability Initiative (GSI) and the EICC showed that metals are sourced from the earth through mining, and from the existing economy through recycled production (GHGm, 2008). Both sources also might be mixed together within the global pool of a metal commodity. Each producer at each stage of production might mix different flows from different sources, depending on economics and availability. Therefore, it is difficult to track clearly the physical flows and trade of metals through the market. Metal recycling is an important contributor to the dynamics of material supply. Metal scrap and refined recycled metal contribute substantially to the global metal commodity supply and to international trade. Even though statistical information on recycling varies for the different metals, the GSI/EICC study found that the contribution to metal production by recycling ranged from approximately 25% to 40%.

According to the study, the general constraint to greater levels of metal recycling is not a lack of demand for recycled metal, but it is the availability of old scrap from end-of-life products that can be recycled economically. The recovery and recycling of metals from electronic products is low compared with other end-use products, like automobiles and industrial equipment. Reasons include the very small amounts of metal present in any given electronic product, the presence of many different metals in each product, the differences in value of each metal, and the great diversity of electronic products. Together, these factors present challenges in the collection of metal from these products and in the ability to recycle the metal content. Economic, environmental, and resource incentives are driving efforts to increase the fraction of metals recycled from electronic products at end-of-life.

Adverse Impacts of Mining Versus Recycling

Interestingly, the focus of the adverse impacts on human rights and the environment by the electronic industry is on the other end of the life cycle—the mining of metals. Without intending to trivialize the problems related to recycling, this focus on extraction has a purpose. Both industrial and artisanal extraction of ores have legacies of serious environmental pollution, destruction of ecosystems, forced displacements of people, slavery and child labor, systemic corruption, and fuelling of civil war (Huisman, 2010). Some of these adverse impacts also are present in small-scale product disassembly and metal recycling, particularly in less developed countries.

The International Council on Mining and Metals, which represents large mining companies and metal commodity associations, has expressed a desire for "shared responsibility" of metals management across the material life cycle (GHGm, 2008). However, the same leading metal and mining companies that engage in corporate responsibility initiatives and implement best-management practice continue to face criticisms and allegations of poor social and environmental conditions.

Because of the adverse social and environmental impact of the mining of metals, it is necessary to reduce mineral mining in general and to increase the efficiency of resources and materials that are extracted. Toward these ends, the electronic industry finds it desirable both to enhance the recovery of metals from end-of-life electronics products and to improve yields of metal recycled from electronic product scrap. However, a shift from producing to recycling metals for electronics manufacturing should not go hand-in-hand with a transfer of social and environmental harms from countries where metals are extracted to countries where metals are recycled. This policy calls for the responsible management of end-of-life electronic products, including efforts to enhance materials efficiency after product use and attention to the recycling of metals. Individual electronic companies need to do better in characterizing specific metal content and use in electronic products. This requirement supports the tracking of metals used in electronics, helps in tracing sources of materials, and facilitates recycling.

Technologies for Sustainable Recycling

A more sustainable approach to the problem does not lie in prohibiting E-waste from being shipped from developed countries to developing countries but in the development of less harmful recycling technologies. Moreover, because emerging economies increasingly produce their own E-waste, the question would be how regulatory policy could contribute to the development and implementation of such technologies and whether this regulation would need a complementary criminal policy.

By examining the actual performance of the recycling chains of both informal and formal recyclers in 11 selected countries, Schluep et al. (2009) showed that sustainable technologies existed as a result of corporate initiatives. Although much still needs to improve, Schluep et al. saw several inefficient and unsustainable operations as having potential for the future implementation of innovative technologies. For instance, China and South Africa are promising to introduce innovative pre- and end-processing technologies following a technology and knowledge exchange. The United Nations Environmental Programme (UNEP) has selected China and South Africa to introduce the strategic technology transfer program for sustainable E-waste recycling technologies. According to UNEP, South Africa is engaged strongly with the manufacturers and with the importers industry in E-waste management. China is supposed to feature large volumes and a large interest in E-waste recycling by the informal and the formal sector, which defines a vibrant selection of technology transfer opportunities.

Nonetheless, these and other emerging economies face many barriers for the transfer of sustainable E-waste recycling technologies—barriers in the fields of policy and legislation, technology and skills, as well as financing and business opportunities. Regarding policy and legislation, the main obstacles stem from the lack of specific legal frameworks, low national priority for the topic, conflicting existing legislation, and uncoordinated enforcement of the law. With regard to technology and skills, barriers primarily are defined through the lack of environment, health, and safety standards; the strong influence of the informal sector; the lack of collection infrastructure; cherry-picking activities; as well as low skills and awareness. Additional barriers assigned to business and financing topics include limited industry responsibility, high costs of logistics, possible exploitation of workers from disadvantaged communities, crime and corruption, as well as false consumer expectations (Schluep et al., 2009).

The development and transfer of innovative technologies for sustainable recycling of E-waste, therefore, require a clear legal framework favoring these technologies, active participation of the government, and the support of the international electronics industry. According to Schluep et al. (2009: 8), the future success of technological innovation in environments with strong informal participation largely depends on alternative business models with financial incentives, which allow the informal sector to participate with "safe" recycling processes while hazardous operations are transferred to state-of-the-art formal recyclers.

Concluding Observations

In this policy essay, we have illustrated that, especially compared with the United States, EU regulation and Dutch regulatory enforcement have adopted several elements of smart regulation strategies in combating the global problem of E-waste. The criminogenics of the electronics supply chain requires such an approach, but it also uncovers the challenges of regulation and enforcement. E-waste policies are aimed at preventing the evolution of E-waste by targeting its sources and by requiring manufacturers of electronics to recycle or to use less hazardous substances. For this policy, cooperation with NGOs and regulatory agencies abroad is enacted, which increases the effectiveness of Dutch regulatory policies.

Motivated by reducing harms, we then have broadened our analysis from the E-waste supply chain to the more general issue of the life cycle of metals in electronics to demonstrate that a solution to the problem of E-waste might be not in continuing to criminalize E-waste but, rather, in better regulating the recycling market. Recycling offers an opportunity to reduce the disastrous social and environmental harms that result from mining operations. At the same time, it offers developing countries opportunities for income and crucial commodities for emerging economies. The downsides are the adverse social and environmental impacts from the techniques currently deployed for product disassembly and metal recycling. Regulation, therefore, should not aim to prohibit the transnational shipment of E-waste but to facilitate recycling and to create incentives for developing sustainable technologies as well as for removing the barriers for the transfer of sustainable E-waste recycling technologies.

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RESEARCH ARTICLE

M O R T G A G E   O R I G I N A T I O N   F R A U D

Mortgage origination fraud and the global economic crisis

A criminological analysis

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Research Summary
The study outlined in this article analyzed the responses of 23 subjects previously and currently employed in the subprime lending industry to understand the implications and role of white-collar crime in the contemporary subprime mortgage crisis and to document the rationalizations that offenders use to explain their involvement in mortgage-related crimes. The subjects represented five sectors of the primary mortgage market, including brokerage, lender, escrow, title, and appraisal offices. Secondary sources of data for the study included media accounts, government reports, and industry studies. The research findings detail accounts of mortgage frauds in the subprime lending industry that resulted from inadequate regulation, the indiscriminate use of alternative loan products, and the lack of accountability in the industry.

Policy Implications
The study results suggest that the problem of mortgage origination fraud would be prevented best by major reform of financial policies and lending practices that characterize the subprime mortgage industry. Several broad recommendations are proposed in this article that highlight the need to recognize the potential for insider fraud, to enhance government regulation

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and oversight, to tighten loan qualification requirements, and to increase standards of underwriting. Observations are offered concerning the need to highlight white-collar crime in understanding the global financial crisis and to preventing future debacles.

Keywords
mortgage fraud, subprime mortgage crisis, white-collar crime, fraud, subprime

In early 2008, former Federal Reserve Board Chairman Alan Greenspan wrote, "The current financial crisis in the U.S. is likely to be judged in retrospect as the most wrenching since the end of the Second World War." By the end of 2008, the financial losses from the global economic meltdown had outgrown that of the savings and loan bailout in the 1980s and 1990s. "By some estimates, it has made that costly debacle look like chump change" (Schmitt, 2008). In a report compiled for the 2007 U.S. Conference of Mayors and the Council for the New American City, it was stated, "The wave of foreclosures that has rippled across the U.S. has already battered some of our largest financial institutions, created ghost towns of once vibrant neighborhoods—and it's not over yet" (Global Insight, 2007: 6).

One important question regarding the current financial crisis that has both theoretical and practical ramifications is whether the subprime mortgage crisis—a real-estate and financial disaster marked by an unprecedented rate of mortgage delinquencies and foreclosures brought on by factors that include lax lending policies, poor underwriting standards, inadequate regulatory structure, and government oversight—entails significant amounts of fraud at various institutional levels. As noted by some white-collar criminologists regarding earlier financial debacles, material fraud built into financial markets could remain virtually undetected until its consequences reach epic proportions (Black, 2005; Rosoff, Pontell, and Tillman, 2010). This situation was a difficult and seemingly yet-to-be-learned lesson of the savings and loan crisis in the 1980s, as demonstrated in several detailed empirical studies (Black, Calavita, and Pontell, 1995; Pontell, Calavita, and Tillman, 1994; Tillman and Pontell, 1995). In the current crisis, economists and other financial experts have failed to observe or, in some cases, have failed to accept, the reality that a significant undercurrent of financial crime exists, particularly mortgage fraud or "the material misstatement, misrepresentation, or omission by an applicant or other interested parties, relied upon by an underwriter or lender to fund, purchase or insure a loan" (Federal Bureau of Investigations [FBI], 2007: 2).

As the housing crisis unraveled beginning in late 2007, the number of reports of mortgage fraud investigations and indictments relating to the financial crisis increased. In January 2008, the FBI stated that it was investigating 14 corporations as part of its Subprime Mortgage Industry Fraud Initiative launched the previous year. Six months later, the FBI reported that more than 400 individuals were charged in a nationwide investigation that included the arrest of two Bear Stearns fund managers (Schmitt, 2008). The report noted that lending fraud involved "mortgage transactions based on gross fraudulent misrepresentations about the borrowers' financial status, such as overstating income or assets, using false or fictitious employment records or inflating property values" (FBI, 2008).

Recently, mortgage fraud has emerged as a major problem in the United States. In 2006 alone, it was estimated that fraud cost the mortgage industry between $946 million and $4.2 billion (Mortgage Bankers Association, 2007). The federal Financial Crimes Enforcement Network (FinCEN) reported similar findings from data collected in the form of mortgage-related suspicious activity reports (SARs). According to FinCEN, the number of SARs filed in the first quarter of 2006 pertaining to mortgage loan fraud increased 35% during the same period in 2005. This follows a 29 percent increase from 2004 to 2005, and an almost 100 percent increase from 2003 to 2004" (FinCEN, 2006). Large mortgage lenders such as New Century Financial Corporation—once the second-largest U.S. subprime mortgage lender—were found to have "engaged in a significant number of highly improper and imprudent practices related to its loan originations, operations, accounting and financial reporting processes" (Kary, 2008). Smaller mortgage broker offices also were under criminal investigation by the FBI: "The question of fraud goes to the entire process—where the loans were created, whether there was fraud in their creation, or misrepresentation as to the quality of the loans in the sales process" (Sasseen, 2008).

Mortgage fraud has been a major topic of concern of social scientists and economists since the beginning of the 2008 economic downturn. Economist James Galbraith (2009), for example, has been an outspoken critic of the government's response to the banking credit and liquidity crisis resulting from the tremendous losses from home foreclosures. Galbraith repeatedly has noted a need for the government to "review loan tapes" before blindly buying these "toxics assets," arguing that such inspections would "reveal a very high proportion of missing documentation, inflated appraisals, and other evidence of fraud" (2009). Former regulator and criminologist, William Black, voiced similar concerns regarding the role of mortgage fraud as underlying the global financial crisis. Lenders should have a large stake in addressing the problem of mortgage fraud; yet according to Black, they were not the principal filers of suspicious fraudulent complaints. The underreporting of frauds discovered in subprime mortgage loans—loan products intended for borrowers with poor-to-average credit worthiness and characterized by higher interest rates, higher fees, higher risk of default, and difficult terms and conditions—by financial institutions does not come as a surprise because those culpable include the lenders themselves. "One only spots mortgage fraud if one conducts underwriting (and accounting control frauds abhor it), and the last thing a control fraud wants is to invite the FBI's attention" (Black, 2008). He noted that fraud incidents found in file reviews indicate that the amount of loans originated that contained fraud in fiscal year 2007 was 1 million, which is a much higher estimate than the actual mortgage fraud suspicious activities incidents filed by federally regulated lenders.

Theoretical Underpinning

The aim of the study outlined in this article was to enhance our understanding of the impact and role of mortgage fraud in major financial debacles and the criminal acts, motives, and subjective experiences of those who are part of the industry. The criminological literature on white-collar crime in major financial debacles, particularly the savings and loan crisis, identified industry and organizational factors linked to white-collar crime (Calavita, and Pontell, 1990; Calavita, Tillman, and Pontell, 1997; Pontell and Calavita, 1993; Tillman and Pontell, 1995). These studies examined the criminogenic impact that competition—unleashed by financial deregulation in the 1980s—inadequate regulations, and weak regulatory enforcement had on the prevalence and forms of white-collar and corporate crime during that period. The research on the savings and loan crisis, for example, which identified links between various types of financial crimes and the structural policies and practices that characterized the thrift industry in the 1980s, has allowed for a general understanding of fraud and the current subprime mortgage crisis because both financial crises involved deregulatory policies that loosened financial restrictions, provided inadequate oversight, and required no accountability. The study detailed here explored the link between mortgage fraud and its role in the current economic debacle by examining detailed accounts by insiders concerning various types of mortgage frauds and the underlying motivations behind their crimes in the context of structural policies and lending practices of the subprime industry.

The detailed accounts document the decision-making processes of those persons involved in mortgage fraud. The notable work on the decision making of white-collar offenders conducted by Benson (1985) was founded on the groundbreaking theoretical framework provided by Sykes and Matza (1957) on "neutralization techniques," or a priori rationalizations that free persons to engage in deviant acts by redefining their behaviors in ways that allow them to maintain positive self-images. Subsequent studies on white-collar offenders have found similar patterns regarding the manner in which criminal acts are redefined to alleviate or eliminate culpability (Coleman, 2002; Conklin, 2004; Jesilow, Pontell, and Geis, 1993; Shover and Hunter, 2010). These studies have found consistent evidence that white-collar criminals explain their actions within the context of both legal and ordinary occupational activities, which makes identifying the illegal activities difficult. For example, Shover and Coffey's (2002: 15) work on telemarketing fraud found that most "subjects have a disinclination to see telemarketing as a crime . . . most deny engaging in criminal decision making at all. They are sustained in this moral stance by blaming their victims and also by the way their work is structured and carried out. They believe that they need do nothing more than comply with business regulation." A major goal of this study was to expand our understanding of the reasons for how and why most white-collar criminals successfully can denounce their criminality.

The findings presented here are informed by rational choice theory, a predominant explanatory model historically used to understand the decision-making processes of street offenders. Recent research on the "crime-as-choice" theory for understanding and controlling white-collar crimes has provided a useful framework from which to understand subprime mortgage fraud.

Shover and Hochstetler's (2006: xvi) model of "lure, oversight, and the supply of tempted and predisposed, concepts at the heart of crime-as-choice theory," will be a useful paradigm for understanding the factors that lead to criminal decision making. The following sections discuss basic relevant background information concerning mortgage fraud and the complex nature of the loan origination process. This discussion will allow for a better understanding of the complex nature of mortgage fraud and its role in the subprime mortgage crisis.

