CAPITALISM'S ACHILLES HEEL

Dirty Money and How to Renew the Free-Market System

RAYMOND W. BAKER

John Wiley & Sons, Inc.

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"*Capitalism's Achilles Heel* is an incredibly thought-provoking book, written for the business executive, the economist, the philosopher, the politician, and the human rights activist, all in one. Author Raymond Baker clearly articulates the superiority of the capitalist system to raise standards of living and reduce global poverty. However, as he so aptly describes in very thorough research, it is not the criminal element that hurts the world's poor as much as it is the intelligent and the well-off in the myriad ways we find to take advantage of weak and often corrupt countries. Our ability to be notionally legal but ethically and morally bankrupt is destroying capitalism, and *Capitalism's Achilles Heel* provides concrete advice on how to turn the tide, starting with those in leadership in both business and government."

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—Thomas Pogge, Department of Philosophy, Columbia University

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—Jack Blum, Partner, Lobel, Novins & Lamont

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To
Deren and Amy, Gayle and Jim,
their friends,
and their generation.

The best reason for optimism.

CONTENTS

Prologue 1

CHAPTER 1 Global Capitalism: Savior or Predator? 11

PART I Illegality: We Like the Money 21

CHAPTER 2 Playing the Game 23
- The Dirty-Money User Manual 24
- You're in Business 47

CHAPTER 3 Dirty Money at Work 48
- The Corruption Industry 49
- The Criminal Component: Drugs, Thugs, and Terrorists 88
- Global Commerce and Tax Evasion: Coin of the Realm 133

CHAPTER 4 Magnitudes and Misunderstandings 162
- How Much Money? 162
- A Failure Rate of 99.9 Percent 173
- Well-Intentioned Efforts 174
- The Patriot Act 177
- Dirty Money Is on the Rise 182
- Chasing Terrorists' Money 183
- Ill-Intentioned Loopholes 186
- Haven and Secrecy Structure 191
- Falsified Pricing Structure 194
- We Like the Money 201
- Challenge 205

PART II Inequality: The Gap Matters 207

CHAPTER 5 The Global Divide 210
The Quintile Canyon 210
Measure for Measure 217
It's an Uncertain World 224
The Monkey Wrench 234

CHAPTER 6 "I Don't Understand" and "Don't Tell Anyone" 240
Myths 241
"Don't Tell Anyone" 246
Corruption—At Long Last! 249
Filling Western Coffers: Mum's the Word 252
Debtor's Prison 254
What If? 257
Intellectual Gap or Character Gap? 258

CHAPTER 7 It's the 70 to 90 Percent that Matters 262
It Can't Last 262
Convergence? 267
The Gap Matters 272
Challenge 275

PART III Disutility: Bentham KOs Smith 279

CHAPTER 8 The Anguish of Adam Smith 282
Theory of Moral Sentiments 283
Wealth of Nations 286
Invisible Hand 290
Das Adam Smith Problem 293
The Tears of Adam Smith 297

CHAPTER 9 The Joys of Jeremy Bentham 300
Jurisprudence 301
Utilitarianism 302
Related Interests 305
John Stuart Mill 307
Problems 309

CHAPTER 10 Philosophy Becomes Culture 312
The Great Infusion 313
Twentieth-Century Utility 319
Twentieth-Century Utilitarianism 321
Inoperable Doctrine, Deadly Practice 323
Disutility 327
Challenge 330

PART IV Run It Right: Trust the System 333

CHAPTER 11 Capitalism's Achilles Heel 337

CHAPTER 12 Spreading Prosperity 342
Delegitimizing Dirty Money 342
Tougher on Corruption 346
Reining in the Support Structure 346
Mispricing and Transfer Pricing 348
Capitalism's Contribution to Slashing Inequality 351
". . . When You Pay Me What You Owe Me" 353
Reconstitute the World Bank 360
Justice First 361

CHAPTER 13 Renewing Capitalism 368

Acknowledgments 377

Notes 383

Index 425

PROLOGUE

THE GREATEST economic arrangement ever devised needs an overhaul. *Capitalism's Achilles Heel* invites you to join in this process, join in a journey that winds its way across the global free-market system. It begins with little illicit transactions and leads on through massive illegalities used by criminals, terrorists, and multinational corporations. It proceeds into global income inequalities, worsened by the illegalities that have come to permeate international capitalism. It continues into philosophical underpinnings that appear to justify flaws in the system. And finally it concludes with what we need to do to renew capitalism and spread its enormous potential across the whole of humanity.

Before we begin this journey, let me set the stage by telling you how I began my journey. For the first 15 years of my international career I lived in Africa. What took me there in the first place? After finishing Harvard Business School and while teaching the upperclass course in management at the University of New Hampshire, I decided to get a taste of business overseas. Job applications went out to some 200 companies, and offers came back to go to Iran, Nigeria, and Brazil. I chose Nigeria because it was a newly independent country and the job had an immediate start date. In 1961, the first year of the Kennedy administration, Africa was "the new frontier," beckoning businesspeople, Peace Corps volunteers, journalists, diplomats, and adventurers to postcolonial nations brimming with opportunity and excitement. It was a heady time to be going abroad.

Before taking up my position in Lagos, I was assigned as a representative

to a U.S. trade fair in Accra, Ghana. This brought me into contact with the Rockefeller Brothers Fund (RBF) and its local agent, Bob Fleming, a burly, articulate American who had lived in West Africa for several years. Bob was a former military police officer in the U.S. Army, and the story was that he had served as James Jones's model for the tough M.P. in the book *From Here to Eternity*, a character played by Ernest Borgnine in the movie. Bob was closing RBF's office in Accra and moving it to Lagos and wanted to get his Land Rover into Nigeria. Customs duty would have to be paid on the import of the used vehicle, about £300, a little less than $1,000. I and two other Americans, Bill Pribbeno, a wheat farmer from Nebraska, and Lyman McKee, a dairy farmer from Minnesota, offered to drive the Land Rover to Lagos and pay the duty, provided we could take the route we wanted, encompassing a large swath of West Africa. Bob wisely inserted his personal driver Steven into our group, in part because he spoke a bit of most of the languages we would encounter along the way.

We set off on our 10-day escapade on December 22, 1961, driving north out of Accra to Kumasi, the heart of the Ashanti region. Among the attractions of the city was the Kumasi Zoo, containing an impressive collection of West African wildlife. Walking through, we passed the cage of a gnarled old chimpanzee. As my traveling companions moved on, I lingered alone in front of this fellow's enclosure.

It reminded me of an incident out of my childhood, visiting an alligator farm. There, the tour guide related how caretakers would bring chicken, beef, rabbit, whatever, to the rail and grunt, "Uuuhhh, Uuuhhh." Knowing this was the signal for feeding time, the alligators would open their gaping maws and the bearers of rations would throw in the meat. While my parents went ahead I stayed behind and, with my most mature voice, looked at this big 18-footer and called out, "Uuuhhh, Uuuhhh." The gator opened its mouth, and, having prepared for my little bit of mischief, I threw a clod of dirt into its waiting jaws. Not altogether trusting the rail fence, I paused just long enough to see this monster sputter and thrash before tearing off to reach the safety of my family.

How would such utterances work on this primate now glaring at me through the cage bars? My voice had deepened, so no doubt my credibility would be enhanced. Facing each other in a one-on-one I bellowed the magic words, "Uuuhhh, Uuuhhh."

This was not a dumb ape. He put his paw behind his rear, discharged the contents of his bowels into his palm, and hurled the full load through the bars of the cage at his protagonist. No time to duck. SPLAT! My face, shirt, pants, and shoes are all hit with this brown, warm, icky, smelly mass.

Now, pause for a moment, taking in the whole scene. He's sitting there in his cage, I'm standing out here with you-know-what all over me, and I could swear to God this furry half-wit is laughing out loud.

Slinking off to rejoin my friends I get hit again with simultaneous queries, "WHAT HAPPENED TO YOU?"

"Don't ask."

We motored on north in our open-top Land Rover, through Tamale and Navarongo and crossed into Upper Volta, since renamed Burkina Faso, meaning "land of the upright men." Here in the Sahel, the base of the Sahara, the terrain, sprinkled with baobab trees, quickly turned more arid and much less populated, and our paved road gave way to a dirt track.

Needing a place to spend our third night out, we passed small villages of round mud huts often decorated with painted walls, sensing that we might frighten the occupants if we veered into their comfort zone, and suddenly lurched to a halt. Having driven some 50 miles from the border with our eyes peeled and as it was now past nightfall, we finally decided to chance it and stop at the next compound, go to the largest dwelling, and ask if we could spend the night sleeping in our Land Rover parked in front. Another five miles and something wondrous happened. We saw an electric light shining in the distance, out in the middle of nowhere. We worked our way in that direction, more lights, and we came upon a single-story, white bungalow with a tall, wrought iron fence around it. Pulling up to the front, we called out to announce our presence, and soon a uniformed steward came to the gate. Explaining that we were weary travelers, we asked if we could spend the night sleeping on the ground inside the fence. He disappeared for a moment and then returned to usher us into quite posh guest quarters at one side of the enclosed area—bedrooms, mosquito nets, toilets, showers, the works.

A bit later the steward appeared again and invited us to dinner, which we gladly accepted, still not having any idea what we'd stumbled onto. A table was set outside under the stars—white cloth, china, silverware, glasses. We washed up and put on decent clothes and appeared as instructed at 9:00 P.M.

In a few minutes out from the main house walks an absolutely beautiful blonde woman. We're wondering, is this a mirage or what? And a few minutes later out walks a second absolutely beautiful blonde woman. We sit down to a meal of soup, gazelle steak, potatoes, vegetables, and wine. After taking the measure of us, the ladies open up. The first relates that she is Parisian, married to an Italian contractor who owns a construction company in Ouagadougou, the capital. The second is her younger sister visiting from Paris. This is a weekend getaway house for the married couple, as the husband particularly likes to hunt lions. We feasted and drank until midnight, having chanced upon, according to our hosts, the one Shangri-La in 10,000 square miles.

The next day we bounced into Ouagadougou and traversed all 400 yards of paved roads of this premier metropolis of a new nation. No apparent hotels, so we asked a Catholic priest if we could sleep on the bench pews of his church; of course, he agreed.

A couple of days later we're in the middle of Upper Volta proceeding east on another corrugated track that jolted us up and down like rubber balls. I was sitting in the open rear on straw mats we brought as bedding, when I reached back to check my wallet and found it missing—driver's license, money, everything. Coming to a halt, we agreed to drive slowly back, stand up looking over the front and search for it, hopefully visible somewhere in the center of the road. This was a deserted stretch, so we might get lucky. We backtracked for about 30 miles, to no avail. In this distance, we passed only one person walking along the side of the road carrying a large straw basket on his head, covered with a cloth to protect its contents. As we dispiritedly turned again in our original direction, we decided to stop and ask if he had found anything in the road, a leather purse with papers and money. He took the basket off his head, untied the cloth, and handed me the wallet, with contents intact.

Coming into Niger Republic, we missed the last ferry across the Niger River and spent the night on our mats looking at the small city of Niamey, the capital, on the other side. After a day in this pleasant former French outpost, we motored on east.

December is the height of the harmattan season in West Africa, when dust storms in the Sahara blow fine-grained silica across all the Sahelian and coastal countries and even as far west as Brazil and the Caribbean. I was badly congested with lungs full of sand, so we decided to stop at a Sudan

Interior Mission (SIM) hospital, about midway between Niamey and Katsina, which is just inside the northern border of Nigeria. SIM had been active in Africa since the 1890s. The very accommodating Canadian doctor allowed us to sleep on the floor of his living room. The next day he gave me some antibiotics and then took us on a tour of his facility. He and two nurses treated an average of 400 patients a day. Based on word-of-mouth, Tuaregs, Mossis, Dioulas, Hausas, and others would walk hundreds of miles across the Sahel to reach this hospital, sometimes passing nearer clinics along the way. We watched as the doctor and his staff set broken bones and treated burns and cuts. He took us to the bedside of a case of smallpox, a four-year-old boy totally covered in pustules, with no more than two or three days of life remaining. And he took us to a lepers' colony that the hospital operated nearby, housing spouses and children as well as the stricken in order to keep families together, rather than cloistering away infected adults and leaving other family members at what might be even greater risk of malnutrition, starvation, and death. We all came away with a very large measure of respect for the work done by this fine organization, now merged into a larger group.

Late that afternoon, we're tooling along in southern Niger when we pass a line of white folks walking along the side of the road. Americans are recognizable almost anywhere, and these certainly were. We stopped and asked where we could get a hamburger and a milkshake, cheerfully bemoaning with these Peace Corps volunteers the lack of stateside amenities. One chap in his early twenties introduced himself as John Demos. I asked, "Any kin to Rafael Demos?"

He answered, "He's my father."

I had studied twentieth-century philosophical movements under Professor Demos at Harvard that preceding summer. Not only was he a stimulating teacher, he also had provided the classroom where I met Pauline, my wife-to-be. His son is now Samuel Knight Professor of American History at Yale.

Crossing into Nigeria, we drove on to Kano, a teeming city founded a thousand years earlier, with remnants of medieval mud walls still visible. More than a half-million tons of groundnuts (peanuts) in bags were being stacked in enormous manmade pyramids, awaiting rail shipment and export. Dyers working at scores of large communal vats produced indigo cloth for sale throughout West Africa. With paved roads once again, we motored

on through Kaduna and Ibadan to Lagos, completing 2,600 miles in 10 days, arriving at our destination on December 31.

Today, you would be taking your life in your hands if you made such a trip in much of West Africa. Bandits, carjackers, roaming thugs, corrupt officials, truck drivers stoned on hemp, AIDS, hospitals without medicines, dashed hopes, duplicity, and deprivation have combined to make many parts of the area inhospitable and unforgiving to strangers. The promises of political independence and economic development remain unrealized for millions of people. The onus for this outcome rests with both local elites and helpful foreigners, those who plundered and pillaged and those who abetted the process. The gap between early potential and later reality, not only for Africa but for scores of countries across the world, has stirred my imagination for years.

Settling down to work in 1962, I soon found myself managing the oldest bakery in the country, delivering bread daily to 200 market women spread around Lagos, at that time the nation's capital. By 1963, I decided to strike out on my own, so I incorporated a company in New York and returned to Africa's largest city to establish an office in Investment House. Pauline and I were married in New York some months later. For the next 13 years, from my ninth floor perch on the upscale side of Broad Street, I looked over the oldest part of Lagos, Isale Eko, two miles long by a half-mile wide (one square mile) with more than 200,000 people, making it one of the more densely packed places on Earth. I came to know the area extremely well and was often asked to take visiting foreigners on tours, particularly through Jankara Market, where thousands of traders sold food, utensils, native medicines, textiles, hardware, and just about everything else imaginable.

As the Nigerian Civil War—the Biafran conflict—began to draw to a close in 1969, Pauline and I decided to reward ourselves for endless business and personal risks we had been taking. We made arrangements to move into a spacious house beautifully situated on Five Cowrie Creek (so named because in years past it cost five cowrie shells, the currency of the time, to take a canoe across) in the Ikoyi residential section of the city. Before relocating our abode and while attending a late-night party at the home of the Bank of America manager, a Biafran plane bombed Lagos and then was shot down, plummeting in pieces into the creek. We grabbed up Samuel, one of two Ibo young men we'd been hiding in our attic for months for protection from tribal pogroms, changed him out of the clothes he was wearing to help at the

party, rushed him back to the safety of our home of recent years, and then tore off to see if the new place was still standing.

Arriving on the scene, we found various aircraft and human parts spread all over the premises. The cockpit was largely intact a few yards into the water, so I waded out, leaned in, and retrieved the plane's documents. At that moment a squad of armed and agitated Nigerian soldiers raced up, which required some fast explanations on our part as I appeared to be emerging from the wreckage and turning for the shore. Handing over the papers, I pointed out that the plane was a converted Nigerian Airways Fokker F-27 that had been hijacked a year earlier.

We moved into our new home a few weeks later. What made this place special was its large patio next to the edge of the creek, sheltered by shade trees and cooled by a breeze off the water. A half-mile across on the other side stood the American and Soviet embassies. Despite the occasional corpse that washed up on the shore or four-foot monitor lizard that slithered into the backyard, this was a place of quiet and repose in the midst of usual tumult. It was here that we talked, welcomed visitors, and entertained, but most importantly for me it was here that I peered across Five Cowrie Creek at those two embassies, representing opposing economic and political doctrines. They, symbolically, focused my attention on competing ideologies and their effects on people separated by enormous variations in resources and opportunities. Much of what follows in this book is from the perspective of that patio and the views it afforded, grounded in one part of the world while contemplating what happens in another very different part of the world.

By the mid-1970s, with ongoing military turmoil and rising corruption, Nigeria was becoming uncomfortable for an expatriate family with young children, so we returned to the States and settled in the Washington, D.C. area. I organized a trading company and for the next 10 years did extensive business in Central and South America, other parts of Africa, Australia and New Zealand, Southeast Asia, and with our biggest buyer, the People's Republic of China. In the late 1980s my activities shifted into offering and providing trade and financial advisory services to governments in developing nations, which enabled me to undertake confidential investigative work in a dozen countries. With this accumulation of experiences, I associated with the Brookings Institution in 1996 as a guest scholar in economic studies.

Over a period now exceeding 40 years spread across more than 60 countries, I have watched the free-market system operate illicitly and corruptly more often than anyone of my acquaintance. I have also seen the impact of such behaviors on the lives of disadvantaged people on all six inhabited continents. And I have reflected on how these conditions—widespread illegality and severe inequality—can exist within the doctrine laid out by Adam Smith precisely to avoid such outcomes. These encounters and observations encompassing lawlessness, inequality, and philosophy have opened for me an unusual window on the state of capitalism and have led to a series of conclusions substantially at odds with prevailing wisdom. The basic structure of our global economic system has fundamental flaws, and the accompanying risks are beginning to be evident to wealthy and impoverished alike. This is what I explore in this book, concluding with steps that must be taken if capitalism is to achieve its potential and lift the whole of humanity.