Mortgage Fraud

Mortgage fraud traditionally has been viewed by researchers, government authorities, and industry organizations as either fraud for property or fraud for profit:

> Fraud for property/housing entails minor misrepresentations by the applicant solely for the purpose of purchasing a property for a primary residence. This scheme usually involves a single loan. Although applicants may embellish income and conceal debt, their intent is to repay the loan. Fraud for profit, however, often involves multiple loans and elaborate schemes perpetrated to gain illicit proceeds from property sales. Gross misrepresentations concerning appraisals and loan documents are common in fraud for profit schemes and participants are frequently paid for their participation (FBI, 2007: 2).

Between the two categories of mortgage crimes, the one that "is the most concern to law enforcement and the mortgage industry" is fraud for profit (ibid). This offense category usually involves fraudsters who are mortgage professionals and who have extensive experience in the real-estate industry. According to the FBI (2007), a proliferation of fraud-for-profit schemes could be so costly as to have had devastating implications for the entire U.S. economy.

As with most other forms of white-collar crime, a thin line between actual "crime" (e.g., mortgage fraud) and "unethical or risky practices" (e.g., predatory lending) exists. Without proactive enforcement, it is often difficult if not impossible to distinguish between the two. According to the Mortgage Bankers Association (2007), predatory lending involves a range of unethical loan origination practices that have detrimental effects on borrowers. Such practices might be financially or racially motivated and can be costly to an unsuspecting borrower. For example, borrowers unknowingly might be steered into a subprime mortgage, which will have higher fees and interest rates, when they actually might qualify for a prime mortgage at lower rates. Similarly, lenders might sell loans with attractive introductory terms and conditions under the pretense that such conditions are fixed throughout the term of the loan when, in fact, they are not. Although predatory lending might be harmful and widespread, it is also legal in most cases (Schloemer, Ernst, and Keest, 2006). Yet, under certain circumstances, such practices can cross the legal threshold of criminality. A loan agent might engage in both predatory lending and fraud in the origination of a single loan, as in the case in which a mortgage broker steers his client into a high-cost loan (predatory lending) while intentionally misstating financial information to qualify the borrower (fraud).

The Growth of Mortgage Fraud

According to a 2006 report by the FinCEN Office of Regulatory Analysis, mortgage-related fraudulent SARs filed by participating financial institutions increased by 1,411% between 1997 and 2005. Several important findings were discovered in the FinCEN report. First, 66% of the sample involved material misrepresentation or false documents including: (a) altered bank statements, W-2s, credit scores, and tax returns; (b) fabricated letters of gift and letters of credit; (c) invalid social security numbers; and (d) false employment. "The most commonly reported misrepresentation (81 percent) was occupancy fraud" (FinCEN, 2006). Second, reports of SARs among mortgage broker originated loans—which accounted for more than two thirds of loans as of 2006—greatly increased between 1996 and 2006, which coincided with the unprecedented growth of mortgage brokers in the United States since the 1990s.

In April 2006, a report on mortgage fraud by the Mortgage Asset Research Institute identified several forms of mortgage-related crimes, including fraud in applications, tax and financial statements, verifications of deposits (VODs), appraisals/valuations, verifications of employment, escrow/closing, and credit reports. Incidents of fraud reported among mortgage applications were the most common type, followed by tax and financial statements. Of the six identified frauds, four fraud types, or more than 80% of the frauds, involved information gathering and verification that take place during the application process (Sharick, Omba, Larson, and Croft, 2006). Material misrepresentation was prevalent among loan products that required little scrutiny of the borrowers' financial disposition. BasePoint Analytics, a consulting firm that specializes in fraud detection software, analyzed more than 3 million loans and found that "as much as 70 percent of recent early payment defaults (EPDs) had fraudulent misrepresentations on their original loan applications; applications that contained misrepresentations were also five times as likely to go into default" (2007: 1–2). The study also found that frauds included income inflated by as much as 500%, appraisals that overvalued the property by 50% or more, fictitious employers, and falsified tax returns.

The growth of alternative loan products such as no-documentation/low-documentation loans, otherwise known as "liar loans," were much more likely to be open invitations to fraudsters. In a Bill Moyers interview, Black (2009) noted, "Liars' loans mean that we don't check. You tell us what your income is, what your job is, and what your assets are and we agree to believe you. We won't check on any of those things. And by the way, you get a better deal if you inflate your income and your job history and your assets." "When the stated incomes were compared to the IRS figures, the resulting differences were dramatic—ninety percent of the stated income loans contained financial information that was exaggerated by 5 percent or more; almost 60 percent of the loans were exaggerated by more than 50 percent" (Sharick et al., 2006: 12).

The growth of the broker system, which has complicated the loan origination process and drastically reduced accountability in the origination process, has aggravated the problem of mortgage fraud within the subprime lending industry. Under the dominant fragmented system, as many as five self-interested independent agencies (broker, lender, appraiser, escrow, and title) work together on a single loan. Currently, no national standards are in place for licensing and oversight of mortgage brokers. Some states license mortgage brokerage offices but not individuals; 24 states have no specific educational or experience requirements for mortgage brokers, and only a few states require criminal background checks on mortgage brokers; making it possible for unethical individuals to move from one mortgage brokerage firm to another (FinCEN, 2006).

To understand the relationship between mortgage fraud and the global economic crisis better, it is instructive to consider other financial debacles in the postindustrial period. Examining the role of white-collar crime in past major financial debacles, such as the savings and loan crisis, provides insight into underlying structural factors that allow for crime-facilitative environments to develop, as well as a criminological context for analyzing the current financial meltdown.

Mortgage Origination Process

The process of a obtaining a mortgage involves interacting with several agents from the initial application to the eventual funding of the loan. To understand the sometimes complicated and convoluted nature of loan origination and funding, it is necessary to describe the roles of the key actors in the mortgage business. Five key players are involved in this process: the borrower, the broker, the lender, the escrow and title agents, and the appraiser. It is important to note this applies only to the "primary mortgage market" (where lenders and banks originated and provide loans to borrowers) and does not include the secondary mortgage market (the business enterprise of managing loans originated in the primary mortgage market).

The mortgage origination process begins when an applicant, or borrower, applies for a mortgage loan. At this initial stage, the borrower has several options that include using a traditional retail bank or using a third-party source such as a mortgage broker. We focus here on the third-party agent or mortgage broker system—or what we term "fragmented loan origination system"—because it has become the main source of subprime origination during the last decade, which ended in approximately October 2007. Once the borrower completes an application, including basic loan documents, a credit check, and employment and financial verification with a mortgage broker, the agent then uses an available network of approved mortgage lenders, appraisers, and escrow and title companies to seek a loan with the most "favorable" or suitable terms and conditions. The broker plays a crucial role in the overall mortgage origination process and is the "go-to" person between the borrower and all other agencies (lender, appraiser, escrow, and title). Once a suitable lender has been selected, the application then is submitted by the broker on behalf of the borrower. The broker often will recommend that the borrower use the agent's own real-estate appraiser and escrow and title companies because they provide the broker with discounted rates. All correspondence between the borrower and the lender, appraiser, escrow, and title company must go through the mortgage broker. For example, once the lender underwrites the loan application and establishes loan approval conditions (e.g., proof of income, employment, and financial assets), the lender forwards these materials to the broker. The mortgage broker then will attempt to obtain the documentation from the borrower. Once conditions established by the lender have been cleared, the loan is funded, thereby completing the process.

The appraiser, an "objectively independent" valuator of real-estate property, plays a crucial role in this process—to determine the value of the property in the transaction. A particular property value is always a condition of a lender's loan approval. The escrow company is responsible for the equitable and legal exchange of monies as determined by the conditions of the transaction, and the title company is responsible for all matters relating to legal ownership records.

For the purposes of this study, the broker system is referred to as a "fragmented loan origination system" because of the inherent problems that prevent such a system from being independently and objectively viable. These agencies are designed to be independent and objective from each other; yet their profitability is predicated upon their willingness to "bend the rules" to please their broker. For example, a mortgage broker might continue to use an appraiser whose property valuations fall, not within the actual range of a given market, but rather are in line with the broker's business agenda—which includes getting the highest value for each property as possible. Appraisers who are unwilling to bend the rules to obtain the "broker's value" quickly find themselves out of business, as few brokers will use them. The same applies to escrow and title companies, the success of which depends on the business provided by mortgage brokers.

Understanding the process of loan origination and the roles of key participants is necessary for comprehending the complex nature of mortgage fraud and its significance in the subprime mortgage crisis. By doing so, an interesting aspect of the third-party broker system is revealed that is in contravention to the accepted financial industry dogma regarding the importance of independent agency, fairness of competition, and the law—the key players involved in originating a loan are extremely dependent on each other for profitability, and those who are willing to "bend the rules" often are rewarded with continued business and success.

Methods and Data

Compared with the rest of the country, southern California is ranked among the most active areas in terms property value fluctuation, rate of foreclosures, and lending activity. It is, therefore, no surprise that California is also home to the largest number of subprime mortgage lenders whose activities contributed to the current global economic meltdown. A recent study that analyzed $1.38 trillion worth of subprime mortgages originated between 2005 and 2007 found that approximately 56% of the loans were originated by 15 lenders from California (Abate, 2009). California, thus, represented a suitable site for the selection of respondents in this study.

The primary goal was to locate and identify a pool of potential subjects who (a) had working experience in the subprime lending industry and (b) represented the five sectors of the primary mortgage market (brokerage, lenders, escrow, title, and appraisal). The selection process and access to interviewees were made more manageable as a result of the primary author's previous work experience in the mortgage industry as a mortgage broker. (Between March 2005 and 2007, the lead author worked in the mortgage industry. Although his short tenure in the industry in no way qualifies him as an expert on the topic of fraud, the established business relationships and connections were used as one means of locating and targeting potential research subjects.) Using business solicitation e-mails, business cards, existing loan applications, and lender lists, 56 industry agents were contacted, including brokers, account executives, underwriters, and appraisers. Of the 56 loan agents, 37 were reached, and 17 offered verbal consent over the phone to participate in the study. Six additional subjects were referred later by the original 17 subjects.

Interviews

All interviews were conducted in person with a total of 23 ($N = 23$) subjects from 2008 to 2009. All interviews took place in a one-on-one context with the exception of two, which were conducted in a group setting. These two interviews involved research subjects who had an established a working relationship with each other and who had agreed to be interviewed together.

A decision not to use a digital voice recorder for the interviews eliminated concern among interviewees about voice recognition. Instead, written notes were taken on a notepad, which led the subjects to feel more comfortable. They were advised to avoid using any identifiers (names, dates, locations, and times) verbally; however, it was common for subjects to speak openly and, in the process, possibly reveal names of persons and places. In such instances, a pseudonym replaced the identifier. No one was allowed to enter or leave the research location during the interview. Once the interview was completed, the data were placed in a locked file.

The interviews were conducted using an elite interview method that allowed the subjects with specialized knowledge of mortgage lending practices and procedures to relate them during the conversation (Dexter, 1970; Lofland and Lofland, 1971). The method followed that used by Pontell, Calavita, and Tillman (1994), who suggested that "the best way to conduct elite interviews is to understand the situation and make full use of the opportunity to extract information from the research situation" (1994: 387). The interviews were semi-structured, which facilitates capturing the subjects' emotions and perspectives. This approach also allowed the subjects to provide information and insight into situations and circumstances that might have been overlooked completely if a predesigned series of questions had been asked. Although structured interviews might benefit the less skilled researcher because they employ a set series of fixed questions, they also necessarily narrow conversations that can omit valuable data.

The discussions with interviewees included topics such as day-to-day mortgage practices and sensitive information, including potentially illegitimate loan origination acts, corporate pressures, and incentives and motivations for fraud. The research questions focused on several broad and specific themes. These themes are personal background and demographic information, employment background and experience in the mortgage industry, understanding of company policies and practices, and employee training. More specific areas focused on the work environment, duties, and responsibilities of the subjects, including common loan origination practices (legal or illegal), organizational pressures, priorities, expectations, financial incentives, and business relationships. Knowledge of the subjects' identities and their actions required extra precautionary measures to ensure that identifiers were not recorded. Subjects were offered the option of giving written consent or waiving written consent. Interviews with each subject lasted between 1 and 2 hours. None required a follow-up interview.

TABLE 1

Research Subjects

Mortgage Sector	Position	*n*
Broker Office	Mortgage broker	3
	Loan processor	2
	Loan officer	4
Lender	Underwriter	2
	Loan representative	2
	Account manager	3
Appraisal	Appraisers	2
Escrow	Escrow officer	2
Title	Title officer	0
Borrower	Not applicable	3
N		23

Research Subjects

Table 1 presents the characteristics of the research subjects. To supplement information provided by loan agents, interviewees also included three borrowers who obtained a subprime mortgage. It is important to note that of the three borrowers, two had lost their home because of foreclosure. These borrowers provided input about their experiences in obtaining a subprime loan and their knowledge, or lack thereof, of questionable practices during the loan origination process.

Access was available to loan practitioners who represented a wide spectrum of mortgage industry players. For example, two of the three account managers and both loan representatives in the study were employed by three of the top ten largest subprime mortgage lenders in the United States. Of the four loan officers interviewed, two were employed by small mortgage brokers with ten or fewer employees. Of the 20 loan agents interviewed, 16 worked in a company of 25 or fewer. It is important to note that, although the subjects did not necessarily constitute a representative sample of loan agents in the subprime mortgage industry because they all resided in southern California, all subjects originated loans both inside and outside of the state.

The research subjects' backgrounds varied considerably. The ages ranged from 20 to 46 years with a mean age of 28. Fourteen were male. Of the 23 subjects, all had completed high school, 14 had an educational background that included some college, and 6 had completed a bachelor's degree. None of the subjects had a postgraduate education. Nineteen had no prior experience or training before entering the mortgage industry; most subjects were trained by their employer. Six subjects entered the mortgage industry with related financial background experience, and all had experience in the retail banking industry.

Secondary Data Sources

This research project began in late 2007, only months into the contemporary subprime mortgage crisis. Daily news media accounts, reports, and coverage related to the mortgage crisis were, thus, an invaluable source of data. These sources of information can provide invaluable insight regarding our world (Larson, 2005). As the financial crisis was unraveling, it was imperative to use data sources such as the *Wall Street Journal*, Bloomberg, and the *Financial Times*, to provide the latest information on the subprime fallout and the responsive actions taken by local and federal agencies.

Another crucial source of data was government reports, such as Senate and Congressional hearings, which addressed mortgage-related fraud or problems relating to the housing crisis. Various reports by agencies, such as the U.S. General Accounting Office, the U.S. Federal Housing Administration, and the U.S. Department of Housing and Urban Development, were examined to determine the government's role and response to mortgage-related crimes. Other government sources of data included published reports of the Joint Hearings by the U.S. Senate on predatory lending and the Congressional hearing on mortgage fraud and its impact on mortgage lenders. State and federal law-enforcement information was another data source. The Department of Justice and the FBI disseminated information on mortgage fraud, such as current investigations, mortgage-related crime rates, and trends.

Industry organizations, such as the National Association of Realtors, the Center for Responsible Lending, the Mortgage Bankers Association, and the National Association of Mortgage Brokers, provided additional data. These agencies collect and disseminate housing data, including real-estate values, homeownership rates, and sales projections. The real-estate and finance organizations also conduct studies and release data on mortgage fraud.

Results

Mortgage Origination Fraud

Perpetrators commonly perceive many acts of mortgage origination fraud as inseparable from conventional lending practices that are necessary in any "successful" *legitimate* subprime business. As noted, the denial of crime is not a new phenomenon among white-collar criminals (see, for example, Benson, 1985; Jesilow, Pontell, and Geis, 1993; Shover and Coffey, 2002, Shover and Hunter, 2010 Sutherland, 1983). For example, research on telemarketing fraud found that most subjects "rejected the label *criminal* and *crime* as fitting descriptions of them and their activities" (Shover and Coffey, 2002: 13). In the current case, it boils down to different manifestations of a common theme: "We are simply doing our jobs and getting our clients what they want. They are usually happy I got the loan for them." An example is illustrated by the following statement from a loan officer:

> When I get an A paper (good credit) client who wants a 30-year fixed loan but does not make enough, all my brokers told me to put them in stated loan program where I can just state whatever is needed to get the loan. Everyone in the offices I

> have worked in would offer stated-loans if the clients didn't make enough money or have enough money in the bank. I have had brokers tell me to state the income much higher on an application just to make sure we get the loan, since we can't restate the income. I have been at many broker offices—this type of stuff is normal in the mortgage industry.

In this particular instance, the perpetrator completely diffused responsibility by redefining the situation so that the blame was placed on the authority figure—the broker. One also can perceive this statement as an appeal to a higher authority, which in this case is the business or corporation s/he works for. Loan agents, especially those who are employed by large organizations, often use this type of rationalization to suborn internal and external controls by contextualizing their actions as consistent with the ethos of the organization to which s/he belongs. When illegitimate loan origination practices are condoned within a working environment—and even promoted by clients, colleagues, and superiors—constraints on unethical and illegal behaviors easily can become suppressed. An important point to keep in mind regarding the statement is the subjects' reference to stated-loans and its relation to fraud, which will be examined in the following section.

Certain types of frauds are not only perceived by loan agents as acceptable mortgage lending practice, but also are considered "good for business." Business leaders might ascribe to the means necessary to make a profit, even if such methods violate the law. Benson (1985: 593) argued that business rules govern profit making and survival in a competitive capitalist environment, thereby superseding legislation and governance. Illustrating business reality's rule of "good business practice," another loan officer stated:

> I work with my clients and let them know right off the bat what income they need to have for the loan. Most of my clients don't make enough so I put them in a stated product where I can state the income that is needed to get the loan. It's hard sometimes to make it (financial information) look legitimate, but most of the time you can find a lender to approve the loan. I took care of my borrowers and gave them what they wanted. They all knew that they can get a loan anywhere, so I have to take good care of them if I want to make money. A lot of my business is repeat business. I have borrowers who have refinanced their one home with me three times.

This is an example of a loan agent who committed both fraud and predatory lending simultaneously. In this case, the agent had prior knowledge that the borrower did not have the ability to pay the monthly mortgage and yet steered the borrower into a particular loan for which it was relatively easy to provide false financial information.

A common theme among our interviewees was the accessibility to fraud. Subjects often referred to the importance of a "willing lender," a specific loan product, or a cooperative borrower in the successful outcome of a loan originated by illegitimate means. For example, having an appraiser willing to “bend the rules” to maximize the value of the property in question is a crucial part of any loan. It was common for interviewees to express that, during the real-estate boom, it was relatively easy to justify appraisal values that exceeded the actual value of a property. Appraisers could avoid taking pictures that showed damage to the property or could use nearby properties with greater appreciation as comparable, for example. One interviewee said all that had to be done was “not reveal anything that would reduce the value of the property.” For example, if a garage was converted into a bedroom without a permit, then the appraiser would include only an exterior picture. In the 1990s, the extraordinary increase in real-estate values made the practice of inflating home prices relatively easy and very lucrative for appraisers. This development is an important aspect of understanding mortgage origination fraud as it directly relates to the overarching theme of alternative loan products, poor underwriting standards, absent accountability, and fraud.

Subjects often described actions such as overstating a borrower’s income and assets, post-dating documents, file stuffing, and altering employment title as a financial skill rather than as a criminal act, which requires a “creative touch” to get a loan funded. These loan agents were proud of their abilities and often would engage in self-admiration. When two or more of these types are present within an organization, competition for status between the agents can occur. Some might perceive themselves to be invaluable to the loan business. Remarks by a loan representative and a broker that “I had many clients who couldn’t get a loan anywhere before they came to me” and “I closed loans using my toolkit when they had nowhere else to go” are some examples of this justification. Although this behavior is an uncommon self-preservation strategy, it can be successful in maintaining one’s positive image. For example, a loan representative remarked that:

> Every month we would check to see who closed the most deals, and it was always between me and two other reps. I had one of the highest funding ratios in the company. I funded a minimum of a couple million dollars a month. I try not to deny any loan, if possible. There is always a way to make a loan work—you just have to find the angle.

The following description from a loan officer is another example of this viewpoint:

> You can get anyone a loan if you are good. You have to work with what your client has. If he has a crappy job, change his title so you can state a higher income. If the income is still not enough, give him another job. There is a lot you can do to qualify someone. Go stated, make him pay off debts, change the loan amount, change his job title, add someone to the loan. If he doesn’t have enough money in the bank, for example, put his name on another person’s account and get a VOD of that account.

The involvement of the borrower in the fraud was described by subjects as much more commonplace and widespread than traditionally understood. Borrowers are well aware that they lack certain qualifications for a loan and depend on their loan agent to qualify them. Illustrating this point, a loan officer stated the following:

> When my clients do not make enough money to get a certain loan or a certain rate they want, I get them a stated loan. You can put down anything for their income or assets as long as it sounds reasonable to the lender. They want the loan, so even though they know that my client can't possibly make what I put down, it's a stated loan. My lenders don't really make an issue about the income I state unless it doesn't make sense at all. So I just work the employment title and that's it. Borrowers are usually grateful that I got them the loan. They don't care that I stated in the application that they make this amount of money when they really didn't. They are just happy I got them the loan.

In this instance, the perpetrator used a classic neutralization technique—denial of victim. Everyone involved in this transaction serves to benefit; the borrower gets the loan, and the remaining parties (loan officer, broker, and lender) get the business. In a period when home values continued to skyrocket and mortgages were paid on time, everyone stood to benefit. It was only when the housing crisis began that the true victims emerged.

In discussing the role of fraud among loan originators and borrowers, Black (2008: 6) noted that "mortgage origination personnel, not borrowers, overwhelmingly took the lead in mortgage fraud—even when the borrowers shared culpability because they knew that the representations the lender recommended were false. It is, therefore, extremely difficult to determine not only the true incidence of frauds but also the true number of borrowers that obtain loans with the knowledge that their financial representations were false." The most common forms of financial misrepresentations that occur in loan applications are the borrower's income and assets, both of which are clearly visible on the loan application. A borrower seeking a mortgage usually finds out early in the process the potential factors (e.g., insufficient credit, income, assets, or mortgage history) that might led to denial of the loan. For example, one borrower stated the following:

> I tried getting a loan but was unable to for like 2 months. Then my broker told me that I was rejected for a loan, and so we needed to go to different lenders. I don't remember exactly, but I think it was because I didn't make enough or that my credit wasn't that great. He had to submit my loan to several banks, and on the loan application, we had to put that I made $14,000 a month, which was obviously not true, but he got me the refinance I wanted so I was happy.

As a result, the loan agents and borrowers in this study each stipulated that a fully informed and cooperative relationship was mutually beneficial to the successful outcome of a loan origination. Loan originators commonly expressed the importance of being straightforward and honest with their clients, despite the legitimacy of the loan. Inconsistent information and poor cooperation between the loan agent and the client can lead to problems should the lender conduct a thorough underwriting of the loan. The following comment made by a mortgage broker illustrates the denial of a victim and the diffusion of responsibility:

> Everyone thinks that borrowers are victims when they know about what is needed to get them approved. I tell my borrowers if they don't make enough or don't have enough money and tell them this is what we have to do or no one will give them a loan. They all know and have to agree or we don't even try to submit the loan to the lender. They have to work with us if they want the loan.

Once the loan application has been submitted to a prospective lender, it is managed by an account manager or an underwriter. These loan agents are critical to the successful outcome or funding of a loan and to the detection of fraud. They work directly with brokers, loan officers, and processors on a regular basis, and it is not uncommon for them to coach their clients on how to structure a loan or document to avoid red flags from their lender. In this stage of the loan origination process, the most common forms of fraud are directly associated with poor underwriting practices:

> Most of my brokers were good. They knew what they were doing, but some brokers came into the industry and didn't know the difference between a 1003 (uniform residential loan application) and a 1008 (transmittal summary). When my bad brokers submitted a loan that obviously didn't work, I would send it back and tell them what to change. Many times, they still wouldn't get it, and I have to go back and forth several times with them. Sometimes, I just tell them to submit the loan somewhere else because it got too fishy. My good brokers knew better. They made sure everything was clean by the time I got the file.

Account managers and underwriters are responsible for approving loan conditions once they have verified the information. For example, a loan approval might be predicated on verification of conditions such as an applicant's employment and assets. It is common for these loan agents to overlook questionable information or to approve a condition of a loan without verification. Funders and appraisal reviewers also commonly overlook questionable information, such as an appraisal that lacks the required comparisons to justify the value of the property in question.

It should be noted that the subjects interviewed in this study stipulated that fraudulent acts were uncommon among escrow and title company agents. Although rare, acts of concerted ignorance sometimes occur among escrow agents, such as intentionally ignoring or leaving out the "yield spread premium" (i.e., the money or rebate that is paid to the mortgage broker by the lender for selling a higher interest loan than what the borrower qualifies) on the final legal disclosure statement. This oversight allows a mortgage broker to conceal from the borrower how much money or "kickback" was paid by the lender. Such a practice by an escrow company is a violation of the Real Estate and Settlement Procedures Act (1974).

Levi (1984: 322) stated, "It is extraordinary difficult to distinguish white-collar crime from ordinary business transactions." The complex nature of financial transactions made it "difficult to disentangle victim from criminal and crime from business as usual" (Lloyd, 2006: k–2). In the mortgage industry, an intricate collaboration must exist among loan agents, borrowers, and lenders (account managers, reps, underwriters, and funders) to originate a loan and get it funded. Information on a loan application must undergo numerous levels of scrutiny and verification by different parties for a loan to be approved. The problem, however, was the widespread culture of maximizing profit margins and achieving financial targets over ethical practices. These detailed accounts provided by loan agents who currently are employed and who previously were employed in the subprime lending industry provide insight into central aspects of mortgage origination fraud. Besides documenting the a priori rationalizations offenders used to excuse their actions, a primary purpose of the accounts was to provide a deeper understanding of the types and patterns of fraud that led to the global economic crisis and to apply this understanding to effective preventative policy.

Conclusion and Policy Implications

To prevent mortgage origination fraud effectively, one must first understand the crime-facilitative environment (Needleman and Needleman, 1979; Shover and Hochstetler, 2006) that naturally led to such practices and, thus, consider strategies that address problematic lending policies and practices in general. As of early 2010, the subprime lending industry held a much smaller market share of the overall mortgage industry because of the massive number of subprime-related mortgage defaults and out-of-business subprime lenders. The subprime lending system, which held a large share of total mortgage originations until the end of 2007, rewarded mortgage brokers for placing borrowers in higher cost loans, which is in contrast to a loan agent's fiduciary responsibilities, making the lender–broker reward system a fiduciary conundrum. A holistic approach to addressing the problem of mortgage fraud requires a consideration of policies that not only directly address offending but also reduce and effectively monitor potential conflicts of interest in the home-lending system itself. What follows are general recommendations aimed at (a) addressing policies and lending practices that provide major opportunities and incentives for engaging in mortgage fraud and (b) eliminating the sources of the justifications loan agents use for their illegal behaviors.

The poor underwriting standards and practices associated with the subprime lending industry are major contributors to fraud. Lenders need to incorporate additional layers of verification regarding sensitive financial data and documents. For example, a separate and independent entity or department can be established by the lender to scrutinize every loan immediately prior to funding. Lenders also might consider the option of an off-site and unbiased independent reviewer. Certain alternative loan products such as stated ("liar") loans either should be abolished or modified into a hybrid loan product that can be an amalgam of stated and verified, whereas fully stated loan products need to be eliminated altogether. Such hybrid loan programs should be combined with strict underwriting standards and procedures that enhance the verification of financial information not only to ensure the accuracy and authenticity of sensitive information but also to verify that the borrower can afford the loan.

Deregulation in the banking industry driven by neoclassical policies has circumvented legal and social constraints, ethics, and accountability in a period of subprime lending expansion where increased government supervision and oversight was paramount. The government protections and internal controls offered by the Community Reinvestment Act (1977), for example, need to be extended over all lending organizations to reconcile the perverse growth of alternative mortgage products, loose underwriting standards, and no accountability—which currently characterize the subprime industry.

The dominant, fragmented broker system that involves as many as four different independent entities (mortgage broker, appraiser, lender, and escrow and title) in the loan origination process has reduced the accountability of loan agents involved in the process greatly. Although benefits exist to this system (e.g., the convenience of shopping multiple lenders), the self-interested motivations of those involved raise questions of a contradictory nature regarding ethics and the goals of finance capitalism. A mortgage broker, for example, should serve the best interests of their client; however, brokers will make more money if they charge clients higher upfront fees, higher interest rates, hidden prepayment penalties, and sell loans that contain difficult terms and conditions. The mortgage industry needs to reconsider this compensation system and, instead, to take a commission or bonus-for-quality approach to rewarding their employees. Employees who are rewarded based on loans that are performing likely will take into account the ability of their client to repay. One approach, for example, is a bonus system that rewards quality screening of applicants rather than how many loans an employee can secure each month. Lenders should consider rewarding employees once a loan has been in good standing for 6 months to 1 year rather than immediately after the loan is funded. Lenders should adopt compensating brokers a flat fee for each loan, which would eliminate the motivation of placing borrowers in loans that contain hidden interest rate charges and fees. Although these recommendations do not address the problem of fraud directly, they aim to correct the poor lending practices that have contributed to the overall problems—including fraud—that characterize the subprime lending industry.

The passage of Bill H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009, in the House of Representatives signifies a major step in the right direction by the federal government. The new law, if passed in the Senate, will mandate new restrictions on lending activities and increased standards regarding consumer protection notification and disclosure in the loan origination process. According to the Bill, mortgage originators, creditors, and lenders will be prohibited from charging certain prepayment penalties, must make a good-faith determination regarding their clients' reasonable ability to repay a loan, and must establish that a concrete net benefit to the borrower exists for all mortgage refinances. The rationale behind these reforms is to ensure that the creditor is acting in the best interest of the borrower. The Bill also improves on existing regulatory inadequacies that have allowed loan originators or creditors to escape accountability for their actions. Under the proposed Bill, creditors will maintain a portion of the risk on subprime loans that they sell to investors, and consumers will be allowed to "obtain redress directly from firms involved in securitizing mortgages" (House Committee on Financial Services, 2009).

Policies that focus on the perpetrator might include techniques that confront the neutralizations that are commonly used by perpetrators, which can be effective at an organizational level. Mortgage companies should be required to provide continued training and legal awareness programs as a condition of operation. These programs could focus on delegitimizing excuses, identifying criminal violations and sanctions of such actions regardless of seriousness, pinpointing victims, and promoting ethical standards. By attacking the belief systems or by blocking the justifications that inhibit the perpetrators' guilt levels, loan agents might be less likely to normalize their actions within the context of their organization. Organizational leaders also can educate their lower level employees of the common lending practices that might be construed as legal when, in fact, they are criminal violations. These measures would make it very difficult for loan agents to justify illegal behavior. For those offenders who "acknowledge the immorality of their conduct," the use of reintegrative shaming might serve as a viable solution (Shover and Coffey, 2002: 21). Such an approach would "try to impress on the offenders the harm they have done to the persons they have victimized, and yet treat them so that they do not find themselves isolated from the support that might set them on another and law-abiding vocational path" (Doocy et al., 2001: 22).