Several prefatory comments may be useful to the reader. First, having spent 35 years in international business before joining the think-tank world, I'm all for the free-market system—free trade, free movement of capital, free convertibility of currencies. I do, however, add a proviso to this: provided it's legal. It's the illegal component of such flows and their destructive effects and attendant rationalizations that have interested me for years.

Second, I make liberal use of the first person. Many points arise out of my own activities and research and are related as such. Also, my venture along the linkage between illegality, poverty, and philosophy has been a rather unique experience. While there is ample work by others on questions of law, the dimensions of inequality, and utilitarian and egalitarian concepts, there is little that reaches across this terrain, attempting to comprehend their combined impact.

Third, most stories and anecdotes are told and people named with well-documented notes (found at the end of the book). Some notes provide published references on points about which I, in fact, have first-hand knowledge. Quotes are attributed where possible and are given without attribution to those who asked for or were offered anonymity. At every point my goal has been to write as honest a book as possible, which I hope will become clear in the pages to follow.

Fourth, some paragraphs are disparaging of some elements in certain groups. I confess to struggling with the tension between candor and diplomacy and have decided to err on the side of clarity. Some readers may feel

that criticisms are inadequate, while others may feel they are overdrawn. I apologize to anyone who is disappointed or offended. At a minimum, the questions posed need to be carefully considered and answered.

Finally, I want to note, so it will not come as a surprise, that the tone of this work shifts as it flows through its stories and subjects. It moves from irreverence and disquiet and perhaps a familiar voice in the early pages to a more serious and at the same time hopeful spirit toward the end.

My objective in writing this book is to contribute to reform of the free-market system, not with any intent that it should be replaced. I sincerely hope that no one will come away thinking that this is an anticapitalist screed. My purpose is the opposite—to make the case for renewal of capitalism's immense capacity for good. It has long been clear to me that the best way to deal with a problem is to hold it up to the bright light of day and examine it from all sides. I arrive at this task having benefited abundantly from a process that rewards vitality and creativity, and I would hope to see similar opportunities extended to everyone. We must accomplish this in the future with a greater commitment to justice than now characterizes the way capitalism operates. Change within the system is necessary to its long-term success.

CHAPTER 1

GLOBAL CAPITALISM: SAVIOR OR PREDATOR?

Candidates for fortune too frequently abandon the paths of virtue; for unhappily, the road which leads to the one and that which leads to the other, lie sometimes in very opposite directions.[1]

—Adam Smith, 1759

Today, the system of capitalism is at a crossroads.[2]

—Joseph Stiglitz, 2002

"I'M NOT trying to make a profit!" This rocks me back on my heels. It's 1962, and I have recently taken over management of an enterprise in Nigeria. The director of John Holt Trading Company, a British-owned firm active since the 1800s, is enlightening me about how his company does business in Africa. When I ask how he prices his imported cars, building materials, and consumer goods, he adds, "Pricing's not a problem. I'm just trying to generate high turnover."

Two years in graduate school reading balance sheets and income statements leave me totally unprepared for this bit of wisdom. I haven't a clue why anyone would run a business with disdain for the bottom line. Staring at myself in the mirror every morning for the next two months, I ask, "Now why did you get an MBA?"

What could possibly be going on here? You know and I know that people will invest their money where they can earn a profit. Right? This is the fundamental precept, the foundation of capitalism. Right?

Wrong! A lot of people will invest their money in one place in order to earn a profit in a different place. John Holt was using artificially high import pricing as a mechanism for transferring all its profits out of Nige-

ria and back to Britain. It took me two or three years to realize that most foreign-owned companies were doing largely the same thing. And then it took another couple of years to learn that most wealthy Africans involved in foreign trade were illegally moving money abroad by the same means. As the decades rolled on and my activities spread to dozens of countries across the planet, I observed that countless forms of financial chicanery are prevalent in international business. Like an iceberg, the little that is visible is supported by vastly more hidden beneath the surface. Thus arose my understanding that the free-market system has a problem, which I have come to appreciate is a combination of several interrelated and undeniably serious problems.

"If a system cannot correct its major malfunctions, then it will be replaced." Pierre Defraigne, director of north-south affairs at European Commission headquarters in Brussels, was my guest at breakfast. "Capitalism can become very corrupt. Profits should be made in the marketplace through quality of goods and prices, not through illegalities." The topic was dirty money. "We think this is part of the normal functioning of the capitalist system. But it can be corrected and won't limit efficiency. It's up to those who defend the system to put their house in order."[3]

House in order? It is difficult to argue that the free-market system is currently performing at the top of its game. While this is a book about global capitalism, a brief detour into what has been transpiring domestically, that is, within western countries, is useful. In North America and Europe, the breadth of business scandals and the recklessness of officers and directors in recent years have been simply astonishing. An assortment of frauds, thefts, corrupt practices, accounting irregularities, earnings restatements, asset write-downs, tax shenanigans, conflicts of interest, and other charges, probes, malpractices, and allegations have corroded the reputations of dozens of companies and sapped the net worth of untold numbers of shareholders and retirees. The list of financial institutions tarnished in the press reads like what should otherwise be the Who's Who of propriety: Citigroup, J.P. Morgan Chase, Bank of America, Bankers Trust, Bank of New York, and some 55 more on the roster I maintain. The corporate rap sheet, ranging from spectacular failures to merely disgraced executives, includes Enron, WorldCom, Global Crossing, Halliburton, and nearly 100 more on my list. All Big 5 accounting firms have been tarred and feathered. The number of law firms taking heat is too long to recount.

Frank Partnoy, in his superb book, *Infectious Greed*, writes about how U.S. stock markets lost $7 trillion of the wealth accumulated in the 1990s, and he goes on to say:

> To any close observer of the changes in financial practices since the late 1980s, the collapse was not a surprise. New forms of risk and deceit now permeated every corner of the financial markets. Financial instruments had continued to develop in complex ways, and no one—including accountants, bankers, directors, regulators, or even plaintiffs' lawyers—was in a position to exercise even a modicum of control.[4]

For several years, the most publicized wrongdoings have captured our attention. They revealed to us just how wrong we were. We thought that these fine companies and their prestigious bankers and critical auditors and cautious attorneys were upholding the highest standards of corporate conduct, only to find out they were in cahoots to cook the books and deceive their employees, shareholders, and regulators. We felt thoroughly violated.

This is a book that also addresses violation but on a global scale. Much more disturbing than what has been happening inside our borders in recent times is the destructive manner in which we have been operating the capitalist system beyond our borders for many years. Subterfuge and dissembling have been far worse in the international arena.

The accumulated outrages of late began to embed themselves into our collective consciousness barely a decade after the twentieth century produced one of history's great turning points. The strength of capitalism became vividly clear, achieving its pivotal moment in the waning years of the last millennium. On November 9, 1989, young people wielding sledgehammers broke through the Berlin Wall, signaling the failure of the major competing ideology, socialism. The end of almost all remaining communist regimes swiftly followed, freeing Central and Eastern Europe and creating 15 independent nations out of the ashes of the Soviet Union. Even the surviving centrally planned economies—China, Vietnam, Laos, North Korea, and Cuba—were forced to recognize that private enterprise brought higher standards of living, leading each of the contrarians to begin or advance its march along the capitalist road. No alternative arrangement had demonstrated such an ability to marshal the initiatives and energies of so many people. After generations of uncertainty, capitalism had flat out won. The

most vocal free traders crowed that, despite occasional blips in emerging markets, the system was working as intended.

But the hubris was short lived. Aircraft were hijacked and crashed, the World Trade Center fell, and part of the Pentagon was destroyed on September 11, 2001, killing and injuring thousands in the world's greatest concentrations of financial and military might. As capitalism's most robust symbols toppled, a dozen years of hauteur ended for some people and were shelved by others. Terrorists had focused on the soaring self-confidence of America and by extension its allies and had, at least for a moment, set back the measure of certainty, of inevitability, that had come to characterize the western example and the tone of advice given to the rest of the planet. A realization that powerful and determined forces viewed the world in very different terms came as a rude shock to many.

Americans responded to 9/11 with incredible resilience. Yet, months later, even as deep pain and a thirst for revenge lingered, introspection began to creep into public dialogue and press commentary. Was it just religious extremism that brought on the terrorists, or were deeper frustrations, power disparities, income imbalances, and social disaffections evident in their motivations? Those who thought that democracy, capitalism, and globalization had emerged as standards after 1989 were set back when terrorists thrust a dagger into the body of the strongest nation in 2001. The anticipation that some fundamental consensus had been reached across vast stretches of humanity yielded to renewed uncertainty. As the Peruvian scholar Hernando de Soto had predicted a year earlier, "The hour of capitalism's greatest triumph is its hour of crisis."[5]

Within the critical review now hesitantly unfolding, some of the old arguments about capitalism are being revoiced. Optimists extol dazzling improvements in living comforts over the past 50 years, as incomes for the average person have more than doubled, and they are right. Pessimists lament that billions of poor are living at historically low standards or are only marginally better off than their ancient ancestors, and they are right. How can both be right? Or, more pointedly, if the first is true, why should the second also be true? The answer is, the second does not have to be, and the fact that it is true poses a danger to rich and poor alike.

Despite banking and corporate scandals in North America and Europe, practitioners generally regard capitalism as tested and proven in its ability to produce and distribute wealth. "Capitalism is the most successful wealth cre-

ating economic system that the world has ever known; no other system . . . has benefited 'the common people' as much."[6] It "encourages and rewards business behavior that is honest, fair, civil, and compassionate, and . . . heroic."[7] The misconduct of a few is seen as an aberration and certainly does not detract materially from the high level of perfection the system has achieved. "Not only are markets not too free, but they cannot possibly become too free."[8] For market fundamentalists, competitive self-regulation in economic and commercial affairs led by a wealthy vanguard is the panacea for society's ills. "Instead of an aristocracy of the merely rich, we are moving to an aristocracy of the capable *and* the rich. The financial revolution is opening the gates of the aristocratic clubs to everyone."[9] The prospect of a new aristocracy is offered as a wonderful design for the years ahead.

This book presents a different view. It penetrates the depths of crime, corruption, money laundering, tax evasion, and illegal transactions, joins these concerns to the impact they have on global inequality, relates both issues to some very basic conventions and ideas underpinning market economics, and hopefully extends perspectives on improving capitalism into new territory.

Lawlessness has permeated global commercial and financial affairs far more extensively than is commonly perceived, as explained in Part I. Writing on "the widespread incidence of fraud, corruption, organised crime and abuse of power" influencing the world economy since the 1970s, Harry Shutt, formerly with the Economist Intelligence Unit in London, laments "the progressive removal of restraints to such criminal activity and indeed increasing incentives to engage in it."[10] On the other side of Earth, a Pakistani banker groused to me, "We have lost the distinction between what is legal and what is illegal. No one hates people who get their money through illegal means. Society is not acting as a restraint."[11] The astute observer of Latin American affairs, Norman Gall, talking with me at the Fernand Braudel Institute of World Economics in São Paulo, characterized international capitalism as "perversities built upon perversities."[12] Yet, we willingly tolerate and indeed encourage a level of lawlessness in global trade and investment that threatens the capitalist system.

The linkage between gross violations of legal norms and the diminished lives of billions of people surviving on a dollar or two a day is not often discussed in polite circles, but will be here, in Part II. "If we have no answer to our appetite for dirty money, we have no answer to the alleviation of

poverty," confided a French banker.[13] But "the question of income disparities has been lost in the competition for growth rates," contended Gil-Sung Park, a sociologist sharing views with me in Seoul. "Growth and distribution; can they go together in a common debate? They must go together."[14] Peter Dougherty, an editor at Princeton University Press, ponders ". . . why no one seems to be paying any attention to the social and political dilemmas that continue to beset capitalism—such as deepening inequality in the presence of soaring affluence. These dilemmas are brought about by the very success of economics, . . . at the expense of a more expansive and critical worldly philosophy."[15] Yet, for most people, poverty and inequality are peripheral issues properly left to specialists in international financial institutions, largely irrelevant to capitalism's more fundamental concern with market access and wealth accumulation.

Both of these conditions—lawlessness and inequality—find justifications in twisted interpretations of the free-market system's founding tenets, addressed in Part III. Adam Smith, who opted for the interest of the poor rather than the rich at every intersection in his writings, is rolling over in his grave. While appreciating a rise in wealth, widespread abuses in global movements of trade and capital, combined with staggering gaps in income levels taken as inevitable and tolerable, is the opposite outcome from what he hoped would arise. "No society," he said, "can surely be flourishing and happy, of which the far greater part of the members are poor and miserable."[16] Smith's vision has been largely set aside, and instead capitalism has drawn its sustaining rationale from his contemporary, Jeremy Bentham, who despised the idea of inalienable rights and argued that it is acceptable to sacrifice the rights or the interests of some people for the good of others. This core idea—that the well-being of a part of society can be overridden for the advantage of another part of society—brutalizes our practice of capitalism in a way completely unimagined by its seminal thinkers.

These three—illegality, poverty, and distorted philosophy—exist on a continuum, and it is these combined systemic shortcomings that reveal capitalism's Achilles heel, summarized in Chapter 11 of Part IV. Looking at each one yields insights into the other two, and an understanding of all three is necessary to an understanding of each. Illegality contributes to inequality. Inequality is worsened by warped philosophy. And perverted philosophical maxims underpinning capitalism serve to excuse rank illegitimacy and severe inequality.

We give short shrift to such concerns when we consider each in isolation. Frankly, as I have learned over many years, it does little good to look at illegal financial dealings detached from the larger context within which they thrive. How many times have I heard the question, "Why should I care?" It is too easy to view such machinations simply as games played by the rich. Grasping the impact these subterfuges have on the whole of humanity has been missing in public dialogue for too long.

Equally, it does little good to look narrowly at inequality and poverty and shrug our shoulders, self-satisfied that this is their problem. For many people, meting out foreign assistance, however begrudgingly, is the limit of obligation. The contrasting fact is, our gains in income in the West flow in part from losses in income in other regions, a point I hope will become unmistakably clear in later sections of this book.

Equally again, philosophical inquiry is now largely separated from public policy. Philosophy can and often does become culture, embedded in the way we rationalize and live our lives. Today, the prevailing precepts underpinning capitalism lend a measure of comfort to justifications for a divided and hypocritical world.

The harmful aspects of modern capitalism which I am addressing—illegality, inequality, and misapplied philosophy—can be viewed as segments on a line, with illegality on one end, inequality in the middle, and economic philosophy on the opposite end. Dropping down on any part of this line leads logically to the other parts of the line. And what becomes evident with growing clarity is the connection of each to the others. This is what has fascinated me for years: the juncture, the nexus, between illegality and inequality, between inequality and philosophy, and between distorted philosophy and its outcomes in poverty and lawlessness.

It does not really matter to the story I am telling whether you start with illegality and trace it through to its effect on inequality and its sustenance in outdated philosophy. Or you do the opposite, and start with misshapen philosophical precepts and trace them through to their impact on inequality and lawlessness. Or you start in the middle with inequality and look on either side at its contributing causes. The linkages are evident wherever the starting point. What I strive to do is integrate these three into a continuum, a triptych, a multiscreen picture, that provides a perspective on the nature of global capitalism as it has come to be practiced today. Together, it is the

interrelated parts of this continuum that constitute capitalism's Achilles heel and present the threat to stability and prosperity that must be resolved.

Are the challenges of these three issues so overwhelming as to be insurmountable? Absolutely not, the subject of Chapters 12 and 13. First, illegalities that permeate our pursuit of global free markets can be greatly curtailed with a few strokes of the pen and without harming efficiency and growth. This is not a defeatingly complex issue; it is instead a matter of political will. Second, inequality can be markedly reduced to the advantage of rich and poor together. This will occur, not through the timid pursuit of poverty alleviation, but through sensible steps underlying our own commitment to shared good fortune. And third, a major contradiction needs to be confronted—the contradiction between fresh thinking emerging from schools of philosophy in America and Europe and entrenched justifications for the status quo in the free market's supporting canons. Revised canons can guide us beyond an economically disjointed planet toward one in which capitalism extends its opportunities and benefits to the whole of humankind.

Anything less than addressing all three of these concerns means that capitalism will remain far short of its full potential. This book quite purposefully takes a holistic view of global capitalism and seeks resolution of problems created or worsened by what has now become a deeply flawed system.

"Markets are made to serve man, not man the market," wrote John Gray, a leading British intellectual.[17] "We take a great risk if we don't combine freedom of markets with social policies that address imbalances," asserted Muhammad Yaqub, a distinguished central bank governor talking with me in Pakistan. "Globalization is driving impatience. People are living in dirt. It's not a vocal minority but a silent majority that must be heard."[18] "With its victory over communism," wrote Hernando de Soto, "capitalism's old agenda for economic progress is exhausted and requires a new set of commitments. It makes no sense continuing to call for open economies without facing the fact that the economic reforms underway open the doors only for small and globalized elites and leave out most of humanity."[19]

Among the readers of this book, I hope that businesspeople and bankers will come away with a heightened awareness of just how badly we are undermining one of the greatest systems ever devised. I hope lawyers and accountants will seriously reconsider the advice given to corporate clients that places them in a position of risking felony offenses. I hope that development economists will resolve to seek better data on the hundreds of billions, accu-

mulating to trillions, of dollars flowing illegally out of poorer countries. I hope that government officials will conclude that, yes, we can indeed improve national security, spread democracy, and boost free markets by cleaning up the global financial system. I hope that philosophers, particularly those focusing on issues of distributive justice, will find additional reason to include in their deliberations the potential offered by and the problems evident in international capitalism. I hope that every concerned reader will share my desire to see capitalism build on its strengths rather than cater to its weaknesses. And finally to students and teachers, I hope that you might come to appreciate with me the finest lesson I learned in graduate school. If we ask the right questions, we can get the right answers. Or, put another way, it is more difficult to ask the right questions than it is to get the right answers. I will have succeeded if, upon finishing this book, you have in mind questions to continue thinking about in years ahead.