The preceding recommendations have major domestic and global implications, of which financial institutions should observe. An important step in the recovery process will be the need to accept, observe, and understand the role of fraud in the global crisis. This study has examined the "bottom level" offending that provided the foundation for the global financial crisis. Subprime loans, which were packaged and sold worldwide, provided the "toxic assets" that poisoned the international banking system through a complex structuring of derivatives and other financial instruments. Through future investigation, it is likely to be found that fraud played a significant role in other aspects of the crisis as well. The savings and loans debacle should have taught us the dangers of poor regulatory oversight and enforcement, loose lending policies, lack of accountability, and underwriting standards that allow fraud to flourish.

The findings in this study also present major theoretical implications for understanding the causes of white-collar crime, albeit outside the economic perspective. Recent application of crime-as-choice theory—a criminological perspective historically used to understand traditional street level crimes—as a model for understanding white-collar crimes provides tremendous insight into mortgage frauds and the perpetrators who commit them. Shover and Hochstetler's (2006: xvi) paradigm of "lure, oversight, and the supply of the tempted or predisposed" illustrates the various temptations (i.e., vulnerable and unsuspecting borrowers eager to obtain a loan and loose lending policies that make it effortless to overcharge borrowers and manipulate financial data) present in the structure of the subprime lending industry, and also highlights the criminal implications of these factors in the absence of credible oversight. White-collar "lure is not criminal opportunity, but in the absence of credible oversight it is" (Shover and

Hochstetler, 2006: 28); couple these factors with a motivated offender and the outcome likely is criminal decision making. The findings in the study illustrate that loan agents—traditionally law-abiding members of society—often face situations (e.g., organization culture that promotes and encourages fraud or management that focuses on profit margins more than ethical standards) in the industry that compromise or threaten their self-restraint (a primary defense mechanism against criminal decision making), thus rendering them criminally predisposed (Shover and Hochstetler, 2006). The results presented here point to the need for more scientific inquiry into choice theory as an explanatory model for mortgage frauds in the subprime lending industry and for understanding white-collar crime more generally.

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Echo epidemics

Control frauds generate "white-collar street crime" waves

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"Control fraud" drove the most recent global financial crisis. Control fraud occurs when those who control a seemingly legitimate entity use it as a "weapon" to defraud (Black, 2005; Wheeler and Rothman, 1982). In finance, accounting is the "weapon of choice." And history repeats itself. Regulators, criminologists, and others have documented the pervasive role of control fraud in causing the second phase of the savings and loan (S&L) debacle of the 1980s (Akerlof and Romer, 1993; Black, 2005; Calavita, Pontell, and Tillman, 1997). That crisis was followed by the accounting control frauds of Enron and its ilk at the turn of the century.

Top economists, criminologists, and the S&L regulators agree that lenders engaged in accounting control fraud operate through a four-part recipe that is a "sure thing"—it produces guaranteed, record (fictional), near-term profits, and catastrophic losses in the long term:

1. Extremely rapid growth
2. Lending at high (nominal) yield to borrowers who frequently cannot repay
3. Extreme leverage
4. Providing grossly inadequate reserves against the losses inherent in making bad loans

The National Commission on Financial Institution Reform Recovery and Enforcement (NCFIRRE, 1993) report on the causes of the S&L debacle documented the patterns. It found that in the "typical large failure," "evidence of fraud was invariably present." In the current situation, nonprime mortgage lenders followed the same recipe: Growth was extreme. Loan standards collapsed. Leverage was exceptional. Unregulated nonprime lenders had no meaningful capital rules. Honest lenders would establish record high-loss reserves pursuant to generally accepted accounting principles.

Accounting control fraud epidemics can cause bubbles to hyperinflate—producing crises (Akerlof and Romer, 1993; Black, 2005). Fraud also can cause markets to fail, rather than to

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"clear." The Federal Bureau of Investigation (FBI) warned in September 2004 that the "epidemic" of mortgage fraud would cause a "crisis" (CNN, 2004). The nonprime lenders followed the four-part recipe. Unfortunately, lessons learned at the time of the S&L crisis were ignored.

Regulators and criminologists had developed "markers" of fraud that honest lenders would not employ. S&L regulators had used these markers to identify and close the accounting control frauds while they were reporting record profits and minimal losses in the 1980s. These markers have been pervasive in the current crisis and would have allowed effective regulatory intervention. They can be used to prosecute the senior officials who caused the current crisis and to limit future crises. Current regulators and prosecutors did not recognize the markers and accordingly act on the FBI warning.

The primary epidemic of accounting control fraud by nonprime lenders produced "echo" epidemics of upstream and downstream control fraud. Nguyen and Pontell (2010, this issue) interviewed upstream participants who fed the primary epidemic. The downstream epidemic consists of those who purchased the nonprime product and is beyond the scope of this essay.

Nguyen and Pontell's (2010) research adds to the literature explaining why the primary epidemic caused an upstream echo. The nonprime lenders needed to induce others to send them massive quantities of relatively high-yield mortgage loans with supporting appraisals, without regard to credit quality. The nonprime lenders created perverse incentives that produced "Gresham's" dynamics—the unethical gain a competitive advantage (Akerlof, 1970). Markets then drive the honest out of business. They can do so without any formal agreement (conspiracy), which makes them more difficult to prosecute. The primary accounting frauds created this Gresham's dynamic by simply gutting loan underwriting and suborning their internal and external controls. Traditional mortgage underwriting and controls detect fraud prior to lending. The upstream control frauds quickly learned that they could get paid for brokering loans to the nonprime lenders regardless of (real) loan quality by providing false loan applications and appraisals that seemed to support a loan because the lenders would not check the accuracy. Brokers maximize their income through volume and securing higher yield loans. It was the financial equivalent of "don't ask; don't tell." The primary control fraud epidemic's recipe for optimizing accounting fraud creates a Gresham's dynamic that produced the intensely criminogenic environment that caused the upstream epidemic of control fraud that Nguyen and Pontell studied.

Many S&Ls originated "low doc" loans in the early 1990s, which caused "hundreds of millions of dollars in losses." Those losses were contained because the regulators promptly used their supervisory powers to halt the practice. The regulatory body of which I was a member ordered the halt despite the lenders' high reported profits. "Hundreds of millions of dollars in losses" is serious, but if the losses are contained at that level, then the number of lender failures will be minimal and there will be no risk of a crisis. Unfortunately, our regulatory successors had no "historical appreciation" for successful supervisory policies or the identification of accounting control fraud. They issued ineffective "cautions" to the industry that "low doc" loans could be risky but refused to order an end to the practice and never considered the possibility that the lenders were control frauds.

Effective Financial Regulation Must Focus on Control Fraud

In the 1980s, the regulators' abilities to recognize, demonstrate, and prove that the high fliers were frauds made possible the policies that contained the S&L debacle before it could cause an economic crisis. It also led to an even more effective regulatory response in 1991 that prevented an incipient nonprime loan crisis. Re-regulation began in late 1983 under Chairman Gray. Gray's predecessor was an academic economist who shaped and implemented the deregulation and de-supervision in 1981–1983 that produced the intensely "criminogenic environment" that drove the second phase of the debacle. By 1983, hundreds of control frauds were growing at a 50% annual rate (Black, 2005). Several hundred S&Ls newly chartered by Texas and California (the states with the most deregulation and de-supervision) awaited only federal deposit insurance. The Southwest bubble in commercial real estate was severe by the end of 1983 (Black, 2005).

Gray's re-regulation was comprehensive and included increasing capital requirements, blocking federal insurance, and prohibiting questionable accounting practices. He targeted the worst control frauds for examination, supervision, enforcement, and closure—even while they were reporting record profits and relatively low losses. He doubled the number of examiners and supervisors in 18 months. He sought increased enforcement authority from Congress and made criminal referrals and assisting criminal prosecutions a top agency priority. Strategic targeting of abuse in Texas entailed the concentrated deployment of examiners to that state.

The policies the agency implemented proved successful. An industry growing at 23% annually (and that rate was increasing rapidly because of the new entrants and the exceptional growth rates of the control frauds) doubled in size in approximately 3 years. S&L control frauds grew at 50% annually double in size in 9 months. If re-regulation and re-supervision of S&Ls had been as delayed (roughly 8 years after the bubble began) and as weak as it has been in the current crisis, the S&L industry would have grown to more than $8 trillion (from $1 trillion). Most of that growth would have occurred in the accounting control frauds. The result would have been a national crisis and a severe recession. The agency's criminal referrals helped secure more than 1,000 priority felony convictions of senior insiders (a 91% conviction rate), which is the greatest success against elite white-collar criminals in history (Black, 2005; Calavita et al., 1997: 159).

Nguyen and Pontell (2010) could not interview the upstream control frauds' senior officers. They are elites, but the chief executive officers of small mortgage brokers might not be financially sophisticated. Roughly 75% of the interviewees worked for small companies (less than 25 employees). Although Nguyen and Pontell refer to their interviews as "elite," only 6 of the 23 subjects had a bachelor's degree and none had any graduate education. None of the interviewees is elite. Overall, this is the modern analog of Cressey's (1953) interviews of imprisoned embezzlers selected because they were relatively low-status office workers. The senior officers who led the primary control fraud epidemic and the downstream control frauds were among the most elite people in the world.

As we have observed, epidemics of control fraud can cause catastrophic damage. Preventing them should be our top white-collar crime priority and top financial regulatory priority. Anti-regulation as well as executive and professional compensation caused the criminogenic environments that produced these epidemics (Bebchuk and Fried, 2004; Black, 2005). Absent effective regulation, "private market discipline" becomes perverse, as banks fund the control frauds' rapid growth instead of disciplining them

Policy Recommendations to Prevent or Limit Control Fraud Epidemics

Even if criminogenic environments develop, the resulting epidemics of frauds, bubbles, and financial crises can be contained if regulators and prosecutors can understand and identify the distinct pattern unique to such frauds. To this end, each financial regulatory agency, the FBI, and the Department of Justice (DOJ) should have a "Chief Criminologist" who is an expert in fraud mechanisms. DOJ's top white-collar priority should be major control frauds. Investigative resources, or the lack thereof, are also crucial. The FBI's white-collar specialists face crippling systems capacity problems that should be addressed by hiring 1,000 new agents. Nguyen and Pontell's (2010) interviews confirm the strength and ease of neutralization and the endemic nature of the upstream accounting control fraud. The DOJ's only means to deter such an echo epidemic is to investigate the 50 largest nonprime lenders—the primary fraud epidemic.

One might also suggest that the techniques used to investigate conventional forms of serious organized crime be applied to the investigation of control fraud. The FBI should place undercover agents in the financial institutions it investigates. Regulatory and law-enforcement authorities also should avoid taking soft options. Each financial regulatory agency should immediately, as a top priority, establish a vigilant criminal referral unit. The Securities and Exchange Commission (SEC) should litigate cases of securities fraud and settle only when the respondent admits wrongdoing in writing in a manner that can provide collateral estoppel. The DOJ should end its policy of not prosecuting corporations and its reliance on "deferred prosecution agreements" as a substitute for prosecution.

Extending access to civil justice also might hold some promise. Allowing investors to sue those who aid and abet securities fraud might enhance the vigilance of third parties. Prevention is no less important than prosecution for the control of fraud. The SEC should assign the auditor and rating agency that a corporation can employ. It also should expand the pool of rating agencies, and it should track the accuracy of each rating agency and remove from the pool those that perform poorly. The federal government should mandate that all entities involved in mortgage lending loan only on full documentation and verification and that they file criminal referrals.

Closer collaboration between regulatory agencies and law enforcement also is desirable. Cross-training and personnel exchange may be one way of building synergies. Lenders should be required to hire the appraiser, forbid any intimidation of appraisers, and be forbidden from informing the appraiser of the sales price. Lenders also should be required to have each appraisal reviewed by internal reviewers.

The Importance and Utility of Fraud "Markers"

Honest lenders do not gut underwriting because it causes "adverse selection" (lending to borrowers who cannot or will not repay loans). Adverse selection's "expected value" is sharply negative (i.e., the lender will invariably lose money). During the S&L crisis, these fraud "markers" were used to identify the frauds even while they were reporting record profits and minimal losses (Black, 2005; Black, Calavita, and Pontell, 1985). These same facts were present during the ongoing crisis, as Iowa Attorney General Miller's testimony at a 2007 Federal Reserve Board hearing shows: "An honest secured lender would never cause, or permit, inflated appraisals. Widespread inflated appraisals, therefore, are not only fraudulent, but a 'marker' of lending fraud."

The current crisis was not contained because financial nonregulation was the norm, which created a criminogenic environment. The worst limitation, however, was not understanding the cause of the fraud epidemic and why it would cause a catastrophic financial crisis. The Mortgage Bankers Association (MBA) controlled the framing of the issue of mortgage fraud and portrayed its members as victims. The officers that controlled its members were the primary beneficiaries of mortgage fraud. As Nguyen and Pontell (2010) note, the MBA claimed that all mortgage fraud was divided into two categories—neither of which included accounting control fraud. Tragically, the FBI formed a "partnership" with the MBA and adopted the MBA's two-part classification of mortgage fraud (FBI, 2007). The financial regulatory agencies gave the FBI no help in this crisis—even after it warned of the epidemic of mortgage fraud. The FBI does not mention the agencies in its list of sources of criminal referrals for mortgage fraud. The data show that regulated financial institutions, which are required to file criminal referrals, typically fail to do so—without regulatory sanction.

Criminologists' warnings that the deregulation or desupervision of a financial industry de facto decriminalizes control fraud (Black, 2005, 2007; Calavita et al., 1997) have proven accurate. There are no criminal cases, only one major SEC action, and few enforcement actions or civil suits against the senior officers of the large nonprime mortgage specialty lenders. The mischaracterization of the fraud epidemic came from the top (Lichtblau, 2008): "Attorney General … Mukasey has rejected calls for the Justice Department to create the type of national task force that it did in 2002 to respond to the collapse of Enron" and "Mr. Mukasey said in June that the mortgage crisis was a different 'type of phenomena' that was a more localized problem akin to 'white-collar street crime.'"

Military generals often have been criticized for ignoring emerging strategic and tactical issues and for thereby fighting the previous war. Ironically, the generals of financial regulation during the most recent crisis can be criticized for not having done so.

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POLICY ESSAY

MORTGAGE ORIGINATION FRAUD

Diagnostics of white-collar crime prevention

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Well-Placed Specificity of Regulatory Analysis

Nguyen and Pontell's (2010, this issue) article makes a strong case that white-collar crime played an important role in the origins of the global financial crisis; specifically, in waves of mortgage origination fraud. Particularly telling is the 2006 Federal Financial Crimes Enforcement Network (FinCEN) report of a 1,411% increase in mortgage-related suspicious activity reports between 1997 and 2005, 66% of which involved material misrepresentation or false documents. Then another 44% increase was reported between 2005 and 2006. The BasePoint Analytics (2007) analysis of 3 million loans, which indicated that 70% of early payment defaults had fraudulent misrepresentations on their original loan applications, was another early warning signal that the mortgage issue was a crime problem. These data also demonstrated that it was a consequential problem, as the loans with fraudulent misrepresentations were five times as likely to go into default. The Federal Bureau of Investigation began issuing public warnings in 2004, claiming that it was seeing a spike in mortgage fraud cases in the mid-2000s (Black, 2009).