Within the stories and remarks presented in Parts I, II, and III, I pose three challenges. One is directed at business and banking sectors, the second is a gauntlet flung down to the World Bank and other international financial institutions, and the third is served up to scholars, wherever they may be pursuing their professions. Each challenge, in my view, focuses attention on the need for major revisions in the way we conceive of and practice global economic affairs.

The question "Savior or Predator?" posed in the title of this chapter encapsulates the issue and the choice before us. If capitalism is to offer adequate abundance to Earth's growing billions, we must fight rampant lawlessness, reduce inequality, and recast the free market's supporting structures around principles of global justice. The progress of the twenty-first century will be influenced in good part by how purposefully we fashion a new strategy to deal with capitalism's conspicuous failures and subtle deformities and how successfully we extend capitalism's opportunities to the whole of humanity.

PART I

ILLEGALITY: WE LIKE THE MONEY

This [Citibank] *account is turning into an exciting profitable one for us all. Many thanks for making me look good.*[1]

—Amy Elliott, 1993

These are the very flaws in the western financial system which are becoming a noose for it.[2]

—Osama bin Laden, 2001

INTERPOL'S HEAD of anti–money laundering operations in Lyon, France, leaned back and asked, "Do you have anything to add?"[3]

He was a highly competent official with three decades of experience in law enforcement. After four years at Interpol and now approaching his retirement, we struck up an easy rapport. For two-and-a-half hours he told me tales of assorted drug dealers and criminal syndicate heads illegally shifting their money in and out of countries, washing their proceeds to make them look clean and legitimate.

"Anything to add?" I repeated. "You haven't cited a single example of moving criminal money that I haven't seen years ago in the business of moving corrupt and commercial dirty money."

Flabbergasted, he bent forward, learning for the first time that everything he'd worked on had antecedents in the accepted routines of transferring the proceeds of corruption and tax evasion. I was stunned to realize that

he thought money laundering was a new phenomenon, bursting onto the scene in recent times.

Since the end of the Cold War, the opening years of the globalizing era have produced an explosion in the volume of illegitimate commercial and financial transactions. North American and European banking and investment institutions have been flooded with laundered and ill-gotten gains. Totaling trillions of dollars, most of these sums are generated through secret arrangements between cooperating but distant private-sector entities. Lagging legal codes have proven inadequate to deal with the situation. Much of this subject is taboo in business and government circles, yet this torrent of stolen, disguised, and hidden resources poses a major risk to state stability, corporate security, democracy, and free enterprise across the planet.

CHAPTER 2

PLAYING THE GAME

"DIRTY MONEY" is money that is illegally earned, illegally transferred, or illegally utilized. If it breaks laws in its origin, movement, or use, then it properly merits the label.

If you think this is just a matter for bankers and law enforcement officials, do the following. Take the dollars, pounds, euros, rubles, pesos, or other currency out of your wallet or purse. You could very well have your fingers literally on cocaine. According to several studies, upward of 90 percent of paper money in New York, Miami, and London, and, it is suspected, other major cities as well, contains trace elements of drugs.[1] And drugs are the smaller part of the dirty-money problem.

There are three forms of dirty money that cross borders: criminal, corrupt, and commercial. The criminal component includes proceeds from a boundless range of villainous activities including racketeering, trafficking in counterfeit and contraband goods, alien smuggling, slave trading, embezzlement, forgery, securities fraud, credit fraud, burglary, sexual exploitation, prostitution, and more. However, in the statutes of many nations, the only financial inflows from criminal activities that are barred are those arising from drugs, bank fraud, and certain acts of violence, including terrorism.

The corrupt component stems from bribery and theft by foreign government officials. While the United States outlawed paying bribes in 1977, handling the proceeds of foreign bribery was not barred until 2001, and most European nations began only in the late 1990s to legislate against paying bribes or banking the proceeds of corruption.

The commercial component of cross-border dirty money has two features that distinguish it from legitimate outflows. First, it is usually tax evading, although that is not the primary motivation for such transfers. And

second, it almost always disappears from any record in the originating country. In other words, legal transfers are recorded as expenses or deposits or investments and remain on the books of the company or individual making the transfer. Illegal transfers are specifically intended to avoid reports or bank statements or evidence of their place of relocation.

What is most striking is that all three forms of dirty money—criminal, corrupt, and commercial—utilize basically the same subterfuges to roll through international channels: false documentation, dummy corporations, shell banks, tax havens, offshore secrecy jurisdictions, mispricing, collusion, kickbacks, numbered accounts, wire transfers that disguise transactions, and more. Whether it's moving drug money or tax-evading money, whether it's a thug or tyrant or terrorist or corporate titan, all use the same bag of tricks. And the truth is, western business and banking sectors have developed and promoted the mechanisms for bringing in dirty money from other countries for more than a century.

What's in this bag of tricks? If you're going to play the game, you should understand the tools that make it so much fun for so many people. Here they are. Enjoy the ride.

THE DIRTY-MONEY USER MANUAL

So you want to get rich and hide money? Not a problem! In a few pages I can outline what you need to know to join the ranks of drug kingpins, criminal syndicate heads, corporate executives, tax evaders, and terrorists. Can you think of any reason why all these folks should be piling up wealth while you're left behind? Get ready to jump into the big time.

Reading the newspapers today might lead you to believe that conveying illicit funds from country to country is a highly complex and specialized process. Not so. Here's a starter kit that provides and illustrates most of the basics. It tells you how to (1) pick your own price in international transactions, (2) use dummy corporations to shield your activities, (3) fake transactions to make it look like something is happening when it really isn't, and (4) take advantage of a grab bag of tricks to handle special opportunities. With these techniques you can shift all types of criminal, corrupt, and commercial dirty money like a pro—like a Mexican drug cartel or the Saddam Hussein family or Al Qaeda or a corporate CEO. You don't have to in-

vent anything; just reach in and use the tools that are already proven to be effective.

Pick Your Own Price

Anything that can be priced can be mispriced. Fictitious pricing serves to relocate money and implement tax-evasion schemes between countries. As you read this, there are tens of thousands of transactions at docks and airports and on trucks crossing borders and in bits and bytes flitting through electronic circuits with mispricing built into commercial invoices, as agreed between willing buyers and willing sellers. This is by far the most frequently used device for transferring dirty money. Common in exports, imports, real estate deals, purchases of services, and nearly every aspect of international business, false pricing has moved trillions of dollars illegally between countries.

A Venezuelan businessman calls on a U.S. machinery manufacturer to negotiate purchase of up-to-date equipment for his factory in Caracas. After hard bargaining, they settle on a price of $1 million. Then the buyer asks that the commercial invoice be drawn to read $1,200,000. Why would he want that? Because when he pays the $1,200,000, he wants the extra $200,000 sent for deposit into his New York bank account. The machinery manufacturer, anxious to conclude the transaction, agrees; the sale is made.

A Ukrainian dealer in icons and antiquities negotiates with a German gallery for sale of several dozen *objets d'art* and they come to a price of €200,000. Then she asks if she can invoice the shipment for €100,000. Why would she do that? Because together they arrange that, at the same time the invoiced amount of €100,000 is transferred to her Kiev bank account, the additional €100,000 will be deposited into her Frankfurt bank account. The gallery, anxious to conclude the transaction, agrees; the purchase is made.

Mispricing in transactions between unrelated parties can and is applied regularly to virtually anything. A heavy equipment exporter pays a 20 percent kickback into the offshore account of the owner of a foreign construction company on his purchases of bulldozers, backhoes, scrapers, loaders, and dump trucks. Mercedes-Benz cars at the docks awaiting shipment have often been invoiced at entirely different FOB prices, meaning prices "free on board" the vessel before transportation charges are added. The price to the

United States is not marked up; the price to a dealer in Africa may be 50 percent higher, helping move money out of the importing country. A U.S. cigarette manufacturer makes a minority investment in a foreign company and overprices the exported production line by enough to profit from the equipment sale and recoup its investment before the first carton of smokes is delivered off the shipping dock. A Swiss textile machinery producer gladly pays a million-franc kickback into the Geneva account of a Central American purchaser who is buying equipment to add to his company's output capacity. German printing presses going to the Middle East have been generously overpriced, larding the European accounts of government and private editors and publishers. Handcuffs sold to the police in Kenya with a delivered value of 1,000 shillings each were invoiced at 3,500 shillings each, making someone very satisfied with the transaction.

Besides physical items, services can also be mispriced. Insurance is a regular candidate, with premiums marked up to provide offshore kickbacks. Foreign advertising is another popular vehicle. Consulting contracts and advisory services are easy to load with kickbacks. Technical assistance agreements offer a regular outflow of money that can be shifted into offshore bank accounts. Similarly, royalties, patents, and licenses have become a recent favorite among skilled money shifters.

You can put together mispricing and bribery of foreign government officials, with local agents playing an intermediary role. Since this is now against the law in many countries, a bit of caution is called for if you are a western executive or salesperson. A typical conversation today with your company's agent or representative in a foreign country should go something like this:

> I want you to understand how extremely interested we are in getting this contract. It's a very significant piece of business for our company in this market. We anticipate that this will take a lot of time and a considerable amount of entertaining and public relations on your part. In order to underline how important it is to us, we want to double your normal commission, from the usual 10 percent up to 20 percent, just for this deal. Now let me be clear; none of this can be for bribery. That's against the law. But we do want the contract. No bribery, but go out and make every effort necessary to be successful. We need to understand each other. Bring this one home. Now, have I been clear?

If the local agent is any good, he throws his arm around your shoulders, looks deeply and confidently into your eyes, and says, "I understand perfectly!"

An expatriate lawyer in the Middle East does a thriving business representing arms manufacturers. He sets up billion-dollar weapons deals under two contracts, one for the main equipment and a second for support services such as training, maintenance, and software updates. The first contract with the government of the purchasing country is priced properly. The second contract is channeled through a joint-venture company in a Caribbean tax haven, owned by the arms manufacturer and by designated friends of the government officials in the buying country. While doing no work, these nominee partners share in the venture's deliberately bloated revenues, passing the funds along to their principals, the officials who are the real but silent partners.

IBM was not sufficiently careful in this kind of business and made the mistake of doing suspect business through its own local subsidiary. In an arrangement called Proyecto Centenario in Argentina, IBM entered into contract with Banco Nación to install computers priced at $250 million throughout the bank's 525 branch offices.[2] The markup for paying kickbacks was allegedly about 15 percent, some $37.5 million. A local prosecuting judge, Aldolfo Bagnasco, getting wind of the deal, accused IBM of paying bribes to get the contract, referred to in Buenos Aires as "a little happiness." IBM Argentina reportedly funneled these payments through two local agents, Consad and its subsidiary CCR. Payments of $37 million went to CCR, a firm with one employee and one telephone.[3]

In turn, CCR redistributed millions, which ended up in bank accounts in New York, Switzerland, Luxembourg, and Uruguay. Upon request from Judge Bagnasco, Swiss authorities revealed that beneficiaries of such accounts included directors or ex-directors of Banco Nación.[4] At least two recipients admitted they received millions and confirmed that the payments were gifts from IBM.[5] The IBM–Banco Nación contract was cancelled in 1997. Following action by the U.S. Securities and Exchange Commission, IBM paid a $300,000 civil fine without admitting or denying the bribery. Swiss banks turned over $4.5 million in frozen assets to the Argentine government in 2002. The remaining $33 million has not been fully recovered. The point is, don't use your own local subsidiary or

affiliate as a conduit for "a little happiness," especially when you're dealing in big money. At a minimum, channel your bribe payments through an unregulated entity operating out of a tax haven.

For someone in a developing or transitional economy who wants to generate deposits into his or her external bank account, the flip side of over-pricing imports is underpricing exports, as the Ukrainian art dealer did. In the business of selling commodities or processed or manufactured goods, agreements between buyers and sellers to accomplish this are common, so don't feel as though you are doing anything unusual.

Toys manufactured in China have produced several Chinese dollar millionaires with their money safely stashed in foreign banks. The big toy companies in the United States and Europe don't necessarily have to pay the kickbacks; these can be handled by wholesalers who buy, mark up, pay the kickbacks into hard-currency accounts, and resell to the multibillion-dollar brand-name companies and retail chains. The same mechanism has reportedly produced a fair number of millionaire sneaker manufacturers. Oil has been piped out of Russia at a fraction of its value and resold in Europe at world-market prices, with the difference ending up in Cyprus bank accounts of the owners or executives of Russian producing and marketing companies.

Now, oddly enough, if you're fattening your foreign bank account by overpricing imported raw materials and machinery and underpricing exported commodities and manufactured items, you may be able to accomplish the same ends by doing exactly the opposite. How can you consistently underpay for your purchases and get anyone to continue selling to you? And how can you consistently overcharge for your sales and get anyone to continue buying from you? Believe me, it's been done a few million times.

Take Argentina as an example of underpricing imports. Argentina dollarized its economy in 1991 and introduced open convertibility between the peso and the U.S. currency. Earlier, Argentina had broadened its regime of value-added taxes (VAT) which meant that imports were taxed at an average of about 18 percent of invoiced prices as they arrived, which later rose to 21 percent, plus additional tariffs and fees. Argentine businesspeople did not take long to figure out how to use open convertibility and dollar bank accounts abroad to minimize VAT. In cooperation with foreign suppliers, imports were often and very significantly underinvoiced, so that the VAT tax payable on goods arriving into the country was reduced in amount. Importers then properly paid the indicated amounts on these fabricated com-

mercial invoices, leaving the amounts not covered by the invoices to be settled by other means. Okay, suppliers now had part of their money and were waiting for the rest.

Argentines by the thousands became expert at keeping an entirely separate set of books, even a separate set of entities, to sell part of their imports or goods produced from such imports. Revenues from these unrecorded transactions and unregistered entities were then taken to a bank for deposit, with instructions to convert and transfer the proceeds into the depositors' dollar accounts abroad. From such dollar accounts overseas, the balances due on underpriced imports were settled. The net result was straightforward; the importer paid substantially less VAT taxes and, with off-the-books revenues and an open pipeline to a foreign bank account, topped up dollar balances out of the country. At least that's what happened until the Argentine economy virtually collapsed.

That is on the import side, but how can you overprice exports that you're selling into competitive markets and stay in business? That makes no sense. Unless the government pays you a subsidy to export; then it makes sense. Take India, for example, which sometimes pays a percentage of the value stated on commercial invoices to encourage exports from the country. In recent years, incentives have often covered products with entirely domestic content, such as leather goods, quarried granite, cotton garments, and forest products. So, the Indian seller makes an agreement with his foreign buyer to overprice the export. With the overpriced invoice the seller goes to the Indian authorities and collects, say, the inflated 20 percent subsidy. Meanwhile, the cooperating buyer can pay the overpriced amount in return for a credit against future shipments or not pay the full invoiced amount after asserting some spurious claim. Once again, everyone is happy, even the government that, for awhile, doesn't realize it's been cheated. Finally reality dawns, and most countries have now curtailed direct cash payments for exports. Export subsidies remain rich and varied, however, including tax and tariff exemptions, subsidized loans and credits, and reimbursements for storage, transportation, insurance, market research, trade fairs, and promotions. Lots of exporters continue to get rich off their government's programs, so be alert to this money-making opportunity.

I have been talking primarily about transactions between unrelated buyers and sellers who cooperate to misprice trade, shifting money abroad and in some cases making a little extra locally. An even bigger opportunity is

transfer pricing within multinational corporations, the use of trade to shift money at will between parents, subsidiaries, and affiliates operating in dozens of countries. For many multinational corporations, exaggerated transfer pricing is standard procedure, a major part of global strategies to minimize taxes and maximize profits.

Intracompany trade across borders represents about 50 to 60 percent of all cross-border trade. I have never known a multinational, multibillion-dollar, multiproduct corporation that did not use fictitious transfer pricing in some part of its business to shift money between some of its entities. In years past, chemical companies were a common example of falsified transfer pricing, taking advantage of proprietary products to move revenues and relocate profits. Then pharmaceutical companies became widely known for the same practice, invoicing as much as 10 times or more for the same product sold to one subsidiary out of which profits were drawn as compared to another subsidiary where profits were permitted to remain.

There are several firms that sell data on transfer pricing, that is, on the laws and regulations that exist in countries that attempt or do not attempt to control transfer pricing. If you've got a question, contact Ernst & Young to obtain the firm's *Transfer Pricing Global Reference Guide*, offering "creative and practical solutions for your transfer pricing needs."[6] For a hefty fee, they'll tell you what's legal and what isn't in a selection of distant countries. That's just to keep you informed, not to stop you from using transfer pricing to shift revenues and profits with ease.

The most marvelous example of transfer pricing I have ever encountered concerns diamonds out of South Africa, which illustrates what you can do in cahoots with a government. For more than a century millions of carats of diamonds were exported at essentially zero value, to be cut, graded, and sold abroad with most of the revenues kept abroad as well. The real volume and value of diamond exports was a classified state secret. When I inquired I was told, "This was a decision by government. It was not allowed to identify a specific company or producer of diamonds for export or the value of diamond exports."[7] As a consequence, no one knows but the exporters what happened to the hundreds of billions of dollars generated from diamond sales.

The situation changed a few years after majority rule was achieved in South Africa. Today a Diamond Board assesses or approves the assessment of diamonds for export, and their quantity and value are published by the South African Revenue Service. In a recent month, exports of 66,560 carats

were valued in rand at R290,195,906, equivalent to $48 million, for an average price of $715 per carat.[8] The point is, when opportunities become available to suborn a whole government, strike quickly, because, even after a century, you never know when they will change their minds.

Arrangements for mispricing in transactions between unrelated parties to generate foreign kickbacks or transfer pricing between affiliates intending to reduce taxes are not matters that either buyers or sellers particularly like to record permanently. Most such arrangements are based on verbal agreements between cooperating parties, perhaps put into e-mail communications, but seldom reduced to paper with a signature. This is because in many countries it's against the law to file a false customs declaration. An import coming into the United States on which a duty is to be levied, for example, would result in undercollected customs charges if the invoice was intentionally underpriced. Similarly, an artificially-priced export going out of the United States, whether above or below its true value, results in erroneous data being forwarded to the Customs service. These are felony offenses. And they are probably the most frequently committed white-collar felony offenses in the United States. The same is true for many other countries. The fact is, the customs declaration is almost always filled out by a freight forwarder handling the paperwork for the buyer or seller. So long as the freight forwarder enters on the customs declaration the same price that appears on the commercial invoice, hardly anyone cares or ever pays attention.

Nevertheless, if erroneously pricing a transaction, which leads to filing a false customs declaration, which can land you in jail, really worries you, never mind. There are other ways to accomplish the same end without quite so overtly counterfeiting the invoice. Let's go back to the Venezuelan businessman who wanted his purchase priced at $1.2 million instead of $1 million. In lieu of asking for the kickback to be sent to his bank account, he can offer an alternative arrangement. The agreed price will be $1.2 million, and you will please contract with my brother-in-law to do a market survey for you in Venezuela, Guyana, Suriname, Colombia, and Panama and pay him $200,000 into his Panama bank account. Again, agreed. It would be preferable if the U.S. company ultimately received a few pages of paper purporting to be the market survey, but if it never shows up, the company can claim it just made a bad business deal.

Same thing for the Ukrainian art dealer. If the German gallery suddenly gets pangs of conscience about depositing a €100,000 kickback into her

Frankfurt account, then it can contract with her to be its eyes and ears in Kiev for hot *objets* coming on the local market, at an agreed fee of €100,000 paid into her Frankfurt account. Again, a piece of paper gives some credence to a payment under the table.

More opportunities are available besides consulting contracts. One of the favorites is damage claims. A U.S. exporter based in New England routinely pays for imaginary damages on sales of kraft paper shipped to an Asian customer, of course, by deposits into the customer's U.S. bank account. Warranty payments based on purported deficiencies in the performance of machinery and equipment are another favorite, all agreed to in advance and covered in the original purchase price. Freight allowances are another, reimbursing the extra cost of delivery above an agreed figure. On smaller transactions you can provide an extended family vacation for a good customer or meet university tuition costs for sons and daughters or agree to settle credit card charges. This aspect of international business offers wonderful opportunities for creativity.

Even more secretive are some countertrade deals. A typical one is a three-way transaction, often with exchange conducted through barter rather than payments with cash. For example, an Egyptian clothing manufacturer can make an uninvoiced delivery of garments to a Spanish buyer. The Spanish buyer sells the garments and puts part of the money into a Swiss bank account for the Egyptian exporter. Then the Spanish firm pays a Polish company for 10 electrical generators to be shipped to the Egyptian manufacturer to provide backup power when outages occur. The generators arrive in Cairo. The only thing the clothing company accountant can tell is that clothes went out and generators came back, and it's rather difficult to equate the value of the two noncash transactions and quite impossible to tell that money got deposited into the factory owner's Geneva account.

False pricing in deals between related or unrelated parties tie the shift of tainted money to legitimate transactions, whether the proceeds are commercially tax evading or corrupt or criminal in origin. The cover provided by the partially legal aspects of the business is a great advantage.

But there is another reason why it is the most popular means of moving illicit funds. Falsifying prices of international transactions is the only mechanism for shifting money out of a country where no one else in the country needs to know about it. Only the CEO or proprietor or expatriate executive or local purchasing manager or government official, whoever is making the

deal, has to interact with a foreign counterpart. Every other method requires interfacing with some other person locally, whether an accountant or co-director or banker or government official or black-market money changer. But varying prices in collaboration with an external trading partner does not. Involving someone else locally risks that the illegal shift of money becomes known by other shareholders, managers, workers, trade unions, tax collectors, even the public. Dealing only with a foreign counterpart avoids this risk.

The first tool you want to reach for in your dirty-money user kit is the tried and true technique of billing otherwise legitimate transactions at false prices. With this method under your belt, you are already in the pros.

Dummies Incorporated

Concocting bogus prices does require you to have that conversation or communication with your foreign trading partner. Many people don't want to do even this, don't want that person or company to know anything about their shifts of money. Whether it's a first-time transaction or a long-term relationship, many would prefer that these trading partners, maybe also friends, do not know all the ins and outs of company or personal financial affairs. If you, too, would like to utilize sham pricing while avoiding these discomforting interfaces with your suppliers or customers, no problem. All it takes is a reinvoicing company that will buy, change prices, issue a new commercial invoice, and resell. In other words, the transaction isn't made directly with you; it's made with this intermediary company, which buys or sells on your behalf, marks the transaction up or down as you require, and then sends the new paperwork on to the other end. With this reinvoicing entity, comprised of a computer, a letterhead, and a bank account, you've accomplished your false pricing and never had to discuss it with your foreign counterpart.

A major U.S. soft drink company has a franchise bottler in Africa owned by noncitizens of that country, a relationship that has lasted for a half-century. At some point, the African bottler formed such a reinvoicing entity in England. The U.S. soft drink company shipped the syrup used to make the soda directly to Africa but sent invoices to the reinvoicing company in England. This entity marked up the price of the syrup by several times its original cost and sent the revised commercial invoices to its African bottling operations in time to meet the arriving shipments of syrup. The

owners of the African franchise got rich in sterling. The U.S. bottler understood full well that it was abetting a tax-evasion scheme taking profits out of the continent, but who cares? And this process continued for years, even after the African firm, now expanded to several bottling plants, gained local shareholders who knew nothing about this arrangement benefiting the original owners.

Reinvoicing can be done more than once. A shipload of wheat left the United States valued at $7 million. The commercial invoice went through several repricings, finally arriving in Abidjan at $70 million. While some Ivoirians got rich, a lot of Ivoirians angrily paid high prices for bread. Honestly, I don't recommend tenfold markups on food items. It generates too much emotion.

Russian exporters learned the repricing game very quickly. In the late 1980s and early 1990s, Russian exports were often sold directly to European buyers, who paid generous kickbacks into offshore bank accounts. But the Russians tired of these arrangements and, instead, set up hundreds of buying entities in Europe to purchase their own exports from Russia. In this way, commercial invoices could be drawn for underpriced amounts on sales made to their own affiliated companies in Europe. Then those entities would reinvoice to the final European buyers. Thus, exports of oil, gas, gold, diamonds, aluminum, pulp, timber, and more left Russia at dirt-cheap prices, were sold to these branch offices domiciled in Europe, and then were resold again at world-market prices to European buyers. The profits, of course, stayed in Europe, and in many cases not even the originally invoiced amount was ever repatriated to Russia.

One of my favorite enterprises is a fruit exporter based in Latin America. I would be happy to name it, but many of you might unnecessarily disturb the equanimity of these fine fellows with excessive inquiries about their well-practiced money-moving techniques. This group grows fruit on its extensive plantation holdings, buys fruit from other nonassociated producers, provides its own trucks to transport fruit to docks, delivers its fruit to distant ports, owns numerous buying companies in overseas markets taking title to arriving fruit for resale, purchases packaging materials abroad, brings these back to the home country, and fabricates boxes in its manufacturing facilities. Trade documents and financial transfers are handled by the group's own banks in various countries and tax havens. This circle of companies performs

virtually every task, roundtrip, from the fruit plantations to the high seas to the foreign importing organizations to the overseas exporting offices and returning to the fruit plantations, transferring many millions of dollars from place to place at will.

After figuring out how to make money by mispricing and transfer pricing and by reinvoicing through a third company, you may want to disguise where all this money originates from and goes to. For this it's useful to have some additional dummy businesses, such as a nonfunctioning corporation or two and possibly an offshore trust or foundation.

Offshore dummy companies are commonly referred to as international business corporations (IBCs) or personal investment corporations (PICs). The shareholders, directors, and officers are usually individual nominees provided by the company formation agent or, alternatively, other dummy companies controlled by the agent. A side letter may be the only evidence of true ownership, and that letter is normally not included in the official incorporation papers. As a rule, IBCs and PICs have no employees and no facilities and are expected to avoid doing business in the countries where they are established. Most are set up for the sole purpose of having bank accounts hiding behind layers of secrecy.

Typically a lawyer in any one of more than 60 small countries or enclaves prepares the incorporation papers or provides an off-the-shelf company that has been preregistered. Already, lawyer-client privilege affords you a great deal of protection. Then, too, the laws of such jurisdictions traditionally make it an offense to reveal any information about the secret entity, its owners, or its transactions. Authorized capital can be negligible or not paid up. Most commonly, income accruing to the IBC or PIC is either tax exempt or subject to very low rates. Audit and reporting requirements are usually nil. But with this well-guarded dummy corporation and its bank account, you can shift dirty money in where its identity is essentially lost, and then shift it back out again with a company name disassociated from you. For further protection, several dummy IBCs or PICs can be set up or purchased in different jurisdictions, each functioning under a different set of laws cloaking your identity, so that anyone, including disgruntled trading or investment partners, assorted thugs, ex- or soon-to-be ex-spouses, tax collectors, zealous journalists and prosecutors, will be frustrated at every step in trying to trace a source of funds back to you.

There are some delightful places where you can situate or purchase your secret companies. In the Caribbean you have Anguilla, Antigua and Barbuda, Aruba, Bahamas, Belize, Bermuda, the British Virgin Islands, Barbados, Cayman Islands, Dominica, Grenada, Montserrat, the Netherlands Antilles, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, and the Turks and Caicos Islands. Or there are Panama and Costa Rica in Central America and Uruguay in South America. If you prefer the Pacific the choices include the Cook Islands, the Marshall Islands, Tonga, the Maldives, the Marianas, Nauru, Niue, Vanuatu, and Western Samoa. Asian and Middle Eastern secrecy jurisdictions include Hong Kong, Macau, Singapore, Labuan off the coast of Malaysia, Bahrain, Dubai, and Lebanon. Africa is getting into the game with Mauritius, the Seychelles, South Africa, Liberia, São Tomé and Principe and the little enclave of Melilla, one of two parts of Spanish Morocco. And, of course, Europe offers some of the most experienced and discreet jurisdictions, including the Isle of Man, the Channel Islands of Jersey, Guernsey, Alderney and Sark, the Åland Islands, the islands of Cyprus, Malta, and Madeira, plus Gibraltar and Monaco at the southern edges of Europe, as well as Switzerland, Austria, Liechtenstein, Luxembourg, Belgium, Hungary, Ireland, the lovely enclave of Campione d'Italia surrounded by Switzerland, and the Principality of Andorra tucked in between France and Spain. Off the coast of Newfoundland the French territory of Saint Pierre et Miquelon is reportedly a player in this business. This totals 63 jurisdictions providing varying degrees of incorporation concealment and protection from probing eyes.

As you select a place to acquire your anonymous international business corporation and plan your circuitous travels to meet clandestinely with a shady lawyer prepared to provide you with a dummy corporation to serve your unrevealed interest in moving ill-gotten gains with the utmost secrecy, you may actually be disappointed to learn that you don't need to go there at all. In almost every one of these jurisdictions, the whole thing can generally be done with a phone call or fax or online. Using your search engine, enter "international business companies" or "offshore corporations," and scores of web sites will pop into view offering instant service, comparing the pros and cons of various jurisdictions and quoting fee schedules for creating your own shadowy company.

I have lost count of the number of anonymous entities existing in these jurisdictions. Several years ago, the British Virgin Islands alone reportedly had 180,000 and the Caribbean as a whole had 500,000. More were being formed at a reported rate of nearly 200,000 a year. The total is certainly well

over a million by now, and some experts put the number as high as three million. According to various estimates, half of cross-border trade and investment passes through a tax haven or a secrecy jurisdiction at some point along the way. So you're already in the best of company.

Stealth and camouflage can also be taken a couple of steps further. Ownership of your one or more IBCs or PICs can be transferred to an offshore trust. In most secrecy jurisdictions contributors to trusts do not necessarily have to be named in trust documents, and such documents do not have to be filed with local authorities. Trustees can carry out your instructions and, except in rare circumstances, avoid answering questions about who is giving them instructions. Furthermore, trustees are usually absolved from responsibility for directives issued, which protects both them and you. Trusts typically offer a strong measure of asset protection from attacks by creditors and, set up in tax havens, allow citizens of many countries to accumulate revenues not subject to income or capital gains taxes. And, being doubly cautious, many trust documents incorporate "flee clauses," allowing the domicile of the trust to be relocated to another secrecy jurisdiction should anyone come asking questions. Be sure to get these flee clauses written into your documents.

The evolution of trust law over a period of centuries typically has required that the contributor to a trust and the beneficiary of a trust can't be one and the same. In other words, you cannot set up a trust to benefit yourself. But have no fear; secrecy jurisdictions are not about to be stopped by such ancient traditions. Take Nevis, for example: "Under the Nevis International Trust Ordinance, the same person can, but is not required to be the Settlor (creator), Beneficiary, and Protector of the trust."[9] Furthermore, "foreign laws, including U.S. laws, do not apply to Nevisian trusts. This means that under Nevisian law, the claim will always have to be re-tried, ab initio, in the Nevisian courts, with Nevisian attorneys and with Nevisian judges who can generally be expected to uphold the Nevisian trust."[10] If someone pursuing you even sets foot in Nevis, he or she must first post a $25,000 bond with the court before any legal action can be undertaken. In other words, now you've got a secret company operated by a secret trust in a secrecy jurisdiction determined to protect your secrets no matter what.

A variation on offshore trusts is an offshore foundation. This is a legal entity that has no shareholders or members, but it can hold ownership interests in other companies. Founders can be beneficiaries of a foundation, but

neither founders nor beneficiaries are responsible for liabilities of the foundation. Once again, anonymity reigns; founders and beneficiaries, as well as operations of the foundation, can almost always be fully concealed. Liechtenstein and Panama, among other countries, offer these vehicles, typically suited for wealthy individuals hiding assets and escaping taxes.

Speaking of liabilities, dummy corporations are also useful places to dump nonperforming assets. If you've gotten overextended and need to clean up a financial statement, just swap your junk for securities in some fancy-sounding financial corporation in a tax haven. You know your securities are worthless, but other lenders and shareholders do not. Enron and Parmalat are your models here.

Now the United States is encouraging havens and secrecy jurisdictions to keep up with the owners of IBCs and PICs and is trying to insist on mutual legal assistance and cooperation in specific tax and criminal matters. This just means that you want to maintain a friendly and profitable relationship with your offshore facilitator, so he will use that flee clause or other devices if needed to protect your interests.

IBCs, PICs, offshore trusts, and private foundations make it possible for you to disguise, shelter, move, and accumulate money that is unseen, unregulated, and untaxed. With these devices and techniques, you can join millions of others who beat the system every day.

Faking It

So far, I've been talking about transactions where prices are falsified and money moved through layers of disguised entities. Another way to accomplish very much the same end is by faking the transaction itself, in part or in whole. In other words, you can manipulate the reality of the transaction rather than the price of the transaction and still generate the illegal money that moves across borders undetected.

For example, cooperating buyers and sellers can agree to vary counts, weights, or measures as necessary to accomplish a shift of funds. Ten thousand tons of tropical hardwoods being shipped out of Indonesia can be documented as 6,000 tons, with the value of the extra 4,000 tons paid into a foreign bank account. A small tanker can take on 20,000 tons of oil by day, then the crew can repaint the water line of the vessel, load another 10,000 tons by night, and steam out of the harbor the next day unnoticed.

Oil trading offers many opportunities for manipulating recorded tonnages, tanker charges, royalties, and more. A Russian fisherman operating out of Vladivostok took the simplest approach. After laboring for days hundreds of miles at sea, he offloaded his entire catch into another trawler of a different flag, got paid in his Cyprus bank account, and returned to port bemoaning his fruitless efforts.

Product quality can be falsified by cooperating buyers and sellers on everything from cocoa butter to used cars to rice to steel. Carnuba wax can be shipped out of Brazil labeled #3 yellow when it is in fact #1 yellow, a higher grade, and the additional value deposited into the exporter's U.S. bank account. The qualities of textile exports are often doctored. A thread count can be described as 250 when it is really 400, a higher quality, and the difference in value deposited to a foreign bank account. Shipping containers arriving in Africa invoiced as expensive "machinery" for a local Chinese-owned factory turned out to be nothing but scrap metal, such fakery done for the intended purpose of removing profits to Hong Kong. There are hundreds of ways to document one reality and deliver another.

A creative example of faking it took place across a four-year period in the 1980s, eventually acquiring the name "La Mina," The Mine. Colombian drug dealers with enormous sums of money converted their cash to gold. At least that's the way it started out.

The Medellín cartel's money manager, Eduardo Martinez, approached a gold dealer in Argentina, Raul Vivas, who had an established international business selling to jewelers. Martinez asked Vivas to ship gold to the United States and accept cash in payment in the United States from the cartel. The cartel, having converted its dollars to gold, could now sell the gold to other bullion dealers, with the proceeds then wire transferred into innocent-looking bank accounts. This worked for awhile.

But why ship real gold to the United States when you can fake it? Vivas and Martinez concocted a scheme to put gold plating on lead bars. The cartel paid cash for the bogus bullion in the States, and Vivas transferred the money from his U.S. account to cartel accounts out of the country.

Why go to the trouble to ship anything at all? Vivas opened a company in Los Angeles to buy gold. The cartel brought in its cash, and Vivas used it to buy gold locally from other dealers. Vivas would then truck the gold across country to New York to sell to yet other dealers. When paid, he wire transferred the funds to cartel accounts overseas.

Why truck all that gold across country to New York? Better to open a New York office to receive cartel cash and buy gold. This, too, was done, making it a bicoastal laundering scheme.

But dumping that gold back on the market in New York might look a bit odd. So, how about trucking the gold from both New York and Los Angeles to Florida, to a refiner there who will buy the gold and pay Vivas? Done. Vivas would then wire transfer the money to his own account in Uruguay and from there distribute it on to cartel accounts.