Even earlier than that, a more abstract early warning drew on the lessons of the history of the savings and loans debacle from Nguyen and Pontell and fellow scholars such as Bill Black (Black, 2005; Black, Calavita and Pontell, 1995; Calavita, Tillman, and Pontell, 1997; Tillman and Pontell, 1995). Of course, other layers of causation were found in the structures of the derivatives market, the bonus culture on Wall Street, the captured ratings agencies that failed to do their job, the structural imbalances of American indebtedness to China to pay for Chinese exports to the United States, and the defective quantitative risk models applied by the financial industry (Braithwaite, 2009; Johnson, 2009; Krugman, 2008; O'Brien, 2009; Partnoy, 2003).

Yet Nguyen and Pontell's (2010) emphasis on the proximate causes in mortgage fraud is well placed for two reasons. First, many other layers of causation are extremely hard to fix and

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to prevent from becoming structural causes of the next crisis. Something like the Volcker plan to regulate bank trading in derivatives, for example, is not hard for other nations to do but is politically fraught in the United States because of the enormous political power and economic interests of Wall Street finance oligarchs. Comparatively, preventing financial misrepresentation in loan applications is an easier regulatory challenge. It is one even developing economies mostly manage reasonably well, so it is one the United States should be able to master.

Second, in retrospect, it is now clear that this was not a global financial crisis; recession only came to those economies that bought bad American housing loans. Most nations had no financial crisis; all they had was a temporary reduction in economic growth, largely driven by reduced exports to the United States. At the time of this writing, there is some risk of a double dip North Atlantic recession as a result of several southern European nations badly managing the extent of their stimulus spending before and after the 2008 recession. Most of the world's population that lives in Asia did not go into recession; Asian economic growth attenuated during the "global financial crisis" but continued throughout at a much higher level than the United States had experienced in the years before the crisis. A few nations like Iceland, the United Kingdom, and Ireland had such disproportionate exposure through the derivatives market to U.S. housing mortgages that they suffered a bigger crisis than the United States. But most of the world's population had a much lesser crisis than the United States and could help pull the United States back out of recession in a way that had not been possible in the 1930s. The main reasons were that their financial regulators did not allow the kind of crime that the United States had allowed in its housing mortgage market, nor had most non-U.S. financial regulators allowed their banks to buy a lot of exposure to it. Many less sophisticated regulators in lesser nations than the United States served their people well by saying to their banks, "We don't understand a lot of this derivatives trading, so we are going to restrict your ability to expose the nation to it." Such nations were even less affected by the last savings and loans debacle (in the 1980s) than by the 2008–2009 crash. This is the second reason why Nguyen and Pontell's (2010) attention to white-collar crime in the U.S. mortgage market as a cause is a well-placed emphasis: Even countries that suffered from other factors in the causation of the "global financial crisis" avoided recession as long as they avoided bad U.S. housing loans.

Many other analyses of the "global financial crisis," originating from New York and London, have been focused far too sweepingly on the general pathologies of the nature of contemporary capitalism, conceiving the Anglo-American North Atlantic as global capitalism instead of part of it, and have been insufficiently focused on specific failures of U.S. financial regulation. That specificity of focus is a strength of Nguyen and Pontell's (2010) article.

Neglect of Preventionism in White-Collar Crime Research

Popular discourse on crime in the media and in politics is overly preoccupied with imprisonment of the guilty as a remedy for crime. Evidence-based criminology suggests that more prison time is rarely the most cost-effective way to reduce crime. One way in which criminology is a superior discourse to media and political discourse on crime is that it directs the attention of policy makers to a great variety of preventive programs, some of which are bound to be more effective and cheaper than building more prisons. This virtue is manifest across the volumes of *Criminology & Public Policy*. Criminological discourse on white-collar crime insufficiently shares this virtue of the mother discipline. Too much white-collar crime literature identifies the failure to punish sufficiently as the only form of prevention failure worthy of analysis. Admittedly, white-collar crime is more under-deterred than other forms of crime, and reasons persist for thinking deterrence can be more effective with it (Braithwaite and Geis, 1982). Equally, white-collar crime suffers more under-investment in prevention and preventive policing than other forms of crime, and reasons also persist for believing that this policy can be more effective than with common crime (Braithwaite and Geis, 1982). Thankfully, this article (Nguyen and Pontell, 2010) and the earlier work from the University of California, Irvine has been focused admirably on the measures required to prevent another crisis. The tragedy is that regulators have been deaf to their message for so long.

The white-collar crime comparativist is bound to ask the question of whether other countries that have not had the U.S. problems of widespread mortgage fraud have averted this issue by filling their prisons with brokers and bankers. It does not seem likely, although a global comparative study of this kind of enforcement has not been done. In many, perhaps most, domains of enforcement against white-collar crime, the United States is the most punitive enforcer, with other Anglo-Saxon economies—particularly Australia—being next in punitiveness, and with continental European and Asian economies being much less punitive (e.g., Coffee's [2007] data on securities enforcement).

Regulation in less sophisticated economies than the United States works in an old-fashioned way of kicking the tires when the wheels seem to be falling off with unusual frequency in a particular sector. So, if something such as a wave of loan defaults is occurring in a particular place or at a particular bank, then old-fashioned regulators in less sophisticated markets are less likely than their U.S. counterparts to use quantitative risk models to try to understand what is going on. They are more likely to go out and talk to mortgage brokers and bankers at what might turn out to be mortgage-fraud hot spots. If they find mortgage fraud, then such old-fashioned regulators rarely call in a prosecutor. They often mutter darkly about the responsibilities that come with having a banking license (see Grabosky and Braithwaite [1986] on the gentle manners of old-fashioned financial regulators in Australia). One denizen of Australia's Reserve Bank in the 1980s called it "regulation by raised eyebrows." An example of responsibilities about which such old-fashioned regulators would mutter darkly is ensuring that mortgage documents are not riddled with misrepresentation.

Like those in Australia, old-fashioned financial regulators in many countries little touched by the global financial crisis were "benign big guns." In countries like Indonesia, they moved from being captives of crony capitalism to being benign big guns after the Asian financial crisis of 1997. Benign big-gun regulators have enormous powers to take over banks, increase the reserves they are required to hold, limit their derivatives trading, and suspend or impose conditions on licenses that, in most nations, were born of the experience of the 1930s Depression.

But these financial regulators almost never fire these big guns. Rather they "express concern," which often is enough to put a banker in fear that a big gun might be pointed at them. In other words, it is a policing accomplishment in which police officers not only do not lock anyone up, but also they do not so much as withdraw their guns from their holsters to point them at anyone. Nevertheless, it is bargaining for prevention in the shadow of a big gun. It is more the old-fashioned British bobby response of uttering "Ello, ello, ello, what's going on ere?" It is preventive regulatory patrol focused on what look like emerging hot spots (Braithwaite, 2009; Sherman, 1995). The aim is more to prevent the hot spots from getting worse than to punish the evidence of crime that already has been lured to the hot spot.

My intuition is that the United States should ask itself the question of whether it is that more old-fashioned method of kicking the tires and expressing concern at the center of the financial regulation in most other nations that has saved most of them from experiencing anything as bad as the savings and loans debacle of the 1980s or the mortgage fraud surge of the 2000s. In advance of fine-grained empirical research to explore such an intuition, its merit cannot be judged. Nevertheless, I am critical of the U.S. policy debate for having such an impoverished comparative imagination that such questions rarely are asked. U.S. policy debates tend to look within the United States for solutions, to U.S. policy innovation, and to policy transfer from one U.S. policy domain to another without even asking the obvious kinds of comparative questions raised here.

So, with banking crime, perhaps the first option for the U.S. criminologist to consider might not be: "What if we were to apply the same incarceration policy that we have applied so successfully with the War on Drugs, the War on Terror, and the War on Street Crime?" That is not to say that financial regulation in all nations, including the United States, does not need a stronger deterrent element than it currently has. It almost definitely does need more deterrent credibility. For responsive regulators, that would be just at the peak of a regulatory pyramid, where the preventive work that made the biggest difference to levels of financial crime would occur at the base of the pyramid. Yet, a benign big gun is more likely to be effective if it is fired occasionally and with telling effect.

Qualitative Empirical Insights

Not enough of the kind of research that Nguyen and Pontell (2010) have provided in their article exists to enhance our understanding of crime-facilitative environments (Shover and Hochstetler, 2006). Although derived from just 23 insiders of the subprime lending industry, the policy implications are suggestive. We learn that the lead in mortgage fraud tends to be taken by mortgage origination personnel rather than by borrowers (Black, 2008). This point is critical for understanding where to target prevention. We also learn about the most common forms misrepresentations takes. This knowledge helps inform the targeting of audit. We learn that "denial of victim" is a central technique of neutralization, which implies the potential for techniques of deneutralization that require perpetrator bank boards to face victims who so often have lost their homes, their marriages, or worse. Restorative justice is another possibility (Braithwaite, 2009). Yet another insight suggests that the U.S. finance sector progressively has become less interested in risk management associated with housing loans and more interested in risk shifting, in slicing and dicing risk so that it can be spread around through derivatives. Nguyen and Pontell (2010) offer the telling policy implication here that rewards should not be based on how many loans an employee can squeeze out each month, but instead be based on loans that are performing. This suggestion indeed appears compatible with credible prevention.

One might be more cynical of some of the reforms Nguyen and Pontell (2010) commend in the 2009 Mortgage Reform and Anti-Predatory Lending Act. Requiring a good-faith determination regarding clients' reasonable abilities to repay loans will not suffice if inspectors never check to see that this determination happens or if they fail to insist on reform when it does not happen. Regulation based on risk models bears scant connection to such law. My hypothesis is that countries that have not had the mortgage fraud problems of the United States have not had more demanding laws; they have had more demanding policing. Preventive policing requires, as argued, kicking the tires and making life difficult for the firm in some way when the vehicle is defective. And it requires brokers, bankers, and ratings agencies to be convinced that the regulator will escalate its intervention into their businesses until they fix the problems. The North Atlantic regional financial crisis of 2008, as Nguyen and Pontell argue, did seem to be a case in which lure, inadequate oversight, and a supply of tempted insiders (Shover and Hochstetler, 2006) allowed crime to lead on to catastrophe. This is an example of an explanatory model that seems suitable in guiding the micro–macro empirical work that is needed to inform financial crime prevention policy. My methodological point is that financial crime prevention policy is best advanced by a more comparative method than prevails in American criminology.

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Mortgage origination fraud and the global economic crisis

Incremental versus transformative policy initiatives

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The central role played by the subprime mortgage market in the global economic crisis that reached its apex in late 2008 is well established and widely acknowledged. In 2006, almost 3 million subprime mortgage loans in the United States, with a value of more than $1 trillion, were originated, followed by soaring foreclosure rates and vast losses to a whole range of parties (Bar-Gill, 2009). Housing values in the United States continued to decline through 2009, and foreclosure rates continued to rise, with close to 90,000 people experiencing repossession of their homes in January 2010 alone (*New York Times*, 2010). The devastating, ongoing consequences of the broader economic crisis, rooted in the subprime mortgage loans, are well known. Although much outrage has been expressed over the policies or practices of a wide range of parties—from politicians, to regulators, to credit rating agencies, to investment bankers, to brokers, and to borrowers—these expressions of outrage typically have not focused on the specifically fraudulent and criminal character of some of these policies and practices. Accordingly, Nguyen and Pontell's (2010, this issue) study is a much needed step in the right direction; that is, empirical criminological research and analysis generating specific policy recommendations. It is a core thesis of the present essay, however, that the scope of both the criminological analysis and the recommended policy responses, if we are seriously committed to the goal of minimizing the chances of another such financial meltdown, must be expanded and broadened greatly.

Mortgage Origination Fraud and Criminological Analysis

Nguyen and Pontell's (2010) article "Mortgage origination fraud and the global economic crisis: A criminological analysis" offers us a provisional exploration of an understudied but significant form of criminal activity. The sample size is very small, but the findings (drawing also

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on secondary data sources) surely identify some core dimensions of the criminality associated with mortgage origination and the potent need to adopt public policies that effectively could contain, if not fully prevent, this type of fraudulent activity.

The principal findings of Nguyen and Pontell's (2010) study will be familiar to students of white-collar crime because they reflect parallel findings across the whole range of such crime. Nguyen and Pontell note that although mortgage origination fraud played a key role in the global economic crisis, many other factors were involved as well. Nguyen and Pontell also note that various "sectors" or independent agencies (broker, lender, appraiser, escrow, and title) were implicated in the mortgage origination frauds. It is characteristic of many of the more consequential forms of white-collar crime that they are complex, involving various interconnected parties and organizations that operate on different levels. This "diffusion of responsibility" contributes in fundamental ways to the capacity for any one party to avoid acknowledging the potential wrongfulness or harm done by its specific conduct. Mortgage originators who engage in fraudulent activity differ from classical forms of conventional, professional, or organized crime actors whose criminal activity is "purely" and unambiguously criminal. Dwight Smith's (1982) notion of a "spectrum" of enterprise from purely legitimate to purely illegitimate applies here; mortgage origination can range from purely legitimate to purely illegitimate and everywhere in between. Mortgage originators initially might operate more on the legitimate end of the spectrum and gradually gravitate toward the illegitimate end in response to various pressures and circumstances. It is noted that a "thin line" exists among risky, unethical, and criminal activity. The "normalization" of fraudulent conduct applies as well to many forms of white-collar crime. This pattern renders the notion of "elite deviance" somewhat problematic because the illegitimate and illegal activities of corporate and occupational "elites," in fact, often conform to peer norms.

Another common theme of the white-collar crime literature also is highlighted in this study—the central role of rationalizations or neutralizations on the part of offenders. The extent to which those engaged in mortgage fraud are genuinely in denial about what they are doing and deluding themselves, or cynically are invoking rationalizations with a full consciousness of the wrongfulness of their conduct, is not always entirely clear. Nguyen and Pontell (2010) invoke Jack Katz's concept of "concerted ignorance" in relation to subprime mortgages. Such activity on the part of escrow and title company agents is said to be "rare," although one can question this. Investigations of the $17 billion title insurance industry have characterized it as a "rigged" market, with pervasive illegal collusion and kickbacks (Eaton and Eaton, 2007). But ultimately—as is true for so much white-collar crime—the privileging of profit over all other considerations is at the heart of mortgage-related fraud.

Nguyen and Pontell (2010) acknowledge the significance of "criminogenic conditions" (an important if, arguably, somewhat neglected concept) and "crime facilitative" conditions. They adopt rational choice theory as a useful theoretical framework for understanding mortgage origination fraud. Although this theory has been applied in different ways, "decision-making is the heart of rational choice theory" (Shover and Hochstetler, 2006: 109). Sophisticated versions of this theory recognize that choice is linked inextricably with structures of opportunity broadly conceived. The benefits of engaging in mortgage origination fraud—often immediately and highly profitable—outweighed the potential costs. The precipitous decline of the housing market nationwide and the drying up of credit, among other factors, greatly diminished the opportunity for subprime mortgage origination fraud in the wake of the economic collapse. But opportunities by mortgage servicers to defraud mortgage borrowers have remained, with exorbitant, misleading fees for mortgage loan modifications, arrears payments, and foreclosures (Kroll, 2010). Many of the same companies that got borrowers into mortgages they could not afford were partaking in billions of dollars of government money made available to entice lenders to assist such borrowers to stay in their homes.