But this was all getting much too slow and complicated and a bit suspicious looking, especially with those armored trucks converging regularly on Fort Lauderdale. So, let's skip the gold altogether and imitate the transactions on paper. A California gold dealer and the Florida refiner were easily enticed by Vivas into the following scheme. A cartel front company delivered cash to the gold dealer. The gold dealer, with fake purchase orders, pretended to "buy" gold on the open market. The pretend gold was, with fake invoices, "sold" to the Florida refiner. The next day the refiner would "resell" the pretend gold back to the dealer. The dealer would pay for the pretend gold by wire transferring the money delivered to him by the cartel to the refiner's account at Chase Manhattan in New York. The refiner then wire transferred the money to Vivas's account offshore, who as usual sent it on to cartel accounts. The Los Angeles dealer and the Florida refiner earned modest fees for their fictitious paperwork.

The Drug Enforcement Administration finally closed down La Mina in 1989 with Operation Polar Cap, a parallel money-laundering scheme that penetrated Vivas's scam. Vivas was arrested, as were the Florida refiner and the California gold dealer. What started out as gold shipments from Argentina ended up as paper shuffling in the United States, and a billion dollars went through this evolving little exercise and into Medellín cartel coffers. But the idea of continuously changing your schemes is a good one. These fellows were just unlucky.

It's not just tangible items that are put through this sort of subterfuge. Billing for services can also be imaginary. A lot of invoices have shown up at a lot of companies for consulting services, public relations, advertising, legal advice, and financial planning without an ounce of underlying reality. Some higher-up in the company is topping off a foreign bank account.

A variation on this theme of creative artifice is where you fake or disguise who is the buyer and who is the seller. Someone steps in between the

two. In the midst of its civil war in the late 1960s, Nigeria did not have enough hard currency earnings to enable us local manufacturers to get the foreign exchange we needed to buy imports. Intermediaries would call on me offering to purchase abroad the raw materials we needed, ship the tonnage to our companies, and I could pay them in local funds, avoiding the long wait for allocations of foreign exchange from the Nigerian central bank. The problem was they wanted a 20 percent commission, which was too steep a hike in costs for my operations, so I never used them.

Today, similar arrangements are common in South America, known as the Black Market Peso Exchange system. A typical peso broker will have offices in, for example, the United States and Colombia. Drug dealers in the States need to get rid of dollars. They deliver huge sums of cash to the U.S. end of the peso broker's operation. The broker feeds the cash into the U.S. financial system by carefully depositing modest sums into many U.S. bank accounts or by paying cash for U.S. purchases.

Meanwhile, the Colombia office is receiving pesos from local businesspeople who need to buy imported goods. Now the U.S. end has millions of dollars and the Colombia end has millions of pesos. The Colombian businesspeople give instructions that so many dollars are to be paid to their foreign suppliers. The U.S. office of the peso broker pays the suppliers, who ship the required goods to Colombia. Meanwhile, the U.S. drug dealers give instructions that so many pesos are to be paid to their Colombian drug cartel chieftains. The Colombia office of the peso broker is happy to oblige, keeping about 20 percent as commission for services rendered.

Goods flow from the United States to Colombia, but no money is wire transferred, thus avoiding bank scrutiny. Everyone ends up happy, except the U.S. government, thoroughly frustrated that it cannot shut down this system. The Customs service regards the Black Market Peso Exchange as an unusually complex and sophisticated laundering mechanism. It's neither; it's the same facilitation at the same level of commission that I was offered nearly 40 years ago. And you can still use it today.

Gimmicks Galore

There are all sorts of financial ruses you should know about, useful in moving dirty money. Many of these serve specialized purposes, so knowledge of such techniques can come in very handy.

Drug dealers in North America and Europe, for example, face the problem every day of disposing of large amounts of cash. For a small local distributor with a take of perhaps a million or two a year, the simplest way to launder cash without detection is "smurfing"—using innocuous-looking bagmen, named after the cartoon characters, to deposit a few thousand dollars at a time into variously named accounts at many different banks. Due diligence procedures at such banks, alert to cash transactions of more than $10,000, rarely catch this activity. Drug kingpins with tens or hundreds of millions of dollars in cash in assorted denominations, weighing several tons and occupying a volume five times larger than the drugs themselves, have a more onerous laundering task. Smurfing won't work because it would require hundreds of innocuous-looking bagmen making repeated trips to the banks, not to mention the control problems arising from those bagmen foolish enough to try to abscond with their day's deposit. Using cash to live high and buy cars and houses isn't very smart and fails to soak up much of the millions. So basically the kingpins are left with two choices, both of which move the transactions into the international arena: ship cash or ship goods overseas.

"Mules" carry suitcases of cash to island tax havens for deposit, a bit risky nowadays with heightened airport security. Couriers hide cash in their clothing, wrap it around their bodies, conceal it in their onboard luggage, or hide it in checked baggage.

More commonly, unaccompanied cash is hidden in something being shipped abroad: appliances, overstuffed furniture, machinery, industrial products, coffins, or even dead bodies. This form of handling drug profits has soared in recent years, as customs authorities in western countries pay more attention to what's coming in than what's going out. A few million dollars inside nicely packaged computers and printers shipped from ABC Technical to XYZ Technical is unlikely to arouse suspicion and, once retrieved, can be easily legitimized in countries with lax controls on large currency deposits.

Something very much like smurfing can be combined with the Black Market Peso Exchange system to handle large transactions. A Colombian, later identified as having links to the drug trade both in his own country and in the United States, approached the local sales agent of Bell Helicopter to arrange purchase of a used chopper. Bell accepted the order at $1.5 million and in 1998 received 30 wire transfers and one check covering the price, none from the purchaser.[11] The company placed a telephone call to the American Embassy in Bogotá asking about the buyer, and did not receive a

negative report. As it turned out, five of the payments came from undercover U.S. Customs agents who had collected drug cash on the streets of New York, banked the nearly half-million dollars in Alabama, and then made wire transfers to Bell on instructions received from a peso broker.[12] The other 26 transfers also were apparently directed by one or more peso brokers. Thirty-one separate payments? All from unknowns? Destination Colombia?[13] Don't let yourself get caught making such elementary mistakes.

Another gimmick useful in providing kickbacks is the real estate swap. For a favorite customer who has been paying intentionally marked-up prices for materials supplied by your company, you can deed to this trading partner a house or building in one country and take in exchange a beach house in another country. The fact that what you're giving away is a nice property worth a million or two and what he's giving away is a grass shack on a desolate shore will probably go unnoticed by authorities.[14]

Share swaps often have been used to move ownership beyond the reach of local authorities, a particularly popular technique among Mexican and Japanese entrepreneurs. An IBC is created in a tax haven, and business owners exchange their shares for shares in the new company. With no money changing hands, the business suddenly has a foreign domicile. From then on, dividends are shifted to the offshore tax haven.

A similar technique for, in effect, conveying a bank overseas has occurred several times in Russia and at least once that I know of in Argentina. You form a bank or take over an existing bank. The bank has or soon accumulates tens of millions in customer deposits. You set up a couple of disguised offshore companies and then have the first company enter into contract to do some fake piece of business with the second company. Your bank issues letters of credit (L/Cs) to the second company guaranteeing the creditworthiness of the first company. Of course, the first one fails to perform on its nonexistent obligations to the second one. But your bank, being an honorable institution, has to pay up on its L/Cs to the second company. The bank goes bankrupt, the innocent depositors lose their savings, and you've made a bundle, now neatly stashed away on a tropical island.

If you don't want to own a bank, you can try cozying up to the key operator in the wire transfer department. This is the fellow given code numbers for making transfers to correspondent banks. For a big enough bribe, he may reroute a transfer away from some intended recipient and direct it to a different account—your account in a tax haven. This may go unnoticed for

quite awhile. By that time the key operator has understood that he can transfer money, that is, steal it, for his own account. Out of many countries, hundreds of millions of dollars have vanished, with hundreds of trusted employees vanishing as well.

Ordinarily you would think that when you transfer money it has to go from your account into the recipient's account. Well, not exactly. If you're a really big player in this game, there's even a way around this. It's a little gimmick called the "concentration account." Raul Salinas, brother of the president of Mexico, was an ideal candidate for this subterfuge. In providing services reserved for only the largest and most clandestine operators, Amy Elliott, vice president of Citibank, gave "white glove" treatment to Salinas's stolen millions.

Citibank Private Bank accepted Salinas as a client in May 1992, undertaking no investigation of his sources of wealth. Over the next two years, Citibank set up a string of anonymous trusts, international business companies, and secret bank accounts for Salinas.[15] A trust account number PC-4730/PT-5242 served as the owner of Trocca Ltd., a Cayman Islands shell corporation.[16] Citibank then utilized six nominee companies to shield Trocca's true owner, three functioning as Trocca's officers and nominee shareholders and three functioning as its board of directors.[17] Salinas's own name appeared nowhere in Trocca's papers. Citibank added a second shell corporation in 1994, Birchwood Heights, Ltd., to hold real estate Salinas owned in the United States, purchased through yet another Caribbean shell company.[18]

Citibank Private Bank opened investment accounts under the Trocca name in London and Switzerland and later another account in Switzerland for Salinas and his wife, operated under the name Bonaparte.[19] From 1992 to 1994 these accounts received some $87 million, $67 million of which was transferred through Citibank's concentration accounts. These are internal accounts used by banks to consolidate large sums from various sources before directing individual sums into private accounts. Thus, funds were shifted from Citibank Mexico to Citibank New York without being wire transferred out of a Salinas Mexico account or being deposited into a Salinas New York account and without ever identifying Salinas by name.[20] When the consolidated funds arrived in New York, Salinas's portion was separated by a communication stating the amount that belonged to him and was then to be forwarded on to Trocca's London and Zurich investment accounts. Amy Elliott enthused, "This account is turning into an exciting profitable one for us all[.] [M]any thanks for making me look good."[21]

In February 1995, Salinas was arrested on suspicion of murdering his former brother-in-law, Ruiz Massieu, a leading politician. As Citibank's handling of his ill-gotten gains began to unravel, Elliott started covering her own tracks, asserting in a telephone conversation with bank colleagues that ". . . in the very, very top of the corporation, this was known . . . on the very top. You and I are little pawns in this whole thing . . ."[22]

Further investigations indicated that more than $300 million had been moved by or for Salinas out of Mexico into foreign accounts, with several Swiss banks also allegedly holding huge deposits including Banque Pictet, Julius Baer Bank, and Banque Edmond de Rothschild.[23] Salinas's wife was arrested in Geneva in November 1995, trying to make a massive withdrawal. Swiss authorities froze some $132 million, $27 million of which was still in Citibank Private Bank, Zurich, nine months after Salinas's arrest. Swiss officials were unable to make a money-laundering charge stick against the Salinas couple.

After extensive investigations by U.S. prosecutors, Citibank was never charged for accepting, wiring, disguising, hiding and overseeing wealth allegedly stolen at the highest level from a neighboring country. The U.S. Senate's Permanent Subcommittee on Investigations held hearings in November 1999, focusing on Citibank's dealings in the Salinas and other cases. Appearing were seven Citibank officers, four government witnesses, a convicted ex-money launderer cum ex-Citibanker serving time in federal prison, and me. Even in the absence of a money-laundering charge, the bank was excoriated in the two-day sessions. For this and other reasons, the central character in the hearings, John Reed, co-chairman of Citigroup, resigned five months later. But for you the point of this tale should be obvious. When you're laundering your money through a really sophisticated bank, don't commit murder at the same time.

Besides banks, remember all the other kinds of financial businesses that can help you transfer illicit resources. Securities firms, brokerage houses, commodity traders, insurance companies, money changers—they're waiting to offer you services that rival the banks in creativity and subterfuge.

In the aftermath of 9/11, many people learned about the "hawala" system, known in Pakistan and India as "hundi" and in China in a slightly varied form as "chop." In existence for centuries, use of "hawaladars" soared when stringent exchange control regulations were enacted in the subcontinent in the 1960s and 1970s. This system takes money in one place and hands it over in another place without ever passing through the banking system. Independent

dealers who know and trust each other arrange the transactions. In a simplified example, suppose you want to send $5,000 to someone in Pakistan. You walk into a hawala dealer in New York City and give him the $5,000 plus whatever commission he requires, perhaps five percent or $250. You also provide the name of the person in Karachi who is to pick up the money, and you are given a code word that person is to use. The New York dealer telephones the Karachi dealer, with whom he has done business many times, and provides that information. The designated party in Karachi walks in, identifies himself by name and code word and, presto, he's handed the rupee equivalent of $5,000, perhaps less another commission charged on that end or some profit extracted on the dollar/rupee exchange rate. New York hawala keeps a record that it owes Karachi hawala $5,000. Over the next few months, Karachi hawala has the same sort of transactions with New York hawala for money going the other way. He keeps a record of what he owes New York. Eventually, if the balance of what is owed gets tilted excessively on one side or the other, they will settle up and then start a new set of records. Basically, what flows is, not cash, but accounts receivable. Hawala, hundi, and chop move tens of billions of dollars around the sphere. Most of it is in small amounts, often remittances by working family members in one country sending money to struggling family members in other countries. It is, however, available to move six and seven figure amounts and has been an effective mechanism for positioning terrorists funds where needed.

Finally, you shouldn't forget the use of plain old credit cards. When you have money in an offshore bank account, often that bank can issue you a credit card in its own name, without your name or signature appearing anywhere. With this you can live high on your ill-gotten gains, and no one is the wiser. Perhaps the perfect method for maneuvering hidden money has already arrived: electronic banking. From a bank in the Caribbean, funds can be transferred via personal computer to a bank account in Europe. With a credit card on that bank, money can be spent anywhere. Or that bank can make a credit to a smart card that is usable today in some countries and could in the future be accepted universally.

So, keep in mind some of these gimmicks, like concentration accounts, smart cards, credit cards in bank names, the hawala system, asset swaps, cash smuggling, and so on, as you plan to move your money from place to place. You never know when one of these techniques might provide just the right way to meet an opportunity or handle an emergency.

YOU'RE IN BUSINESS

Everything in your dirty-money user kit basically falls into four categories: falsifying prices, passing money through dummy entities, faking transactions, and using a few specialized devices as needed. Occasionally a gimmick or two may be declared illegal or require a bit of caution, but the basic facilitating structure that has been around for years remains intact. Some of it may sound a bit complicated, but it really is not. Besides, there are office buildings full of bankers and lawyers and accountants here and abroad ready to help you, whether you are a crook or a CEO or just a run-of-the-mill tax evader. Most of these professionals can do the dirty work for you, or structure deals to keep you out of trouble, or tell you where laws are particularly lenient, or help you stay ahead of authorities where laws are stronger, or defend you if in that extremely rare circumstance you should get caught, or impart to you sage counsel on how to place your criminal or corrupt or commercially tax-evading money in secure and profitable investments. The whole process of dealing with dirty money is routine and well honed and functions effectively every day for people just like you. And let's face it, it's so very satisfying being smarter than the next person and making money no one knows about or can find.

There's only one catch. Use of instruments in the dirty-money user kit carries a high price. The price is damage to the capitalist system. The price is bolstering international crime and terrorism. The price is deprivation for billions of people. The price is heightened risk to the shared security of a globalizing world.

But I'm getting ahead of myself. These are topics for the pages to come.

CHAPTER 3

DIRTY MONEY AT WORK

HOW DO I tell the story of trillions of dollars of dirty money lodged around the world, derived from many types of illegal activities, shifting across some 200 countries, affecting both economic and political affairs? It's not easy. Some writers report tale after tale of illicit dealings, leaving unifying themes unmentioned. Others delve entertainingly into a particular example of skullduggery. Still others treat dirty money as just one item on a laundry list of ills hurting a weakened state.

A French banker said to me something both simple and profound: "Politicians think nationally. Criminals think globally. They win. We lose."[1] He's correct. For people who deal in dirty money, the globe is their playground. For nations trying to curtail some types of dirty money, their borders are a major limitation. For me trying to convey the effect of dirty money, this variety of sources and intermix of geographies, economies, and legal systems makes for a complicated task.

I have found over the years that the best way to tell the story of dirty money is by relating the impact of this phenomenon on particular countries. In other words, global tax evasion, corruption, and crime are important to understand and at the same time are somewhat fluid, abstract concepts. But Russia or China or Nigeria or Indonesia or Iraq are nations about which we already have some understanding. Therefore, while I write about corruption and crime and tax evasion, I recognize that it is in the illustrations of what happens in and between countries that the larger points are best conveyed.

So, in handling this subject matter, two approaches are combined:

money and country. Dirty money is broken down into its three components: corrupt, criminal, and commercial. Each is illustrated with stories of countries that exhibit some of what is happening arising primarily from one aspect of illicit dealings, while touching on other aspects as well. In other words, I am talking globally and demonstrating locally.

Specifically, we proceed as follows:

Type of Dirty Money	*Illustrated By*
Corrupt	World leaders: Nigeria and Indonesia. Dominated by military: Pakistan.
Criminal	Drugs: Afghanistan and Colombia/Peru treated together. Thugs and racketeers: North Korea and the Japanese Yakuza. Terrorists: Al Qaeda and Iraq.
Commercial	Long in the business: Congo. Transitional economies: China and Russia.

Furthermore, there is usually an interweaving of financial shenanigans and political machinations, and in rounding out the impact of dirty money, brief comment on national political affairs is offered as well. The role of western financial and corporate interests and the use of mechanisms created in the West for moving dirty money have a large place in the tales to follow.

To put it simply, in this chapter I paint a word picture of corruption, crime, and commercial deception and the damage these combined features of the present age impose on our shared world. It is a picture rendered both in broad brush strokes and in pointillism, which I hope in the end will leave you with a deep impression of a capitalist system badly in need of change.

THE CORRUPTION INDUSTRY

Corruption shatters the economies of poorer countries and contributes to conditions in which crime, in all its manifestations, including terrorism, thrives. The word "corruption" as applied in the past 15 years refers to corruption by public officials, not private citizens. A working definition of the

term is "the abuse of public office for private gain." Bribery is the most common form of public corruption. Additional forms include theft of money and property from the public treasury, award of licenses or concessions to personal, family, or associated interests, improperly obtaining intangibles such as office, prestige, or power affording opportunities for future enrichment, buying votes to rig elections, and more.

For years, I have observed people bribing those in power guided by the simple question, "Do the ends justify the means?" Right up front, it should be acknowledged that the answer is, "Sometimes, yes." Suppose you are leading a convoy of trucks delivering emergency relief supplies to an encampment of refugees. As you get within sight of hundreds of shelters containing thousands of people, including the diseased and the dying, you encounter a roadblock and an officer or rebel who demands a hefty bribe before letting you pass. It could be thousands of dollars, or it could be the entire contents of the first truck. You have a choice: Pay the bribe or return to base. But the fact is, you don't have a choice, because delivering your lifesaving cargo is far more important than your moral compunctions. This is not a hypothetical situation; it is a reality encountered by countless humanitarian aid workers, relief teams, and medical personnel working in the lawless reaches of the planet. Anyone unprepared to answer, "Sometimes, yes," shouldn't go into this line of work.

Bribery under these conditions is only a tiny percentage of the global problem. Virtually the whole of the problem is about getting rich or gaining an advantage that leads to enrichment. Contrary to the views of some experts, bribery and corruption (except in situations of saving lives) do not have redeeming social value. They produce a litany of harmful outcomes, devastating to scores of developing and transitional economies. Bribery and corruption:

- Worsen poverty and inequality.
- Limit government tax revenues.
- Curtail health and education expenditures.
- Reduce economic growth.
- Discourage foreign direct investment.
- Slow creation of new enterprises.

- Channel public money into defense and infrastructure, where kick-backs are typically high.
- Increase debt burdens on poorer countries.

Having watched the debilitating effects of corruption for more than 40 years in dozens of countries, I don't want to hear the argument that it has a good side, oiling the wheels of commerce and enabling rich people to dole out money to poor people. That's like arguing that HIV/AIDS has a good side, promoting research and enhancing profits of pharmaceutical companies. No, there is no good side to HIV/AIDS, and there is no good side to corruption. Both kill people.

The most nervous civil servant I've ever encountered was a top official at the Brazilian central bank during the administration of Fernando Collor de Mello. I had been referred to him by a senior advisor in Palacio do Planalto, the office of the president in Brasilia. This central banker monitored capital inflows and outflows. I offered some preliminary data on illegal outflows from Brazil, and he panicked. He paced, pulled another colleague into his office, drew his chair close to mine, whispered, and squirmed. Little wonder. Collor was accused a few months later of robbing the till to the tune of tens of millions of dollars. Later, on a sunny Sunday in August 1992, I watched as a hundred thousand people took to the broad avenues of Brasilia demanding Collor's resignation, which was tendered a few weeks later. The Brazilian Senate proceeded to impeach and convict him of corruption, though this was later overturned by the country's supreme court for insufficient evidence. Based on the Senate outcome, Collor was nevertheless barred from public office for eight years.

Transparency International (TI) lists some of the larger kleptocrats of recent years, as in Table 3.1. Many more names could be added. Saddam Hussein must feel terribly slighted not being included among the great thieves of recent years. During the presidency of Ibrahim Babangida of Nigeria, $12.4 billion in oil revenues received during the Persian Gulf crisis of 1990–1991 allegedly disappeared. Alfredo Stroessner of Paraguay was world class, believed to have ripped off millions. The Angolan government of Jose Eduardo Dos Santos was accused in a 2004 report by Human Rights Watch of mislaying $4.2 billion from 1997 to 2002.[2] Daniel arap Moi, ex-president of Kenya, is currently being suspected of frauds that allegedly gen-

TABLE 3.1 WHERE DID THE MONEY GO?

Head of Government	*Estimates of Funds Allegedly Embezzled*
Mohamed Suharto, Indonesia, 1967–1998	$15 to $35 billion
Ferdinand Marcos, Philippines, 1972–1986	$5 to $10 billion
Mobutu Sese Seko, Zaire, 1965–1997	$5 billion
Sani Abacha, Nigeria, 1993–1998	$2 to $5 billion
Slobodan Milosevic, Yugoslavia, 1989–2000	$1 billion
Jean-Claude Duvalier, Haiti, 1971–1986	$300 to $800 million
Alberto Fujimori, Peru, 1990–2000	$600 million
Pavlo Lazarenko, Ukraine, 1996–1997	$114 to $200 million
Arnoldo Alemán, Nicaragua, 1997–2002	$100 million
Joseph Estrada, Philippines, 1998–2001	$78 to $80 million

Source: Transparency International, *Global Corruption Report, 2004* (Sterling, VA: Pluto Press, 2004), 13.

erated tens of millions of dollars sloshing out of the central bank. Benazir Bhutto and Nawaz Sharif of Pakistan certainly understood the concept of self-enrichment and will be covered shortly. Omar Bongo of Gabon was tagged with $130 million in U.S. deposits in a 1999 Senate hearing at which I testified. Robert Mugabe of Zimbabwe is currently accused of grabbing all he can and shifting money to Singapore and Malaysia. And then there is that most genial of master pickpockets, Felix Houphouët-Boigny, president of Côte d'Ivoire. The key person in the Bank of France in a position to know told me that, at the time of Houphouët-Boigny's death in 1993, his accumulated assets outside Côte d'Ivoire totaled seven billion dollars! Startled that a small one-crop country selling cocoa could produce such offshore wealth for its leader, I blurted, "Dollars or francs?" He repeated, "Dollars!" Côte d'Ivoire has since descended into chaos. This rogues' gallery could continue for many more paragraphs.

Indeed, where did the money go? Into western coffers, where it can be accommodated with all the courtliness and secrecy available to the world's rich, whether saints or scoundrels.

In terms of financial flows, the decade of the 1990s was the most corrupt in the past half century and probably the most corrupt in history. And despite all the attention being given to stemming corruption, it is not clear that the current or next decade will be any better. Even the *Economist* said as recently as 2002, "Most half-reliable measures of bribery around the world show it to be growing, not fading away."[3]

The United States passed the Foreign Corrupt Practices Act (FCPA) in 1977, after 400 U.S. firms were reportedly found using bribery of foreign government officials as a primary negotiating tactic in overseas sales. The act barred bribery for the purpose of "obtaining or retaining business." It was amended in 1988 in order to clarify that "bribery" was not intended to include minor "facilitating payments," a point that will become important in a few pages. It was further amended in 1998 to bring the FCPA into line with the Organisation for Economic Cooperation and Development (OECD) convention against bribery, adding that payments to secure an "improper advantage" are likewise barred. Nearly three decades after the act was first passed, U.S. courts are still interpreting whether bribes to avoid foreign taxes and duties come under the act.[4] European Union countries began adopting antibribery laws only in the late 1990s and will go through years of legal wrangling before what is barred becomes clear. Meanwhile, there are legions of lawyers who advise on how to get around anticorruption laws and win coveted contracts.

While the FCPA made bribes by Americans illegal, handling the proceeds of foreign bribery was not illegal, and U.S. banks continued their pursuit of these billions from countless despots, tyrants, and corrupt government officials for the next quarter century. Not only U.S. banks but also banks in every European and many Asian countries went after looted funds.

A few years ago I called on the regulatory compliance officers of two Swiss banks. Each tried to convince me that his institution refused to handle the proceeds of bribery and corruption or any other forms of illegal flight capital. They both showed me their lengthy policy declarations demonstrating how aggressively their banks fight the scourge of dirty money. I saw through these elaborate statements, finally wringing confessions from the two compliance enforcers that the only thing meant by their legal obfuscations was that bank officers themselves should not physically carry cash, gold, or negotiable instruments across borders on behalf of their clients.

That's all the statements meant: Transfer all the dirty money you can; just don't carry it on your person!

Riggs Bank

For years U.S. and European bankers have tried to convince me and others that handling dirty money is in the past: We don't cater to corrupt officials, the institution's anti–money laundering safeguards are very effective, our reputation is our most valuable asset. Okay, bring all this reassuring talk right up to 2004, to the capital of the United States and its venerable Riggs National Bank.

Founded in 1836, Riggs catered to the elite of Washington, serving 17 presidents including Abraham Lincoln, generals and admirals including Sherman and Grant from the Civil War and MacArthur and Nimitz from World War II, and 95 percent of the embassies and foreign missions located in the greater metropolitan area. It regarded itself as "the most important bank in the most important city in the world."

At the request of Senator Carl Levin, the U.S. Senate Permanent Subcommittee on Investigations launched an examination in 2003 into money laundering at Riggs. The report it released in 2004 plus a supplement in 2005 are the most damning documents produced on any financial institution since the Bank of Credit and Commerce International (BCCI) was turned inside out in the early 1990s.

Riggs had few scruples about the kind of money it accepted. It graciously serviced the wealth of a murderous dictator, Augusto Pinochet of Chile; a world-class thief, Teodoro Obiang of Equatorial Guinea; and Saudi Arabian money that was suspected of ending up in the hands of terrorists. "Serviced" is an understatement; Riggs groveled before some of the dirtiest money on Earth.

Pinochet. As the Senate report says, "Mr. Pinochet has been accused of involvement with human rights abuses, torture, assassinations, death squads, drug trafficking, arms sales, and corruption . . ."[5] Riggs took deposits from Pinochet as early as 1979, and then in the mid-1990s, using its own Bahamian trust company, established two offshore shell corporations, Ashburton Company and Althrop Investment Company. Riggs also issued up to nine certificates of deposit (CDs), each for a million dollars or more for Ashburton and

Althrop. At various times, Riggs maintained 28 Pinochet-related accounts and CDs, and held $6 to $8 million of the ex-dictator's funds. To meet its Know Your Customer (KYC) requirements, Riggs described Pinochet as "a retired professional who achieved much success in his career and accumulated wealth during his lifetime for retirement in an orderly way."[6]

In 1998 Pinochet was arrested in London. In 1999, while Pinochet was still detained, Riggs moved some of his money on deposit at its London branch to its head office in Washington. Pinochet was freed in 2000, and Riggs senior officials immediately flew to Chile to meet with him. As news of the accounts began to leak out, Riggs altered their identifications, removing Pinochet's name. From 2000 to 2002 Riggs issued 38 cashiers checks for $50,000 each, eight in Pinochet's name and 30 in the altered names. Some were hand delivered to Chile by Riggs officers.

Obiang. Equatorial Guinea is comprised of a small piece of the mainland and five inhabited islands off West Africa. Teodoro Obiang overthrew and executed his uncle in 1979 and has reigned as president ever since. Oil made him very rich, very corrupt, and a very good Riggs customer.

From the mid-1990s on, Riggs opened and handled 60 accounts for Obiang, his family members, other officials, and the Equatorial Guinea government. As much as $500 million was on deposit, and Obiang could withdraw funds from the main accounts on his sole signature or together with his son or nephew. Riggs also helped set up Bahamian offshore shell corporations: Otong S.A. for the president and Awake Ltd. for his sons.

Riggs ministrations to Obiang were effusive, including a luncheon hosted in 2001, an invitation to visit the Ronald Reagan Library in California, a private meeting with senior bank officials in 2003, and even a special committee comprised of the chairman, president, president of the holding company, and account manager. Writing to the embezzler, the bank confirmed that the committee "will meet regularly to discuss our relationship with Equatorial Guinea and how best we can serve you" and asked that "you provide us with any projects that you would like us to review on your behalf . . ."[7] After all, Equatorial Guinea, a tiny state being robbed blind by its ruler, was Riggs' biggest customer.

To be a really good banker to the corrupt of the world you have to be willing to handle cash covertly. Six cash deposits were made to the president's

Otong account from 2000 to 2002, totaling $11.5 million. The senior Riggs official overseeing Equatorial Guinea's needs hauled suitcases stuffed with dollars into the bank for deposit. Similar courtesies were offered to Obiang's wife, but cash deposits to her accounts were a mere $1.4 million. None of the cash deposits led Riggs to file a Suspicious Activities Report, as required by law.

Perhaps this was because the Riggs account manager, Simon Kareri, seemed to have ample reason to keep some of his dealings hidden. His wife had an offshore shell corporation, Jadini Holdings, Inc., and wire transfers totaling more than $1 million went from an Equatorial Guinea account into a Jadini account.[8] When discovered, Kareri took off for Equatorial Guinea and, finding little solace there, returned to Washington to plead his Fifth Amendment rights against self-incrimination.

Out of the Equatorial Guinea oil account at Riggs, wire transfers totaling $35 million were sent to a Banco Santander account in Spain and to an HSBC account in Luxembourg. When Senate investigators attempted to trace who owned the accounts into which Equatorial Guinea's oil money was being shifted, they realized that, due to secrecy laws, the two European banks "were unable to find out from their own foreign affiliates" who were the beneficial owners on the accounts.[9] Equatorial Guinea's oil money is disappearing into a black hole, and even the power of the U.S. government cannot plumb the depths.

Saudi Arabia. Riggs at one time had some 150 Saudi accounts for the embassy, the long-time ambassador Prince Bandar bin Sultan, his wife, and others. A little more than a year after 9/11, the FBI began examining Saudi accounts at Riggs. Expected to take one month, the probe lasted five months, apparently producing disturbing information. Million-dollar movements of funds in and out of Prince Bandar's accounts and perhaps out of embassy accounts, with little explanation, has led to speculation that money could have unintentionally ended up in the hands of terrorists. The U.S. administration seems hesitant to offer details of Saudi financial affairs, choosing instead behind-the-scenes pressure on the kingdom to strengthen laundering controls.

Now, where were U.S. regulators during the years Riggs was laundering the money of Pinochet and Obiang and paying little attention to

huge transfers in and out of 150 Saudi accounts? Some of the responsible officers were right across the street from Riggs at the U.S. Treasury Department.

The Senate investigation found that "the anti–money laundering program at Riggs Bank was almost completely dysfunctional."[10] Examiners from Treasury's Office of the Comptroller of the Currency (OCC) reported major deficiencies continuously from 1997 on but then failed to take actions necessary to enforce corrections. Instead, examiners repeatedly found that, despite obvious shortcomings, Riggs anti–money laundering efforts were "making progress" and were "satisfactory." Furthermore, the examiner in charge allegedly kept information critical of Riggs out of OCC files and then left government employment for an executive vice presidency at Riggs, where he continued to meet with OCC officials, contrary to post-employment regulations.

For Riggs Bank and its many customers in Washington and worldwide, it seems that KYC meant "Kleptocrats, You, and Crooks," all receiving polished service from the bank's highly professional officers. Riggs and its regulators utterly failed in their most fundamental task: insuring the integrity of the institution. Riggs paid a fine of $25 million and a second fine of $16 million and agreed to settle court action in Spain by paying $8 million to a foundation set up for victims of Pinochet's rule, with two owners of Riggs agreeing to pay the foundation an additional $1 million. Sale of the bank to new owners was completed in early 2005.

The proceeds of corruption coming out of developing and transitional economies are lodged in western coffers. Many U.S. and European banks ignore or skirt regulations in order to receive and profit from this money. The following pages will focus on Nigeria, Indonesia, and Pakistan. In each, keep in mind where the money goes.

Nigeria

Ladies and gentlemen, we have a winner. In the global corruption sweepstakes the grand prize goes to—and let's have a loud cheer for—**N I G E R I A**—the most corrupt country in the world!!

How can I possibly make such a bald statement? I've observed financial skullduggery in many countries, but from my perspective no nation with

which I am familiar has descended so deeply into this suffocating abyss as Nigeria. Consider the following:

- Joseph Stiglitz, Nobel Prize winner in economics, boldly went to the capital, Abuja, and said that Nigerians have taken an estimated $100 billion out of their country. That's 2.3 times the current GDP. Almost every dollar of this disappeared illegally. I do not know of any large country that has a higher multiple of GDP spirited illicitly beyond its borders into western accounts.
- Corruption has permeated every level of society. Whereas after independence it was limited to a few ministers receiving bribes, now "dash" is necessary to get almost any routine service performed.
- Political murders were common during military regimes and have continued under civilian rule, recently reaching as high as a federal attorney general.
- Members of the judiciary, most of whom owe their appointments to previous dictators, have become terribly corrupted, often selling judgments to the highest bidder. The very weak rule of law curtails investment and growth.
- Nigeria has become world famous for "4-1-9" scams, advance fee frauds that bring in millions of dollars. More on this shortly.
- Nigerian criminals have spread throughout Africa, earning the enmity of other states from south to north.
- Nigerian drug gangs, estimated at 500 in number, have gone global.

Finally and most persuasively, Transparency International (TI), the anticorruption organization, says that Nigeria is the longtime winner in the global corruption sweepstakes. TI rates corruption perceptions for more than 130 countries on a 10-point scale, with 10 being the best. From 1996 to 2004, Nigeria never rose above 1.9, and its average across these years is lower than the average across the same period for any other country. In fact, Nigeria's total score across these years is lower than the total score of many countries that have been on the list for fewer years.[11] I rest my case; Nigeria takes the blue ribbon.

I have both railed against corruption and been sucked into the edges of it, and, consistent with trying to write as honest a book as I can, I tell

stories to illustrate each side of my own experiences. In the late 1960s, while the Nigerian Civil War was still raging, I negotiated to buy a medium-sized packaging manufacturer whose pesky balance sheets and income statements showed five years of losses. I figured the Syrian family who owned majority interest, besides being poor managers, was overloading imported raw material prices and thereby eliminating local profits in order to generate hefty kickbacks out of the country. I offered 10 times book value to buy the company. Harvard students later studying the case unanimously agreed this was convincing evidence of tropically induced dementia. After the acquisition, I purchased imported supplies at much cheaper world-market prices, paid off all the debts of the company in the first year, and then distributed generous dividends to myself and minority stockholders for years thereafter. It was simply a process of not overpricing imports, but instead letting the profits earned locally accrue locally and be properly recorded on the company's books.

Then in late 1972 I ran into a situation I couldn't sidestep. The military was still in power, oil production was growing, money was flowing, and corruption was soaring. In one of my companies, the purchasing manager and the imports clearing clerk came to me and said that a senior customs officer was demanding a bribe before he would release 500 tons of material waiting at the docks. I sent them back to demand that the cargo be cleared without delay. To no avail. I sent them again pleading for the needed goods, again to no avail. I said I'll go with them, and they said, No, that will only drive up the price of his extortion. Reluctantly I agreed to a £200 "clearing fee." Of course, once that started, it never stopped. I finally allocated £200 per month for "miscellaneous importation expenses" and told my two employees that if they did not have to spend it they could keep it but not to raise the subject again.