A basic premise for this policy essay is that addressing the "supply of opportunities" for white-collar crime is more likely to be effective than addressing "individuals willing to exploit them" (Shover and Hochstetler, 2006: 1). Integrated theories of white-collar crime attend to the interplay of structural, cultural, organizational, dramaturgic, and individual factors in bringing about white-collar crimes, highlighting opportunities and pressures that promote motivations and choices (Friedrichs, in press). Specifically, on the structural level, an integrated theory of subprime mortgage market frauds takes into account the architecture of the capitalist political economy in a globalized world; on a cultural level, it takes into account delusional optimism about affordable housing; on an organizational level, it takes into account the form of securitization that provides incentives for involvement with high-risk loans; on a dramaturgic level, it takes into account the successful promotion of an image of respectability; and on an individualistic level, it takes into account the attributes of narcissism and entitlement, among other personality factors (Friedrichs, 2010: 245–247). Integrated theories of crime do not lend themselves as readily to empirical testing as such theories as low self-control ("the general theory"), but are likely to be much more in accord with the ultimate complexity of mortgage-related fraud.

Near the end of their article, Nguyen and Pontell (2010) acknowledge that they only have addressed the "bottom level" of those implicated in the global financial crisis. This concession is important, but in terms of policy initiatives, it raises the question of whether any such initiatives, if they are to be truly effective, can be uncoupled from policy initiatives directed at the "top level." Although various parties can be identified on this top level, in relation to subprime mortgage loans, Wall Street investment banks played a central role.

Wall Street Investment Banks and Mortgage Fraud

The fraudulent misrepresentations of mortgage loan originators as well as borrowers never could have occurred on the scale that they did in the first place and certainly could never have precipitated a global financial crisis had Wall Street investment banks not been prepared to buy up these mortgages worth billions of dollars, to securitize them, and to sell them to investors. The banks reaped billions of dollars of profits, with top executives receiving tens of millions of dollars—or even hundreds of millions of dollars—in compensation and bonuses in relation to these securitization activities. This topic is multifaceted and has many important players, so I will restrict myself here to only one of the players. Goldman Sachs is among the most prestigious and the most successful of the major Wall Street investment banks. Early in 2010, Greece was in a state of severe financial crisis, undermining and threatening the entire European economy. Goldman Sachs sold complex deals to Greece that greatly facilitated its overspending, and then Goldman Sachs earned even more major profits by betting against the Greek economy (Schwartz and Dash, 2010). In relation to the subprime mortgage crisis specifically, among other activities, Goldman Sachs sold billions of dollars of subprime mortgage loan securities to investors, bet against these investments doing well, and reaped another fortune from these bets (Morgenson and Story, 2009). On April 16, 2010, the Securities and Exchange Commission filed a civil fraud case against Goldman Sachs in relation to these transactions (Story and Morgenson, 2010). Although Goldman Sachs was among the firms that received billions of dollars of taxpayer funds in the midst of the financial crisis, as well as 100 cents on the dollar on its investments, it was reporting record profits and rewarding huge compensation and bonuses in 2009 and early in 2010. Policy initiatives that fail to address the policies and practices of Wall Street investment banks such as Goldman Sachs are likely to be limited in terms of preventing, or at least containing, future global economic crises.

Incremental versus Transformative Policies

Nguyen and Pontell (2010) call for new policies that will address offending, as well as monitor potential conflicts of interest and provide oversight with added layers of verification and independent reviewers for loan entities. The Congressional Bill HR1728—The Mortgage Reform and Anti-Predatory Lending Act of 2009—if implemented, would impose some constraints on mortgage fraud. Indeed, some standards incorporated in this legislation would seem to be so obvious (e.g., requiring a good faith determination of a client's ability to repay) that it begs the question: Why weren't they adopted much earlier? The call for creditors to maintain part of the risk of subprime loans sold to investors, and an option for consumers to obtain redress from those who "securitize" mortgage loans, would seem to make sense. But do the benefits of securitization itself really outweigh the drawbacks? Some analysts are calling for a return to "boring" banking, with originators retaining the full responsibility for ensuring that mortgage loans are paid off.

Nguyen and Pontell (2010) call for programs initiated by "organizational leaders" to confront the "neutralizations" of mortgage originators their research uncovered, but the potential effectiveness of these particular policy recommendations seems questionable. Historically, the principal message that has come from organizational leaders has been to produce high numbers (i.e., profits), by whatever means, or you are out of a job or contract. Ethical principles all too often are trumped by both immense opportunities and pressures to produce profits and to avoid losses.

In anticipation of the election of Barack Obama as President, *The American Prospect*'s Robert Kuttner (2008) called for the adoption of transformative new policies. Incremental public policy focused on neutralizations for greedy decisions is too limited. Structural and organizational levels of the integrated theory outlined earlier address those dimensions of the current financial architecture that produce opportunities that are criminogenic, and they call for transformative policies if we are to minimize the chances of a future, catastrophic economic crisis. John Braithwaite (2009) called for "negative licensing" of unethical investment bankers and for a reassertion of risk management as opposed to risk shifting. If one accepts the premise that oversized financial institutions with inherent conflicts of interest, excessive leveraging of investments, compensation practices promoting unwarranted risk-taking, and overly complex, nontransparent financial instruments were among the key criminogenic conditions that contributed to the huge buildup of toxic subprime mortgage loans and the financial meltdown itself, then one must identify and adopt policies that effectively address these conditions. Financial industry practices that put the economy at risk need to be outlawed and, in some cases, criminalized. Some commentators believe we must go further and institute global financial governance (e.g., a world financial organization) and must transform in fundamental ways not only the very architecture of the Wall Street financial system but also the character of capitalism itself.

Concluding Thoughts

If the proposed policies specifically aimed at subprime mortgage origination fraud were to be adopted and successfully implemented, then it is possible that they would constrain some measure of fraud going forward in that particular realm. But this essay also has suggested that the history of such policy initiatives should impress on us the great limitations of policies directed primarily at the "bottom level." Even if the transformative policies directed at the "higher level" are not currently "actionable," as criminologists we still should identify and promote them.

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Mortgage origination fraud

The missing links

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In the current work, "Mortgage origination fraud and the global economic crisis: A criminological analysis," Nguyen and Pontell (2010, this issue) find three root causes of the mortgage crisis that launched the Great Recession. First, fraud made easier by inadequate regulation created the ideal climate for deceptive dealings in the solicitation, origination, financing, sales, and servicing of mortgage loans. Second, indiscriminate use of alternative loan products, like subprime and alternative A-paper (Alt-A) instruments—whether for those who easily would have qualified for higher quality products or for those who should not have qualified for a mortgage loan under any circumstances—were the earliest and most costly defaults in U.S. housing history. Taking the first and second findings together, Nguyen and Pontell suggest a compounding effect of one finding on the other.

Finally, Nguyen and Pontell (2010) argue that there is a lack of accountability in the mortgage lending industry in the form of regulation, enforcement, and governing mechanisms, which allowed for the rapid escalation of mortgage fraud. The absence of accountability, however, is symptomatic of a larger structural issue. In short, the credit industry is a labyrinthine structure with numerous participating entities (e.g., borrowers, brokers, lenders, appraisers, servicers, ratings agencies, and investment firms). This complex structure leaves the industry rife with opportunities for fraud writ large. As Nguyen and Pontell point out, the credit industry's compensation policies and practices ultimately were too far removed from the actual lending transaction.

In this essay, we first review the research and the market-based linkages to Nguyen and Pontell's (2010) principal findings. We then analyze Nguyen and Pontell's recommended mortgage lending industry changes, including (a) tightening loan qualification standards and redressing loan origination compensation policies; (b) recognizing the potential for insider fraud and using greater transparency, as well as stricter governance, to mitigate fraud likelihood; and (c)

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modifying existing legislation to regulate and oversee better the various parties to the mortgage process. Finally, we propose several changes in both market structure and regulatory oversight in mortgage lending markets to support Nguyen and Pontell's results.

Inadequate Regulatory Oversight

The underlying causes of the subprime mortgage crisis have been analyzed extensively. In sum, the current and unprecedented rates of mortgage delinquencies and foreclosures stem back to factors such as lax lending policies, poor loan underwriting, financially illiterate consumers, financial innovation, and inadequate regulation and oversight. Fraud is the common thread woven through most of these causes.

A full critique would examine not only the five primary players in the mortgage origination process (borrower, broker, lender, escrow/ title agents, and appraiser) outlined by Nguyen and Pontell (2010), but also it would include the ratings agencies (i.e., Moody's and Standard & Poor's), investment banks (e.g., Goldman Sachs), and the housing government sponsored enterprises (GSEs).[1] These secondary market players indirectly encouraged and enhanced mortgage origination fraud by creating the necessary liquidity for fraud in the mortgage market. Securitization allowed both originators and lenders to compete for market shares by lowering their underwriting standards, which eventually led to significant increases in lending volume and in the opportunities for mortgage fraud.

Indiscriminate Use of Subprime and Alt-A Products

At a minimum, a mortgage transaction requires a borrower, a lender, a credit agency, an appraiser, and a title/escrow attorney. In more than one third of all mortgage applications, another party is involved—a mortgage broker, representing the buyer in both the application and the origination processes. The source of a mortgage broker's power lies not only in his or her assessment of the borrower's credit quality and income, but also in his or her assessment of the loan products for which the borrower qualifies.

Exploding Loan Product Menus

Mortgage brokers' fluency in mortgage products gives them a competitive advantage over the lay borrower. In recent years, loan products have undergone a transformation from cookie-cutter 15-year and 30-year fixed-rate loans to a vast array of lending options, including stated income, stated asset (SISA); no income, no asset; stated income, verified assets; no income, no asset, no job; and option adjustable-rate mortgages (giving borrower's the option to make a principal payment). In short, the mortgage product market just prior to the Great Recession offered the mortgage broker and lender numerous tools to complete the mortgage transaction for the borrower. The exotic mortgage market grew dramatically during the crisis, whereas

1. The primary housing GSEs are Fannie Mae and Freddie Mac, and their primary business line is to repackage mortgages into securities and guarantee the credit risk. For an in-depth discussion of the housing GSEs, see Green and Wachter (2005).

the conforming mortgage market volume of prime borrowers peaked in 2003 (Ashcraft and Schuermann, 2008). However, the growth of the exotic mortgage market exacerbated the moral hazard and opacity issues in this contracting process; too short a history in exotic mortgages meant weak default prediction models.

Securitization Does, in Fact, Serve Valuable Purposes

The securitization process separates loan origination from ultimate loan funding, leads to a transfer of credit and interest rate risk, and has potential benefits for many mortgage market constituents. First, securitization lowers the originator's costs of funding and lowers the amount of capital a bank holds against mortgage loans. Second, securitization benefits investors because mortgages typically are pooled across different geographies and because mortgage-backed securities (MBSs) typically are tranched, so investors can choose their repayment terms and risks. Third, securitization improves the liquidity of the loan originator and raises the loan "multiplier" (i.e., the lender uses the same set of funds several times in a calendar year to earn fees during each use). Finally, securitization benefits consumers by enhancing credit availability and typically offering lower mortgage rates than consumers otherwise would pay in a less liquid marketplace (see Fabozzi and Kothari [2008] for an in-depth discussion of securitization).

Yet, Securitization Increases the Opportunity for Fraud

The mortgage arena is more open to fraud as a result of securitization, despite its potential benefits. Mortgage fraud is "the material misstatement, misrepresentation, or omission by an applicant or other interested parties, relied upon by an underwriter or lender to fund, purchase or insure a loan" (Quinones, 2009). In fact, the growth in mortgage fraud closely parallels the growth in securitization—especially for subprime and Alt-A mortgages. Specifically, the private-label securitization market grew from 24% of all MBSs in 2003 ($586 billion) to a 55% share in 2005 ($1.19 trillion; England, 2006). In that same time period, reported suspicious activity reports for mortgage fraud grew more than 400% (FinCEN, 2006). Because securitization removed the historical link between origination and funding sources, mortgage fraud became more widespread. That is, the mortgage fees were earned at closing and the loan's subsequent performance was not linked to the mortgage originator's follow-on compensation.

Fees are earned both at origination and during the various stages of the securitization process (e.g., bundling fees, tranching fees, and ratings fees). Throughout the process, the parties earn their fees without a subsequent penalty for any poor loan performance. Although the MBSs generally have put-back clauses for early and first payment default situations, those loss predictions were not accurate in these new, exotic mortgage instruments. As the proportion of those exotic mortgages overtook the balance of traditional mortgages in MBSs, the securities became increasingly complicated, and their repayment traits were difficult to model correctly.

Furthermore, the market in which these MBSs exist (and are traded) is a fairly opaque one. Private MBSs, for example, do not supply monthly reports to the Securities and Exchange Commission, so changes in repayment behaviors (e.g., early payment and first payment defaults) are not widely known. This fact is particularly important because private-label MBSs were the largest part of the mortgage credit market by 2004.

The Absence of Accountability in the Mortgage Credit Industry

As Nguyen and Pontell (2010) share, the mortgage credit crisis precipitated the Great Recession largely through lax oversight and opacity in the mortgage lending and securitization processes. Whether mortgage broker or lender, the environment provided enough mortgage lending tools to secure a loan for almost any borrower no matter whether the borrower had assets, a job, or an income. The missing accountability is evidenced in the compensation structures of the loan officers or brokers—always paid within the year and in the absence of a follow-on mechanism regarding a loan officer or broker's loan pool performance. No mechanism was developed to hold these people accountable for loan performance after loan origination.

Backley, Niblack, Pahl, Risbey, and Vockrodt (2006) analyzed the impact of broker licensing policy on credit availability and foreclosure experience in Minnesota and Wisconsin. They found that stricter licensing is a barrier to entry, although the overall availability of credit is not adversely impacted by differences in licensing requirements. Using foreclosure rate data, they found stricter licensing reduces the incidence of unaffordable loans.

In addition, the compromised independence of credit ratings agencies exacerbated the system's vulnerability to new and exotic products marketed by the fast-growing mortgage segment in brokered loans. Credit ratings agencies were not held to high or even to exacting standards in modeling the credit risk inherent in MBSs—whether in measuring and estimating the early payment default, or even first payment default—of subprime and Alt-A borrowers. Relationships among parties in the market for credit ratings, much like borrower–lender relationships, are fraught with misaligned incentives. For example, credit ratings agencies were not particularly well versed in credit modeling for MBSs underwritten for subprime and Alt-A borrowers. In fact, no good models were available for managing these behaviors given the short history of performance (less than 4 years when the crisis began). As such, the relationship between the investment bank underwriters and the credit ratings agency analysts was one in which both parties were happy to earn fees even though people had little confidence in their models (see Ashcraft and Schuermann, 2008).[2] In sum, no market or system triggers could slow the process or make the system's players accountable for the growing risk in the secondary mortgage marketplace. How might we correct these behaviors with policy and market changes?

Nguyen and Pontell (2010) propose that the mortgage lending industry tighten its loan qualification standards and redress compensation policies in loan origination. These changes potentially would alleviate the problem by taking mortgages out of the hands of subprime and Alt-A borrowers while better managing broker and lender compensation and performance as a long-term goal. The current credit-market tightening, however, already has managed this

2. For example, Tomlinson and Evans (2007) stated that during the peak, Moody's made 44% of its revenue from structured finance deals.

change to some extent, as remaining lenders now underwrite to tighter standards than were seen even 5 or 10 years before the collapse. For example, SISA loans and 0% down loans are no longer marketable.[3]

Nguyen and Pontell (2010) also advocate that lenders and regulators recognize the potential for insider fraud and use greater transparency, as well as stricter governance, to mitigate the likelihood of mortgage fraud. These changes would help increase the information on, and the quality of, mortgage market transactions, although current securities complications revolve around the disclosure and discovery for privately issued, privately traded MBSs.