This galled the hell out of me, being placed in a position where no outcome was satisfactory, and I took little comfort in knowing that many others were doing it without batting an eye. I sold the company a few years later and eventually wrote a play in which a bribery situation was a central event.[12]

Then after carrying this unpleasant memory for 15 years or so, something wondrous happened. The Foreign Corrupt Practices Act, originally passed in 1977 and not in force when my incident in Nigeria occurred, was amended in 1988 to clarify that these little facilitating payments, or "grease"

payments as they were called in congressional committee hearings, of less than say $1,000, were not bribes at all. They were just a normal part of what we have to do from time to time to stay in business. In other words, the U.S. Congress came riding to the rescue of my conscience. Thank God! Here I'd been thinking for years that my corruption-fighting credentials were compromised. But, no, I never was a briber in the first place; I was merely a greaser! What a relief!

The most brutal of Nigeria's military dictators was Sani Abacha, in power from 1993–1998. When Abacha graduated from Sandhurst, the military training college in England, his British instructors, recognizing that he hardly possessed the qualities of an officer and a gentleman, noted on his confidential personnel file that he should never be permitted to rise above the rank of colonel. Three decades later as a general, he became possibly the richest unelected person ever to take over a country. Amassing his initial fortune allegedly through drug trafficking and arms purchasing, he was by some estimates a dollar billionaire while still number two in the political hierarchy, below Ibrahim Babangida.

Nigeria's position as a transit point for drugs emerged a little more than a year after the notorious BCCI opened for business in the country in 1981 and began facilitating linkages with South Asian and Latin American sources of heroin and cocaine. Nigerian generals competed to provide security for shipments arriving at urban airports and military bases, arranging temporary storage and perhaps movement to another landing strip, and then overseeing reloading and onward flights to markets in North America and Europe. Members of Abacha's family formed an air service and contracted with American Trans Air based in Indianapolis, Indiana, for equipment and services. This secured his hold on the Lagos-to-New York smuggling route, though American Trans Air officials may not have known of his nefarious intent even after he lost his U.S. landing rights.

Abacha had already developed a reputation for brashness in the business of corruption. When he was head of the defense establishment he had government checks for tens of millions of dollars written to his own name, supposedly enabling him to go abroad and purchase arms for his forces. For example, one check, said to have been for $75 million, was intended to fund weapons procurement for Nigerian troops stationed in Liberia, with little or nothing ever arriving.

Until the late 1990s, Nigeria had a succession of increasingly corrupt military regimes that began in 1966, broken only by a four-year return to equally corrupt civilian rule in the mid-1970s. By the mid-1980s, it was clear that when a general ascended to head of state he was expected to leave the dirty business of drugs to lesser officers and concentrate his larceny on loftier means of enrichment. Abacha followed suit. In 1993 he forced out a weak, three-month-old, interim government and took over the country, thus placing Nigeria's huge oil revenues at his disposal.

A portion of the nation's two-million-plus barrels per day oil production, arising from joint ventures with foreign corporations, is allocated to the federal government. Heads of state awarded "lifting" contracts (purchase rights) to members of the elite whose support they valued. A low purchase price paid to the government accommodated large profits on sales to foreign buyers, generating huge margins out of which multimillion-dollar kickbacks were deposited into foreign bank accounts. Marc Rich's Swiss trading company, Glencore, allegedly was a frequent intermediary.[13]

Even as one of the world's largest oil producers and with four local petroleum refineries, Nigeria had to import diesel fuel, jet fuel, and gasoline. Abacha starved the refineries of maintenance funds, cutting their combined output to a fraction of capacity, so that products had to be purchased abroad. By the tanker-loads, hundreds of millions of gallons of usually off-quality fuel were brought in mainly from European refineries, at markups as much as 400 percent above world market prices. This became one of Abacha's most prized sources of graft, draining hundreds of millions of dollars from state revenues.

Finally, Abacha entered that elite group of rogues who had the power to direct the central bank to deliver currency straight out of the national treasury. Locked trunks and canvas bags containing millions in dollars and pounds often showed up late at night at Abacha's various residences. Ferdinand Marcos of the Philippines and Mobutu Sese Seko of Zaire did the same thing.

When he took over the presidency of Nigeria in 1993, Abacha's ambition seemed to be to stay in office longer and steal more money than any of his predecessors. He was well on the road to success when unexpectedly in 1998 he succumbed during an orgy with two other generals and three prostitutes

imported from India. His legacy had to settle for a lesser distinction: merely one of the world's two or three biggest thieves in his own time.

I have often been asked why dictators continue to steal long after they have accumulated more than they can ever use. Beyond the first billion or two, what's the point? The answer is straightforward: It becomes addictive. For Abacha it was the daily stimulant that fed his ego, proving to himself that he was shrewder than those around him. Having "street smarts" but only average intelligence and perhaps rather low self-esteem, Abacha's kleptomania was a habit central to his notions of power and satisfaction. Millions of Nigerians lived lives of deprivation and destitution while he continuously fed his insatiable appetite. The driving force for him and others of his ilk, long after there is any rational purpose for continued theft, is less the wealth and more the process of reaffirming total dominance.

Shortly after his death, his wife, Mariam, tried to take millions of dollars in cash through the Kano airport in 38 trunks, bags, and briefcases in an unsuccessful attempt to leave the country. In addition, one of Abacha's sons was reportedly caught with $100 million in cash. It remains unclear how much of these seizures was ever returned to the national treasury.

Abacha's plunder was facilitated by some 100 banks all over the world—in the United States, England, the Channel Islands, France, Switzerland, Germany, Luxembourg, Liechtenstein, Austria, Dubai, Singapore, Hong Kong, Australia, Brazil, and elsewhere, with services allegedly performed by such institutions as Citibank, Barclays, Standard Chartered, HSBC, NatWest (now part of the Royal Bank of Scotland), ANZ Grindleys Bank, BNP Paribas, Crédit Agricole Indosuez, Credit Suisse (including Bank Hofmann and Bank Leu), Banque Baring Brothers, Banque du Gothard, Union Bancaire Privée, M.M. Warburg, Banque Edouard Constant, Deutsche Morgan Grenfell, J. Henry Schroder Bank, Pictet & Cie, S.G. Ruegg Bank, Commerzbank, Bank of India, and many more. With a fortune estimated at $3 billion to $5 billion, a feeding frenzy arose to receive, shelter, and manage Abacha's wealth.

Citibank Private Bank, for example, opened accounts for Abacha's sons, Mohammed and Ibrahim, in 1988, when the general was allegedly generating the bulk of his money from drugs and arms. The two sons received the most discreet treatment aimed at assuring transaction secrecy, including establishment by Citibank of an offshore shell corporation, three additional accounts set up under the names "Navarrio," "Gelsobella," and "Chinquinto," tailored codes to facilitate funds transfers, and a "Hold All Mail"

directive issued to bank employees in order to avoid any paper trail. Balances reached $60 million in London and deposits and withdrawals approached $50 million in New York. Account managers in both cities later claimed that for years they were unaware that the brothers were sons of the man who took over Nigeria. Becoming aware of this fact in January 1996, Citibank calmly noted that "wealth comes from father who accumulated wealth as head of state," and Citibank then proceeded to handle a tripling of deposits into the London account and to provide confidential services for the next three years. Even after Sani Abacha died in June 1998 and the Nigerian government initiated an investigation into his bank accounts, Citibank facilitated the sons' transfer of $39 million from London to Switzerland. The money was on a time deposit requiring a penalty for early withdrawal, so Citibank arranged a $39 million overdraft enabling the shift to be effected immediately.[14] In the entirety of this 10-year relationship, both before claiming to know the identity of the account holders and after knowing of Nigerian government investigations and seizures of Abacha family funds, Citibank broke no U.S. laws in holding and transferring wealth stolen by one of the decade's most corrupt individuals.

In Switzerland, 120 Abacha-related accounts in Geneva and Zurich totaling $670 million were found and frozen. The biggest offender, Credit Suisse, was reprimanded in 2000 by the Swiss Federal Banking Commission for failing to exercise due diligence in accepting more than $200 million in Abacha funds.[15] Banks in Luxembourg froze another $650 million and in Liechtenstein $100 million was added,[16] totaling more than $1.4 billion that had been deposited in these three traditional money laundering centers.

In the United Kingdom, the Financial Services Authority found that 23 London banks had handled $1.3 billion in Abacha funds, some of it on the way to Switzerland and elsewhere.[17] Barclays was cited for handling $170 million.[18]

French implication in the Abacha scandal arose primarily through branches of Paris banks in London and Switzerland. In October 2001 a French parliamentary committee condemned "feeble" efforts in the City of London's battle against money laundering, noting that, "Great Britain does not cooperate with European countries and offers a totally unacceptable haven for criminal funds."[19]

Abacha's frozen accounts have opened the door to protracted legal proceedings to recover funds. For some countries, criminal charges must first be

lodged or adjudicated in Nigeria, not a certainty in a judicial system itself steeped in bribery.

Meanwhile, Nigeria has spread its reputation for fraud worldwide. Hundreds of thousands of businesses, organizations, churches, and individuals in North America, Europe, Asia, and elsewhere have received letters humbly asking for foreign assistance in pocketing remnants of wealth stolen from the country by Abacha and others. Called "4-1-9" schemes for the section of the Nigerian criminal code supposedly violated, these appeals offer to give 25, 30, or even 40 percent of the purported $50 million or $100 million stash, in return for facilitation through the contacted person's overseas bank account. I have received dozens of these letters since the early 1990s. A recent bogus letter purported to be from a committee comprised of officials of the Nigerian National Petroleum Corporation, the Federal Ministry of Finance, and the Central Bank of Nigeria. After explaining how they had acquired $75 million "by carefully inflating the amount of indebtedness" owed by the government on a contract to rehabilitate a refinery, the letter goes on to say:

> We need a reliable company to be included in the list of companies to be paid. We have agreed to share the funds thus: 1) 70 percent for us (the committee members), 2) 25 percent for you (the account owner), and 3) five percent will be used in settling taxation and all local and foreign expenses that will be incurred in the course of this transaction. We need assurance from you that you will let us have our share once the inflated amount ($75 million) is transferred into your account. We shall commence the transfer of the funds immediately we receive the following information: 1) your company name and full address, 2) your bank's name, telephone and fax number, 3) your account number and name of the would-be beneficiary.[20]

As correspondence with unsuspecting dupes progresses, an advance fee of some thousands of dollars is requested to bribe others and speed matters along. If money is not coughed up, then the fraudsters, now enlightened with the mark's name, bank, account number, and perhaps signature, simply order funds transferred out of the account. Some especially naïve individuals have even been persuaded to travel to Nigeria for meetings with supposed central bank or ministry of finance officers, often arriving with-

out visas, where they can be further shaken down or even forced to ransom their departure.

The take from gullible foreigners has been estimated at more than $1 billion. As of this writing, five Nigerians are charged with defrauding a Cayman Islands account of a Brazilian bank, Banco Noroeste S.A., of $242 million, leading to the bank's collapse. The chairman of Nigeria's Economic and Financial Crimes Commission reported in 2004 that "200 Nigerians are currently serving jail terms for advance fee fraud all over the world but not a single person has been convicted for the offense in the country."[21]

In a private meeting with President Olusegun Obasanjo discussing this and other corruption issues, I gave him a scam letter on official-looking presidential letterhead bearing his own forged signature. This was the first one he had seen with that level of brazenness among his country's con artists.

With so many gangs doing this in Lagos and Abuja, infiltrating telephone exchanges and post offices and now using e-mail, competitive pressures have forced some to take their activities on the road, setting up operations in Ghana, Namibia, Angola, South Africa, Saudi Arabia, and elsewhere. Who would fall for such schemes? Professors, businesspeople, managers, bookkeepers, religious organizations, charities, students, you name it, on every continent. Nigerian advance-fee fraudsters even work on a personal, face-to-face basis in the United States and Europe, embarrassing some very successful businesspeople. I know three wealthy Americans who have been duped out of thousands of dollars.

Among multinational companies, which have been involved in corruption in Nigeria? Just a few names will suffice. American and British subsidiaries of ABB Ltd., a Swiss engineering firm, recently paid fines of more than $10 million to settle charges of alleged bribery in Nigeria to gain details and recommendations on seven construction contracts.[22] Baker Hughes, the Houston-based oil-field services company, has been cooperating with U.S. authorities investigating allegations of bribery in Nigeria.[23] This follows settlement of claims that the company bribed officials in Indonesia. One Enron and four Merrill Lynch executives were convicted in 2004 for a bogus sale of barges in Nigeria, done to dress up Enron's faltering income statement.

Halliburton has had many problems. In 2003 the company admitted that it had paid a bribe of $2.4 million to a Nigerian tax consultant who offered to intervene with the Federal Inland Revenue Service (FIRS) to reduce

taxes for the local subsidiary. Turns out the "consultant" was a FIRS officer himself, in a position to make the tax go away.

The really big scandal centers on a $4.9 billion project in Nigeria. Natural gas, produced together with Nigeria's oil and almost entirely bled off and burned for three decades, is now being piped into gathering systems, processed, frozen, and shipped to foreign buyers. A contract for expansion of the liquefied natural gas plant was given in the mid-1990s to a consortium of four companies: Technip of France, Snamprogetti Netherlands, an affiliate of ENI of Italy, Kellogg Brown and Root (KBR), now a subsidiary of Halliburton, and JGC Corporation of Japan. The four companies formed a joint venture called TSKJ, drawing on the first initials of each corporate name. This entity, along with a second consortium entity known as LNG Servicos, was based in that nice little Portuguese tax haven, the island of Madeira.

Among the four partners, KBR was the coordinator of the project. A London lawyer named Jeffrey Tesler reportedly had a relationship with Halliburton dating from the 1980s and also was allegedly an advisor to Sani Abacha.[24] At some point in the 1990s he was designated as an agent to represent TSKJ in Nigeria. He formed Tri-Star Investments in Gibraltar and made only one trip to Nigeria, yet from 1995 to 2002 payments totaling $166 million were reportedly made out of a TSKJ "slush fund" to Tri-Star accounts in Switzerland and Monaco. In 2002 a French prosecutor pursuing the much-publicized bribery scandal involving Elf Aquitaine and French politicians chanced upon information regarding these payments. An investigating judge, Renaud van Ruymbeke, was assigned to the case. Thus far he has reportedly turned up payments of $2.5 million into a Swiss bank account belonging to former Nigerian oil minister Daniel Etete,[25] $5 million into a Swiss bank account of the former chairman of KBR Albert Stanley,[26] and more than $1 million to William Chaudan, also a former KBR executive.[27] It is suspected that much of the remaining millions was transferred to Abacha and other Nigerian government figures.

In 2003 a senior official of the Economic and Financial Crimes Commission said, "Most of the cases of corruption in Nigeria are linked to the operations of multinationals in the country."[28] In June 2004, Halliburton's chief financial officer was quoted saying, "As anyone who does business in Nigeria knows, one needs an agent in Nigeria."[29] This struck some people as a justification for bribery. Halliburton beat a hasty retreat, severed relation-

ships with Tri-Star and Tesler, as well as with Stanley and Chaudan, and agreed to cooperate with the ongoing French investigation. This story will unfold for years to come.

To keep up with the country where I lived for 15 years and still have interests and close friends, I read the excellent e-mail newsletter Nigeria 2Day@aol.com. A sense of the severe strains on the country is conveyed by a few excerpts from Nigeria2Day, quoted with the permission of the publishers and with minor edits to abbreviate passages.

- Oil industry experts say criminal networks, operating with the tacit support of powerful political and military elements, are illegally siphoning off about $1 billion of oil a year. Between 100,000 and 130,000 barrels a day with a market value of around $3 million is being stolen. (May 30, 2003)
- Over 150 villagers are now known to have died when a fire erupted around a leaking fuel pipeline in the village of Amiyi-Uhu. Despite the risks, hundreds of people waded through a river of highly flammable fuel with buckets and jerry cans. "There is too much hunger, there is too much unemployment" says Bernard Orji, an extremely angry local politician who visited the scene. "Young boys and young girls died here. If you look around you can see slippers and shoes that belong to kids. It is an index of the poverty level in this community." And it provides a stark image of the inequality and poverty that is widespread in a country where successive governments have conspicuously failed to invest the billions of dollars earned from oil over the decades, back into developing the nation's potential. (July 7, 2003)
- The federal government has told several international oil trading companies to repay more than $100 million it says it was defrauded of through the inflation of oil import costs. The Nigerian National Petroleum Company fired seven oil-trading officials last month on suspicion of conspiring with suppliers to defraud it of "hundreds of millions of dollars" by manipulating shipping documents. (May 27, 2004)
- Nigerian waters were the most deadly during the first half of 2004 according to a new piracy report, and analysts are blaming the proliferation of weapons in the coastal oil-rich Niger Delta region where

armed gangs trade stolen crude. The International Maritime Bureau said that half of the 30 deaths recorded in pirate attacks around the world between 1 January and 30 June occurred in Nigerian territorial waters. (July 29, 2004)

- Three former Nigerian cabinet ministers and two other former government officials are due in court today on charges of accepting part of more than $1 million in bribes from France's electronics giant SAGEM SA. (January 23, 2004)
- The federal government released a report detailing a $400 million graft case involving former ministers and other prominent figures who helped ruin Nigeria Airways. (November 24, 2003)
- Security agencies and human rights workers blame traffickers, operating an international network that covers most of West and Central Africa and several European cities, for the plight of tens of thousands of children exploited for their labor and women bonded into prostitution. (November 14, 2003)

Nigeria has had some very venal individuals in positions of power and authority. The West has serviced their venality, opening its bank vaults to all the money that can be extracted from the country. Tens of millions of Nigerians are living at lower standards today than they were decades ago. Are the billions of dollars that come to the West worth the cost to them?