Finally, Nguyen and Pontell (2010) suggest that Congress modify existing legislation to regulate and oversee the various parties to the mortgage process better. Changes in regulatory oversight would increase the costs of mortgage originations but might reduce the opportunity for mortgage fraud at various stages in the mortgage lending process. We examine each of these three recommendations in the paragraphs that follow.

Tightening Loan Quality Standards

The large increases in the volume of both Alt-A and subprime mortgage loans were facilitated primarily by the mortgage securitization process, which provided fertile ground for parties involved in mortgage fraud. The first area where fraud might occur is between the originator and the borrower. Originators have an informational advantage because most subprime borrowers are financially unsophisticated and are steered easily into products (Black, 2008). The products offered to these borrowers often were overly complex and easily subject to misunderstanding. For example, the borrower might not know the mortgage options available (e.g., 30 year vs. 15 year), the risks involved (fixed rate vs. adjustable rate), and the true costs (e.g., yield spread premiums)[4] of the various products. Consumers' lack of financial literacy makes it difficult for most borrowers to ascertain whether the financial representations of the lender were false. Furthermore, as Nguyen and Pontell (2010) state, some borrowers were just happy to get a loan and did not worry about the fraud in the loan approval process. Because brokers are compensated by volume, and they pass on the loan risk to investors, securitization encourages fraud on both the borrower and the lender side.

3. In fact, the "shadow banking" system and the market for private-label securitizations disappeared during the crisis. See Nolle (2010) for an excellent discussion of the shadow banking system.

4. Consumers are required to receive a HUD-1 report from the originator. Receiving a form does not mean they understand it and some of the underlying costs. Furthermore, costs such as the yield spread premium are not included on the form (i.e., Is the money or rebate paid to a mortgage broker for giving a borrower a higher interest rate on a loan in exchange for lower up-front costs generally paid in origination fees, broker fees, or discount points?).

Enhanced Transparency

Currently, various proposals argue for greater transparency as well as for stricter governance to mitigate the likelihood of mortgage fraud. Possibly the most important to align incentives better in the mortgage process is one that is contained in the current financial reform bill (better known as the Dodd Bill). The Dodd proposal would require originators and securitizers of financial assets to retain a portion of the credit risk of securitized financial assets or, in more popular terms, to have "skin in the game." This would help establish a stronger link between origination and funding and would provide an important incentive to reduce fraud at each stage of the mortgage origination process.

Regulation and Oversight of the Mortgage Process

Beside changes to enhance mortgage underwriting and to improve the securitization process, policy makers also must consider enhanced supervision of mortgage brokers, credit ratings agencies, and most importantly, the ongoing role of the housing GSEs. All three of these players contributed to the level of mortgage fraud, either directly or indirectly. Proposals to link broker and lender performance better would reduce the level of mortgage fraud greatly. Second, policy makers continue to evaluate the role of the raters in the crisis. [5] Currently, the Securities and Exchange Commission is considering various reforms to minimize conflicts of interest that often lead to fraud. Finally, we need to assess and evaluate fully the government's role in the housing market. Although Fannie Mae and Freddie Mac are now smaller players in the market because of their conservatorship, it seems that mortgage fraud has moved to an increasingly important part of the housing finance market—the Federal Housing Administration (FHA) government loan program. According to El Boghdady and Keating (2009), low down-payment mortgages insured by the government FHA program accounted for nearly one third of all mortgage loans post-crisis, and the number of borrowers failing to make a single payment before defaulting on the loans has nearly tripled within a short time period. Thus, we need to evaluate whether government participation in the mortgage finance market by providing guarantees at both the FHA and the housing GSEs increases the likelihood of fraud.[6]

Conclusions

As Nguyen and Pontell (2010) note, to understand mortgage origination fraud fully, one must understand the crime-facilitative environment that naturally led to the practices. The mortgage finance area, however, is an incredibly complex environment with no shortage of possible culprits. As this essay outlines, one key culprit that led to conflicts of interests between numerous parties is the process of securitization. Poor underwriting practices, the lender–broker reward system, and the credit ratings game all were facilitated in one way or another by the securitization process. However, we must be careful not to let the pendulum shift too far given the importance of the shadow banking system (i.e., securitization) to economic growth.

5. For example, see Gudzowski (2010).

6. More than 18 months after their conservatorship, reform of the housing GSEs remains an open question.

Second, we need to encourage greater consumer financial literacy programs. Enhanced disclosure always has been the primary focus of consumer protection mortgage regulation. For example, the Truth in Lending Act (1968), the Real Estate Settlement Procedure Act (1974), and the Home Ownership and Equity Protection Act (1994) focus primarily on uniform disclosures regarding the costs of home loans. These rules often are evaded easily, and their impact on consumers is limited at best. As Nguyen and Pontell (2010) note, the Mortgage Reform and Anti-Predatory Lending Act as proposed mandates placing new restrictions on lending is a step in the right direction. However, legislation will not eradicate the inherent conflict problem. To eradicate the potential for fraud more fully, we need to treat the source of the problem by better educating consumers on the lending and mortgage process.

Finally, policy makers need to evaluate the ongoing role of government in housing finance fully. The credit guarantees on mortgages provided by both the housing GSEs and, more recently, the FHA proved fertile ground for mortgage fraud. Some recent proposals to change the private-label securitization market also should be considered in the government market. However, whatever the proposed changes to reduce mortgage fraud, one also must consider the unintended consequences of reducing credit availability to otherwise credit-worthy borrowers.

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EDITORIAL CONCLUSION

Forestalling the next epidemic of white-collar crime

Linking policy to theory

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Crime-as-choice theory is useful not only for organizing thinking about the causes of white-collar crime epidemics, but also for drawing attention to potentially promising ways of reducing the odds of recurrence. Three target areas for policy initiatives stand out: (1) reducing the supply of lure, (2) increasing prevailing estimates of the credibility of external oversight, and (3) increasing the use of effective systems of internal oversight and self-restraint. Effective policies aimed at one or more of these promise to reduce both the supply of white-collar criminal opportunities and the size of the pool of individuals and organizations tempted, if not predisposed, to exploit them.

There is currently a remarkably optimistic consensus in some academic quarters about how to reduce the harm caused by privileged predators. The heart of it lies in the presumed promise of pluralistic, cooperative approaches, and responsive regulation. These assumptions highlight the need for enhanced prevention, more diverse and more effective internal oversight and self-monitoring, and more efficient and effective external oversight. They have gained use throughout a variety of regulatory realms, many since their earliest, albeit embryonic, formulation nearly three decades ago (Braithwaite, 1982). Despite variation on specific points, taken together the policy essays reflect this, now textbook, treatment of white-collar crime control. They make sense theoretically, and we endorse them. We do so not because they have a record of demonstrable success but principally because sole or excessive reliance on state oversight and threat of criminal prosecution is difficult, costly, and uncertain. Still, we are mindful, as others should be, that the onset of the Great Recession occurred during and despite the tight embrace

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of self-regulation, pluralistic oversight, and notions of self-regulating markets by policy makers and many academicians.

Lure Reduction

Reducing the supply of lure is a formidable challenge. An increasing supply inevitably accompanies the complexity of modern life (Shover and Hochstetler, 2006). When coupled with weak oversight, almost every new commodity and government program presents opportunities for criminal exploitation and attracts attention from potential malefactors. Absent credible oversight, every new tax becomes an opportunity for evasion. Every new program of public expenditure is a potential lure for those who would appropriate from it unlawfully. This is no less true of policies implemented with the best of intentions; programs designed to extend opportunities for home ownership to those previously excluded from the residential housing market helped create the subprime mortgage debacle (Collins and Nigro, 2010, this issue). The challenge is to enable use of lure for legitimate purposes, while reducing its potential for use as an instrument or target for crime.

Reducing lure, without stifling individual initiative and precluding legitimate opportunities, is complicated. Command economies and socialist systems have tried, but with notable lack of success. These systems, moreover, tend to create substantial black markets and official corruption. Whether the sumptuous levels of executive compensation that prevail in the United States can be significantly reduced, is questionable. So too are the consequences of such policies for individual initiative. If implemented, the effects of such restraint would not see bankers deserting their profession in favor of academic careers.

Some lure can be reduced by technology. Thanks to technological innovation, many of the hazards that regulation exists to mitigate have been significantly reduced, if not eliminated. Some traditional products and practices, alluring but harmful, are no longer attractive. Innovations in paint technology and the development of lead-free petrol have significantly reduced the prevalence of environmental lead. “Greener” products that require fewer raw materials and energy to produce, and which generate less waste, have contributed to a cleaner planet (van Erp and Huisman, 2010, this issue). The appeal of midnight dumping is thereby significantly reduced. Satellite imaging can now facilitate more efficient agricultural practice, including water use and the application of agricultural chemicals and fertilizers. Irresponsible or illegal use of these is no longer seen as tempting.

The lure represented by dependent and vulnerable populations has increased in size and importance in the decades since World War II (Shover and Hochstetler, 2006). They include a sizable group of the greedy and gullible. Reducing the supply and vulnerability of these potential victims is challenging, but steps taken in the United States to curb criminal telemarketers suggests it is worthy of attention. Enhancing financial literacy among the general public is a good idea, but gullibility may be deeply engrained in the human behavioral repertoire. It supports a massive global gambling industry. Ponzi schemes likely will remain with us for a while.

Increasing the Credibility of External Oversight

Vigilant and determined oversight can provide some protection against the worst excesses of capitalism. Most observers believe that weak oversight was the principal cause of the Great Recession, and this view is represented by the authors in this issue (e.g., Black, Reichman). Certainly, any dissenters have been conspicuously silent. Prudential regulation in Australia, Japan, and Finland shielded those economies from the dislocation experienced in parts of Europe. Enhancing credible oversight might be more achievable than lure reduction as a means of reducing the rate of white-collar crime. A number of institutions—public, private, and non-profit—are in a position to exercise surveillance over financial and other commercial activities. When non-governmental energies can be harnessed in furtherance of public policy, or to the extent that they can operate spontaneously with beneficial effect, this can complement oversight by an overburdened state.

The credibility of external oversight is important not only for would-be offenders, but also for the general public. Belief in the fairness, effectiveness, and equity of a regulatory system is essential to the very legitimacy of a state. Leona Helmsley once stated "We don't pay taxes. Only the little people pay taxes." To the extent that citizens believe that tax is optional for the rich, the tax system, and the state as a whole, can fall into disrepute (Levi, 2010, this issue). The weakening of the Greek state as a result of ineffective tax administration became starkly apparent in April 2010.

We live in a world in which symbols matter. In terms of conventional crime, reassuring statistics are less reassuring than visible "blue shirts." The response to sex offenders (especially those who offend against children) in English-speaking democracies tends to be vengeful and unforgiving. The enactment of draconian legislation in the face of public anxiety is a time-honored political strategy, and the imposition of savage sentences serves a similar function. The 150-year sentence imposed on Bernard Madoff might not have restored the financial well-being of his victims, but some of them, and many members of the public, felt better (Pontell and Geis, 2010, this issue). The deterrent value of this and similar sentences may be nil, however, and the certainty of detection and response from overseers probably has a more significant effect (Leighton, 2010, this issue).

Even a relatively equitable regulatory system can be discredited easily when it is seen to be administered heavy-handedly. When authorities treat those subject to oversight with respect and fairness, the latter may be more inclined to meet their obligations. But a persistent posture of arrogance can be off-putting and can give rise to an "organized culture of resistance" (Bardach and Kagan, 1982). This could find expression in individual, and statistically rare, extreme response. In February 2010, an aggrieved taxpayer flew a light aircraft into a building housing an office of the U.S. Internal Revenue Service in Austin, Texas (Leighton, 2010). V. Braithwaite (2010, this issue) observes the importance of discriminating between degrees of non-compliance and the necessity of mobilizing response commensurate with the degree of transgression. Probably the overwhelming majority of oversight personnel do so in any case;

it is a characteristically moral and organizational response to managing a volume of work that invariably exceeds resources.

Globalization, as reflected in the rapid movement across national borders of finance, commodities, labor, ideas, and viruses (digital and microbial), poses significant regulatory challenges, as it both creates lure and inhibits development of credible oversight. The "race to the bottom" to find deregulatory havens in developing countries has become a familiar theme. Shipping electronic waste to the third world may rid a wealthy nation of a disposal problem, but in other cases, analogous practices may return to haunt one. Carbon emissions generated in a poor country contribute to climate change for everyone. The global financial system might not be totally integrated, but it is sufficiently tightly coupled that a problem in one nation could reverberate elsewhere. Global financial markets suffered in 2008 in the aftermath of the subprime mortgage crisis in the United States. Greek financial woes were felt not only throughout Europe but also across the Atlantic. Institutions of external oversight must be global, as well as local, in scope.

Confidence in the integrity of markets is essential to the stability and growth of financial systems. If too many citizens believe that their money would be safer if kept hidden under a mattress at home than if deposited in a bank or invested in the stock market, the entire economy suffers. Only the most nonchalant of laissez-faire economists would favor a return to the law of the jungle. Most of the rest of us would concur that a degree of criminal enforcement is an essential component of a regulatory system. What is contested is the *context* in which the hard edge of the state is required, and the degree of severity that is appropriate.

Increasing Effective Internal Oversight and Self-Restraint

It will be extremely difficult to engineer cultural change to bring about greater self-restraint (Nguyen and Pontell, 2010, this issue). Corporate executives often bring a sense of entitlement to the job (Friedrichs, 2010, this issue), and for some people, enough is never enough. The marginal satisfaction to a high flying banker of an additional 2% in bonus on top of $20 million might strike us mere mortals as insignificant, but any baseball player would rather bat .357 than .350. Moreover, incentives matter to most people, and for better or worse, money is a measure of performance. In addition, shareholders generally are happy to acquiesce in lavish rewards to chief executives who are successful. And when times are difficult, it is always tempting to cut corners.

More difficult to measure than personal wealth, but a value that is more important to many, is personal integrity. Despite the old adage that "nice guys finish last," captains of industry often go to great lengths to promote an image of respectability. Philanthropic largesse is one means of cultivating such an image, but ironically, visible largesse tends to vary with personal wealth. Then of course there is the cynical use of philanthropy for insurance against regulatory or law-enforcement authorities. Prominent white-collar offenders often flaunt their generosity, before or after their transgressions. Like Bernie Madoff, some use philanthropy as a means of winning the trust of those who later become victims.

Crime and unethical conduct by corporate personnel typically take place out of public view, behind the respectable facade of their employer, and it can be nearly impossible for outsiders to penetrate this organizational veil. This is one reason why whistleblowers and informants rank among the most important sources of information about corporate crime, illegalities, and unethical conduct (Association of Certified Fraud Examiners, 2010). *Whistleblowers* are employees of legitimate organizations who divulge to outsiders knowledge or suspicions of wrongdoing in the workplace. Recognizing their importance as a source of oversight, van de Bunt (2010, this issue) makes encouragement of whistleblowing a center piece of his proposals for reducing corporate white-collar crime. In the United States, several states and the federal government have enacted legislation providing employment protection and monetary rewards for them. This is meant to spur insiders with knowledge of wrongdoing to come forward and report to authorities and to do so without fear of reprisals.

Beyond Self-Regulation and Pluralistic Oversight

The absence thus far in most industries and business firms of clear or persuasive evidence of the effectiveness of self-regulation and cooperative approaches to oversight increases the importance of exploring additional policy options grounded in criminological theory (Laufer, 2010, this issue). The dominant paradigm of responsive regulation does not preclude innovation and indeed invites continuing reform. Recent history has seen some isolated innovation in regulatory reform, some of which might be replicable. In the aftermath of a bribery scandal that resulted in marketing of tainted products, the former head of the China State Food and Drug Administration, Zheng Xiaoyu, was executed in 2007. Nothing comparable has occurred in any other Western nation.

Perhaps more feasible is public shaming. One recalls that as their companies were failing, chief executives of three major U.S. automobile manufacturers flew to Washington in their corporate jets to ask for federal bailout funds. Although shameless behavior such as this leads one to despair about the prospect of good corporate citizenship, forceful chastisement is still appropriate. The reception that the auto executives received on Capitol Hill was less than warmly welcoming, and their ridicule by the press was entirely fitting. Leighton (2010) suggests that the U.S. Internal Revenue Service publish the names of delinquent taxpayers. There will always be white-collar offenders who are irredeemably shameless, but those captains of industry who depend on a modicum of political and social support for the continued viability of their business ignore public opinion at their peril. And nearly everybody values respect. The potential utility of ridicule as a means of mobilizing public indignation is, in our view, worthy of further attention. We say this despite the fact that refusal to acknowledge the criminality of their conduct is one of the sharpest distinguishing characteristics of white-collar criminals, one reported in studies using a variety of research methodologies (Benson, 1985; Shover and Hunter, 2010).

Outright prohibition of designated products and practices should remain an available option. In other areas of criminology, behaviors that appear at first blush benign, might be prohibited because of their potential for misuse. In Australia, ordinary citizens are effectively prohibited from possessing semi-automatic firearms or oleoresin capsicum spray. One commits a crime by producing data with the intention that it be used in committing a serious computer offense (by creating worms and viruses). Whether certain types of financial instruments could be similarly prohibited is an interesting question. In the United States, Congress currently is debating a potential ban on derivatives trading.

Although there might be no “magic bullet” in the offing, one could take some comfort in the potential for technological developments to enhance regulatory capacity, especially the capacity for credible guardianship and oversight (Gibbs, McGarrell, and Axelrod, 2010, this issue). As with computing, the decreasing cost and increasing accessibility of technology make such enhanced guardianship increasingly feasible. Satellite imaging can detect unauthorized land clearing and water storage on individual farms. Digital technology can identify the origin of every pork product produced in the Netherlands, down to the farm where the animal was raised. Automated surveillance methods can identify anomalous patterns of trading on stock markets. The pace of technological change is great and growing. It is safe to assume that applications unforeseen today will increase the capacity of regulatory oversight in years to come.

Ayres and Braithwaite (1992) observed that public interest groups play a central role in some regulatory domains, a role that could easily be enhanced and expanded. They noted that many countries around the world have elected worker safety representatives that complement state inspections. Long before the widespread take-up of digital technology, it was recognized that ordinary citizens are in a position to play a significant role in the regulatory process. In the United States, the Better Business Bureaus (BBBs) grew out of the truth-in-advertising movement in the early 20th century (Pannell, 2002). Comprised of local businesspeople, BBBs scrutinized advertising for deceptive content, gathered evidence, and presented it to local authorities for prosecution.

Consumer boycotts exemplify mass participation in furtherance of oversight reform. Such participation can result in the creation of new regulatory prohibitions in the face of recognized harm, or additional external oversight that complements an existing regulatory regime. Harsh labor practices experienced by California agricultural workers gave rise in the early 1970s to boycotts of lettuce and table grapes. Some amelioration of working conditions followed. The rise of the environmental movement has seen a flowering of grassroots activism, on land and sea. In recent years, the environmental NGO Greenpeace has sent vessels to the Southern Ocean to monitor Japanese whaling. Images of whales being harpooned attract little sympathy for the whaling industry or for the nations that host it.

Private regulatory activity can be autonomous or guided by the state. In the United States, the Surface Mining Control and Regulation Act 1977 permitted citizens to request an inspection by federal regulatory authorities. In the 1980s, consumer protection authorities in at least one Australian state mobilized volunteers from the consumer movement to keep an eye out for potentially hazardous products on the market. The state can even delegate regulatory power to private interests. In Australia and the United Kingdom, Royal Societies for the Prevention of Cruelty to Animals investigate and prosecute cases of animal cruelty. A former Australian police commissioner once publicly mused that fraud investigation might similarly be undertaken by the private sector.

Technology could enhance not only the capacity of state oversight, but also the power of private parties. We are now well into the information revolution, and the enormous potential for digital technology to enhance the regulatory capacity of ordinary citizens is becoming apparent. More than ever before, private individuals and institutions are in a position to engage in the co-production of regulatory services. Torgler (2010, this issue) notes the importance of the media in the regulatory process. In years past it was said that freedom of the press belonged to the person who owned one. Today, thanks to digital technology, individuals around the world can communicate instantaneously, to millions of people, and at negligible cost. Mobile phones can serve as cameras, video recorders, or listening devices and can capture activities that errant companies or government agents would rather not share. The notorious images of prisoner abuse at Abu Ghraib were broadcast around the world in 2006. Investigative reporting is by no means the monopoly of journalists employed by great metropolitan newspapers. Indeed, the economics of the newspaper industry have begun to militate against serious (i.e., expensive) journalism. Instead, individual bloggers and other digital news entrepreneurs have begun to develop an increasing profile (e.g., see slate.com/, wikileaks.org/, and propublica.org/). A ProPublica reporter was awarded a 2010 Pulitzer Prize for Investigative Reporting.

As envisaged by Ayres and Braithwaite (1992), citizens can exercise vigilance over the performance of regulatory agencies, or over the behavior of corporate actors directly. In the West, we already have seen online encouragement of consumer boycotts (boycottnestle.blogspot.com/) and Web sites that monitor particular industries (info.babymilkaction.org/) or companies (untied.com/). The even greater potential of social networking sites, blogs, and related media can be glimpsed in contemporary China. Despite the censorship of Facebook, Twitter, and YouTube by Chinese authorities, alternative media may be seen to flourish in the form of such sites as like QQ Zone, Tianya.cn, and Kaixin001.com (Barboza, 2010). The potential investigative capacity of such media is formidable, although thus far it has been mobilized primarily against low-level corruption and other gross anti-social behavior. The private diary of a mid-level party official in south China was posted on-line, and, unfortunately for him, it contained details of sexual indiscretions and bribes accepted. He was cashiered as a result. In another case, a video clip of unknown provenance depicting a woman killing a kitten was posted on the Web. Public indignation was so great, and cooperation of participants in the network so strong, that the woman was tracked to a small town in a far northeast corner of China. Both she and the camera man were dismissed from their government jobs. In October 2007, a provincial department of forestry announced that it had identified a surviving South China Tiger. Images posted on the Web aroused the suspicions of netizens, and the provincial government later conceded that indeed they had been faked. Thirteen local officials were disciplined (Jin, 2008). If sunlight is the best disinfectant, the potential for vigilance now within the capacity of citizens looms larger and more important than ever before. The potential of technology as an instrument for mobilizing mass indignation against corporate crime may be quite significant.

Policy Adoption and Implementation

Rothe (2010, this issue) is only partly correct that "policy suggestions are difficult to conceptualize and to implement." Development and promulgation of policy proposals is anything but difficult and the diverse policy essays in this issue attest to this. Seeing proposed policy adopted and implemented faithfully is exceedingly difficult. Conspicuously absent from many of the policy essays included here is discussion of how the proposed policies might be put in place and obstacles to implementation. Snider (2010, this issue) is one of the few authors who highlights the critical importance of power relationships in constructing and gaining passage of new rules and oversight. Regulatory space is almost always contested. Proposals for oversight reform, regardless of their intrinsic merit, invariably meet with opposition from someone, somewhere. Not all reforms are costless; those who are asked to the bear increased costs resulting from regulatory initiatives might understandably object. Routinely, proposed oversight initiatives encounter opposition grounded in ideology or political partisanship. More important perhaps, struggles for reform invariably are waged within the political and ideological confines of the political–economic context. Given this fact, fundamental and far reaching policy changes likely will not occur; only proposals for incremental tinkering will be defined as legitimate and potentially workable.

Windows of Opportunity

The strategic environment for reform is changeable, but "to everything there is a season" (Ecclesiastes 3:1–8). Much reform is born of crisis. Acute problems demand solutions. Emergent structural contradictions in the political economy can give rise to problems that cannot be papered over with cosmetic reforms. In these historically opportune circumstances, acute problems can produce mass disaffection and cause citizens to organize and to demand official action. At the very least, crisis conditions can cause a loss of legitimacy and forced acquiescence from those who normally resist oversight. The stock market crash of 1929 and the Great Depression that followed ushered in a degree of government activity that was historically unprecedented. The Federal Deposit Insurance Corporation (FDIC) and the SEC are but two of the institutions created at that time (Schlesinger, 1958). The Watergate cover-up was followed by energetic prosecutorial and legislative oversight activity in defense of public sector integrity (Katz, 1980). The S&L crisis of the 1980s gave rise to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Criminal scandals by Enron and other large corporations helped launch events that culminated in the Sarbanes-Oxley Act of 2002. This legislation mandated new standards of corporate governance and personal responsibility for corporate reporting by high-level executives. By the time this special issue of *Criminology & Public Policy* appears in print, we might know if the window of opportunity opened by the Great Recession was wide enough to allow significant reforms of financial sector oversight.

Scandals and accidents might also create circumstances favorable for reform, as noteworthy historical examples make clear. The death of 146 garment workers in the Triangle Shirtwaist Factory Fire of 1911 not only gave rise to new safety laws, but also inspired the Progressive movement, forerunner to the New Deal, in the United States (von Drehle, 2003). The disastrous Santa Barbara oil spill of 1968 was a powerful catalyst to development of the environmental movement (Molotch, 1970). In April 2010, an explosion in an underground coal mine in West Virginia killed 29 miners, and a few weeks later, a drilled but uncapped undersea well spewed perhaps millions of gallons of oil into the Gulf of Mexico. As this essay is written, the flow of oil has continued uninterrupted for more than five weeks with no end is in sight. The long-term impacts of the spill are inestimable. Mine explosions and oil spills, particularly when there is reason to believe that lax oversight contributed to their occurrence, are opportunities that do not come along everyday.

Opportunities, however, are only as good as those who would exploit them. The skillful policy entrepreneur might succeed, where the inept would fail. In addition, the relational distance between policy entrepreneurs and sources of potential resistance might be highly significant in explaining the success or failure of reform initiatives (Black, 1993). Consider Richard Nixon, conservative president of the United States. The Nixon Administration saw the creation of the Environmental Protection Agency (EPA) and the Occupational Health and Safety Administration (OSHA).

Social Movements

In the absence of acute crisis, public consciousness about a given harm and support for regulatory reform may grow slowly together with calls for remediation. In some cases this public consciousness can be boosted by a landmark publication. Among the earlier manifestations of risk identification and information was the classic novel, *The Jungle* (1906), by the author and journalist Upton Sinclair. The book led to the enactment of The Meat Inspection Act and the Pure Food and Drug Act.

A half century later, the nature writer Rachel Carson published *Silent Spring* (1962), which led not only to the strengthening of pesticide regulation in the United States, but also to the growth of the environmental movement more generally. Three years after publication of Carson's book, Ralph Nader published *Unsafe at Any Speed* (1965), a critique of automobile safety in the United States. Nader's book contributed to the enactment of the 1966 National Traffic and Motor Vehicle Safety Act, which established the National Highway Traffic Safety Administration. Reforms that emerge almost effortlessly from changing public consciousness and spontaneous calls for action are the exception. More common are reforms that owe their adoption to organized and sustained movements (Snider, 2010).

Voluntary/Private Actions

Trust is the foundation of responsive regulation. And like successful perpetrators of fraud, corporate officials are skilled at creating belief in others that they merit trust. When subjected to external scrutiny and criticism for criminal or illegal conduct, they unfailingly attribute the problems to a few "bad apples." The vast majority of officers and firms are said to be honest and honorable and can be trusted to behave in a socially responsible fashion. Likewise they can be trusted to implement effective internal controls, to detect and respond to rule breaking, and to report the incidents to state agencies.

For corporate officials, however, trust is treated not as something which continually must be earned in day to day actions but instead as an entitlement. There are countless actions they could take to demonstrate that trust is merited. One is changes in policies of corporate governance. *Corporate governance* refers to a variegated mix of structural and procedural changes put in place by business firms to reduce the likelihood of financial loss to shareholders or investors caused by distracted, incompetent, or overly self-interested managers. Exemplary initiatives include change in the composition of boards of directors, revamped compensation schemes for managers, and more robust internal monitoring systems (Denis and McConnell, 2003). But the importance of compliance with externally required standards of conduct and performance is almost entirely absent from corporate governance codes; the emphasis instead is limited almost entirely to the importance of honesty in internal dealings. Revisions to code of ethics and internal governance documents that emphasize the obligation to obey the law would send a clear signal to those skeptical of the integrity of respectability of corporate actors. They also might promote self-restraint.

Another way of demonstrating that corporate actors can be trusted to behave responsibly is by spending funds for research on serious non-compliance and crime. Historically, empirical research into these matters has been funded almost entirely by state and other non-corporate sources. Research supported by corporate interests by contrast has focused narrowly on economic misconduct that victimizes business firms (Bussmann and Werle, 2006). If trust and compliance with oversight are priority concerns, business could demonstrate this by committing resources to support research into illegal actions that harm outsiders and the general public. The costs to victims of their experience at the hands of corporate criminals is a topic pregnant with potential symbolic messages of trust and responsibility. Research into a wider and less self-centered range of topics would send a powerful signal of commitment and might lead to more effective internal oversight and self-restraint. Trust in corporate officials could be enhanced also by reforming their approach to and treatment of whistleblowers.

Far from the venues in which celebration of self-regulation takes place, corporations engage relentlessly in attacks on countless aspects of oversight of their activities. In legislatures, regulatory fora and appellate courts, they work to expand their self-interested notions of fair and reasonable oversight (Michaels and Monforton, 2005). As they support efforts to weaken the capacity of regulatory agencies to monitor and sanction their misconduct, for example, they press for relief from civil suits on grounds that they have received certificates of compliance from regulators (Harris and Berenson, 2008). These efforts do little to promote and much to undermine trust. The results of a mail survey of compliance with requirements of trade practices legislation by 999 large Australian businesses showed "that implementation is overwhelmingly partial and possibly symbolic. Most businesses have implemented some, but far from all, of the compliance system elements considered by the [government], practitioners and scholars to be necessary for effective compliance management" (Parker and Nielsen, 2006: 482). It is noteworthy that corporate actors apparently have made little effort to fund studies of the implementation and efficacy of "trust-and-hope" oversight. It is difficult to credit their good will when they seem disinclined to commit resources to identifying best practices of internal oversight. The electronics industry Citizenship Coalition noted by van Erp and Huisman (2010) might be an exception.

Discussions of how to devise and gain adoption of policies that limit lure, reduce the ranks of those who are predisposed or tempted to exploit it, and increase the credibility of oversight can be overly technocratic in focus and neglect larger constraints and obstacles. The dominant political economy, its structural integrity, operating premises, and power relationships severely constrain consideration and adoption of policy options. Prominent among these constraints is the perceived need to avoid any actions that would jeopardize business confidence and the stability of the markets. They can cause advocates to lose sight of the fact that the fight against corporate crime is linked inextricably to the fight for social justice. It is a fight in which wealth, access to policy makers, and other resources generally are determinative. But populist social movements can make a difference. Crises, scandals, and accidents will continue to occur, giving rise to episodic disaffection and attempts at reform. The odds of success will be affected significantly by political–economic conditions. Reform is harder to resist and more likely to succeed during economic boom times when profits are up. Future attempts to limit the harm caused by white-collar crime likely will mirror the past, and whether or not the Great Recession will inspire organized and unrelenting demands for change in the practice of governments and the choices made by industry remains to be seen. The contributors to this special issue have shown what form these might take.

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