Indonesia

If Nigeria has a rival for the title Most Corrupt Country in the World, it's Indonesia. A population of nearly 250 million lives on 6,000 islands spread across 3,500 miles straddling the equator. Endowed with agricultural and mineral resources, its diverse peoples, some 300 ethnic groups, have been ripped off for 60 years by two regimes of autocrats and a succession of feckless leaders, while the western world participated in a level of lawlessness breathtaking in its sweep and duration.

Sukarno, preferring one name as did his successor, came to power at the end of World War II, fought the Dutch for independence, and achieved diplomatic recognition for his country in the late 1940s. Ruling an increasingly corrupt regime, he was displaced in 1967 by his chief of army staff,

Suharto (also spelled Soeharto), already alleged to be an experienced sugar smuggler. Suharto then unleashed a wave of mass arrests, internments, and killings of perhaps a half-million suspected communists, indelibly establishing his willingness to use violence to maintain power. Over the next three decades, he and his family centralized economic control and implemented some very creative schemes for self-enrichment.

His first major act of thievery was to take over two large business conglomerates owned by cronies of Sukarno. Recast as a state enterprise called PT PP Berdikari, control gradually passed to foundations under Suharto's personal direction.[30]

Another early step in 1969 allowed Liem Sioe Liong, a Chinese immigrant, founder of the Salim Group and close Suharto associate, to establish PT Bogasari as a virtual monopoly in flour milling, utilizing wheat supplied under the U.S. Food for Peace program, which makes available surplus production to needy nations.[31] Wheat imports rose to four million tons a year, making Bogasari reputedly the world's largest buyer of this grain.[32] The Salim Group expanded into instant noodles, cement production, and dozens of other businesses and banks in Asia and North America, all the while retaining various partnerships with Suharto family members.

From the 1970s onward, the Suhartos used almost every technique known to man to extract money from the Indonesian people. Four methods produced the most wealth, complemented by outright extortion and theft. First, trade monopolies were a favorite mechanism, granting exclusivity over some aspect of foreign or domestic commerce to a family member or crony. Second, foundations known as *yayasans* were particularly innovative schemes, taking percentages of revenues out of almost every rupiah that moved in Indonesia. Third, incurring banking and commercial debts was a favorite practice among Suharto's children, usually without the slightest intention of repaying. And fourth, founder's shares in joint ventures with foreign companies, whether given free or financed out of loans seldom repaid, put the Suhartos in bed with many U.S., European, and Asian multinationals operating in the resource-rich country.

Exclusive monopolies were handed out by Suharto to family members and friends for a range of commodities including flour, rice, sugar, cloves, imported Chinese medicines, oil product imports, paper for currency printing, urea fertilizer tablets, movies, armaments, military aircraft, and more. Such monopolies made hundreds of millions of dollars for the clan.

But not nearly as much as the yayasans, ostensibly collecting money for social welfare but in reality larding the Suharto coffers. George Aditjondro, a courageous chronicler of Suharto wealth, reported that 97 foundations were established over a 30-year period.[33] A government investigation into just seven of the foundations laid out some of the sources of "donations":

- Two-and-a-half percent of the profits of the central bank and all state-owned banks.
- Two percent of the incomes of individuals and state and private companies making more than $40,000 a year.
- A percentage off the salaries of civil servants and other government employees.
- A percentage off electric bills, movie tickets, and other consumer expenditures.[34]

Some of the money was dispensed for the welfare purposes stated. Out of the seven foundations probed, well over a trillion rupiah, adding up to billions of dollars, flowed to enterprises controlled by Suharto family members and their partners, as shown in Table 3.2.

To put it simply, Suharto ruled the country, set up the foundations, required the donations, controlled the funds, approved the distributions, and hugely enriched himself, his family, and friends. This is one of the neatest cycles of corruption seen in the twentieth century, with nearly every foreign investor required to participate. And, incidentally, it is the same technique used by terrorists across two decades: collecting money for supposedly charitable work, spending a little on social welfare, and using the rest for nefarious purposes.

When you are in full control of a nation, one of the great perks of office is that you and your family can renege on personal debts or get the state to pay them for you. Suharto's eldest daughter, Tutut, understood the drill well. She set up a private television station, TPI, in the early 1990s, using equipment "borrowed" from the state television service and funds "borrowed" from her own Bank Yama. Running up heavy debts, she twisted the arm of Indosat, the state long-distance telephone company, to buy $45 million of convertible bonds, rescuing both her TV station and her bank.[35]

Tommy Suharto, youngest son of the president, and crony Bob Has-

TABLE 3.2 THE ABUSE OF FOUNDATIONS

Foundation (Purpose)	*Intake (rupiah)*	*Outflows to Suharto Family, Friends, Their Businesses, and Private Banks*
Supersemar (scholarships)	1.54 trillion	Bank Duta, Sempati Air, timber companies, property investments
Dharmais (orphans, homeless)	1.54 trillion	Bank Umum Nasional, Sempati Air, timber, and industrial investments
Dakab (education)	950 billion	Bank Pesona Kriyadana, Sempati Air, timber, and industrial investments
Damandiri (poverty alleviation)	4.96 trillion	Bank Andromeda, Bank Alfa
Siti Hartinah Soeharto (disaster relief)	88 billion	Bank Alfa
Trikora (scholarships)	26 billion	Private museum, other personal foundations
Yamp (mosques)	79 billion	Private investments

Source: Japan Economic Newswire, "Suharto's Funds: Where Money Came From, Where They Went," August 29, 2000, http://web.lexis.nexis.com/.

san bought Sempati Airlines in the late 1980s. Competing against the state-owned Garuda Airlines, they decided that the best way to reduce costs and assure profits was to stop paying the state-owned oil company, Pertamina, for jet fuel. Other charges for such things as landing fees and catering expenses were left unpaid as well. Garuda, sensing that it, too, had an excuse for nonpayment, also let the bills pile up, leaving Pertamina holding the bag.[36]

One of the more blatant abuses was Tommy's pet scheme, the National Car project. Tommy lived high, liked fast cars, and dreamed of owning a stable of Lamborghinis, so when he got rich he bought them. Not the cars; the whole Italian company! This whetted his appetite, so in 1995 he set out to dominate the automotive industry in Indonesia. Cars already were being assembled locally from imported parts by European, Japanese, and South Korean manufacturers, but Tommy's idea was to work with Kia of South Korea to produce a "Timor" car out of locally-made parts. To get started, he imported 45,000 specially-branded Kias from South Korea and got his dad to

waive customs duties and sales taxes so he could price his imports one-third lower than competing vehicles.[37]

Tommy the all-too-visible playboy and his tinny little Timors were not particularly popular in Indonesia. Driving the car and getting stuck in traffic risked being set upon by angry youths wielding sticks and rods, beating the thing into a pile of scrap. Thus, sales fell way below expectations. Tommy leaned on the government to buy his inventory, resulting in a directive to that effect issued to all departments and state institutions.[38]

Granted "National Car" status, PT Timor Putra Nasional needed $1.3 billion to commence manufacturing. Tommy, lacking a sound loan repayment record, was turned down by every foreign and local bank he approached. For you or me, this might be somewhat discouraging, but not for Tommy. He marched into the central bank and insisted on a state guarantee of the requested $1.3 billion. The bank choked, but finally, backed by the government, ordered 4 state banks and 12 private banks to provide the financing, resulting in an offer of $690 million.[39] Work commenced on the factory buildings, and production lines were imported, until the project was finally cancelled in 1998.

The state banking system generally was ripe for picking by the Suharto clan. No one could easily turn down their requests for multimillion-dollar fundings. As a member of the National Development Planning Agency said to me quietly in his office, "Being the son of a president or minister and getting access to capital based on this heritage, that's feudalism, not economic democracy."[40]

The World Bank certainly understood these realities as early as the 1970s, continued lending through the 1980s, and even advanced more than $300 million to the Indonesian government in the early 1990s on a promise that banking procedures would be strengthened. The Indonesian government leaped at the money, plowed it into the state banks, and distributed much of it to the Suhartos all over again. An astute observer Michael Backman wrote, "Thanks to the World Bank, the Soehartos had found a way to pillage the funds of the international community and not just those of their countrymen."[41]

In the midst of the country's economic collapse, a highly respected official, who later became minister of finance, met with me in Jakarta and said, "In government, corporations, banks, all sectors, transparency is at the heart of the current crisis. We don't deserve this bad treatment on the basis of eco-

nomic factors alone, but on the basis of succession issues and economic transparency, we deserve it."[42]

According to an estimate prepared by World Bank economists, by the mid-1990s the Suharto family controlled 16.6 percent of Indonesia's market capitalization.[43] Generating huge sums of money from trade monopolies, fraudulent charities, and unpaid banking and commercial debts, the Suhartos parlayed their stolen loot into a staggering range of schemes, activities, pursuits, and further ripoffs. In most of these, efficiency was not the goal; easy money was. My list covers nearly a hundred categories of businesses encompassing thousands of separate entities in manufacturing, oil, mining, land, property, transportation, services, agriculture, and more.

Offshore properties and investments belonging to the Suhartos reportedly included for-profit toll roads in Malaysia, Philippines, Burma, and China; mansions and penthouses in Singapore, Los Angeles, London, Boston, Geneva, Auckland, Queenstown, Bermuda, and Hawaii; a hunting lodge in New Zealand; an 18-hole golf course in Ascot; the Christmas Island Casino; and assorted investments in Uzbekistan, Portugal, Sudan, Guinea Bissau, Australia, and New Zealand. Accounts in bank secrecy jurisdictions and tax havens were reportedly spread to Curaçao, Cayman Islands, Panama, Bahamas, British West Indies, British Virgin Islands, Gibraltar, Hong Kong, Cook Islands, Vanuatu, and West Samoa.

And I am only now getting to the Suharto's greatest money-making scheme of all, extracted particularly from foreign corporations: free shares, or, as often called in conversations with me in Jakarta, "empty" shares. Michael Backman wrote, "The Soehartos' power over foreign investors was assisted by the fact that all foreign investments over US$100,000 had to be personally approved by Soeharto himself."[44]

The distribution of empty shares was accomplished in two ways, by giving completely free shares at the outset or by giving a loan for purchase of shares, with payments on the loan made out of future earnings. So long as the free shares or the loan in purchase of shares appeared to be in return for some small assistance rendered or patronage afforded, such actions on the part of U.S. companies, at best, very narrowly skirted laws against bribery contained in the Foreign Corrupt Practices Act. Or, to put it differently, the U.S. government chose to overlook what could easily be interpreted as bribery.

The family accumulated interests, according to Backman, in 1,251 large companies.[45] George Aditjondro, taking into account both large and small

investments and the activities of Suharto hangers-on, put the number at more than 3,200 companies.[46] Table 3.3 is a partial listing of family interests, current or past, documented or alleged, in some cases reflecting the activities of close cronies and foreign companies patronizing the ruling clan.

George Aditjondro alleges that a number of Dutch banks have been especially close to the Suhartos, providing "an international financial network for the Soehartos to globalise their businesses."[47] He names MeesPierson, ABN-AMRO, ING Bank, and Rabo Bank. He further alleges that Credit Suisse, UBS, and Swiss Banking Corporation "have played an important role in underwriting the fortunes of Indonesia's First Family."[48]

The corruption of the Suhartos has corrupted many other institutions in Indonesia. The army is deep into the charities scam, collecting money for welfare in the ranks, while directing money to high-ranking officers. The civil service has compiled an impressive record of bribe demands that could go on for pages, for administrative appointments, diplomatic postings, travel documents, airport clearances, petty approvals, licenses, and everything else imaginable. Officials in the Ministry of Forestry and Plantations are paid to overlook unbelievably rapacious logging, which is followed by burning hundreds of thousands of hectares of cleared land (spreading smoke to Singapore and Malaysia), which is followed by driving villagers off their land, which is followed by creating huge oil palm plantations belonging to the president's family and friends. The central bank has been called a "den of thieves," with regulators taking bribes to overlook fraudulent practices in the financial sector. Members of the judiciary buy more prestigious judgeships and then charge litigants for favorable judgments. Foreign aid and World Bank financing have been siphoned off for years, perhaps as much as 30 percent going into the pockets of corrupt officials. Which all brings the country close to the ranks of a weak or failing state, where terrorists thrive and threaten the continuity of the nation.

Estimates of the accumulated wealth of the Suhartos are all over the board. One of the best examinations was done by *Time* magazine in 1999 after Suharto's fall, placing the amount of money that had passed through the family's hands at $73 billion and the amount that had remained in their pockets at $15 billion. *Time* went on to report that as the regime tottered, "$9 billion of Suharto money was transferred from Switzerland to a nominee bank account in Austria."[49] Angered Suhartos threatened suit and then backed away, leaving the allegation uncontested.

TABLE 3.3 SUHARTO FAMILY HOLDINGS AND FOREIGN PARTNERS

Family Member and Companies[a]	*Principal Foreign Partners*[b]
Siti Hardiyanti Rukmana "Tutut" Eldest daughter 111 companies	El Paso Energy, General Dynamics,[c] Lucent Technologies, Motorola, Energy Equity, Marubeni
Siti Hediati Prabowo "Titiek" Middle daughter 70 companies	General Electric, Edison Mission Energy,[c] Merrill Lynch,[c] Fashion Café, National Power, Tomen Power
Siti Hutami Endang Adyningsih "Mamiek" Youngest daughter 6 companies	
Sigit Harjojudanto Eldest son 115 companies	California Energy, Du Pont, Freeport McMoRan, Unocal, British Petroleum, Thames Water, Mitsui, Nichimen Corporation, Sumitomo, Tomen Corporation
Bambang Trihatmodjo Middle son 327 companies	Atlantic Ritchfield, Duke Energy, Enron, Hughes Communications, Hyatt,[c] Montrose,[d] Union Carbide,[d] Uniroyal Goodrich,[d] United Parcel Service, Warner Lambert,[d] Waste Management,[d] Equatorial Energy, Telsat, BP Chemicals, Ergon Energy, Lloyds of London, National Power, Powergen, Alcatel, Deutsche Telekom, Siemens, Nestlé, Idemitsu Petrochemical, Marubeni, Mitsubishi, Nippon Shokubai, Hyundai, City View Energy, Nufarm
Hutomo Mandala Putra "Tommy" Youngest son 127 companies	Bell Atlantic, Detroit Diesel, International Wireless, Jupiter International, Guinness Peat,[d] Rolls Royce,[c] Mitsui OSK Lines, NEC, Nissho Iwai Corporation, Sumitomo, Kia Motors, Nettlefold Outdoor, Asia Power, Electricity Corporation
Probosutedjo Half brother of Suharto 119 companies	

(Continued)

Table 3.3 *(Continued)*

Family Member and Companies[a]	*Principal Foreign Partners*[b]
Sudwikatmono Cousin of Suharto 288 companies	Lawry's Prime Rib, Morrison Knudsen, Planet Hollywood, Sotheby's, Asahi Glass, Pohang Iron and Steel, Axiom Properties
Hashim Djojohadikusumo Son-in-law's brother 9 companies	Cabot Corporation, Metropolitan Life, MEC, New Hope Corporation
Ari Sigit Grandson 28 companies	EDC International, Leever Continental, Kuk Kong Construction

[a]Michael Backman, *Asian Eclipse: Exposing the Dark Side of Business in Asia* (Singapore: John Wiley & Sons, 1999), 262–266.
[b]Backman, *Asian Eclipse*, 293–294 is the source of information in this listing, except where otherwise noted.
[c]Peter Engardio and Michael Shari, "The Suharto Empire," *BusinessWeek*, August 19, 1996, 46–47.
[d]George J. Aditjondro, "US Business Links of the Suharto and Habibie Families and Their Cronies," Southeast Asian Science Policy Advisory Network, July 1998, www.icsea.or.id/sea-span/0798/OT0819LL.htm, (accessed July 8, 2003; no longer available online).

In an interview on the Australian Broadcasting Corporation, Indonesian political commentator Wimar Witoelar was asked, "So when it comes to the kleptocrats, those dictators that corruptly took money from their own countries, is Suharto at the top of the heap?" His reply well encapsulated years of misrule: "In modern times, I would say yes. It's hard to think of anyone who can combine excellence in human rights abuse, in financial theft and in the undermining of the legal system and the political system. He is a man who did it all. He is the Grand Slam of all despots."[50]

Pakistan

Arguably the most dangerous nation on Earth, Pakistan is a bubbling cauldron of corruption and crime, where grasping politicians, greedy generals, drug smugglers, and terrorists intermix in a volatile web, made more threatening by a nuclear bazaar operated as a national sideline. Corruption and criminality run from the top down, with the political class constantly loot-

ing the national treasury and distorting economic policy for personal gain. Bank loans are granted largely on the basis of status and connections. The rich stash much of their money abroad in those willing western coffers, while exhibiting little inclination to repay their rupee borrowings. Banks fail and Pakistanis lose their meager savings. At the bottom, wretched and illiterate masses seethe with discontent, a perfect nurturing ground for terrorism.

It started a long time ago:

> In the distant past the East India Company used to siphon away a great deal of the assets and treasures of the Indian subcontinent or buy them at very low prices and send them abroad when the British ruled the country.
>
> But in recent decades it is the rich and crafty Pakistanis who have siphoned away a large part of the resources of the country with unremitting vigor. That began when a part of our export earnings was allowed to be kept abroad, with the practice of under-invoicing the exports or over-invoicing the imports. And that was followed by retaining abroad an increasing part of the money obtained as kickbacks during the import of machinery from the late 1950s.
>
> Later, politicians in office, senior bureaucrats and top military commanders joined them by sending their illegally earned money abroad. Subsequently, obtaining large bribes abroad and putting them in their bank accounts there became the fashion. Some of the top rulers too joined them merrily. . . .
>
> The total wealth siphoned away in this manner has been estimated to be between 60 billion and 100 billion dollars.[51]

Pakistan's recent history has been dominated by two families—the Bhuttos and the Sharifs—both merely tolerated by the military, the real power in the country. When it comes to economic destruction, there's not a lot of difference among the three.

Benazir Bhutto. Born in Karachi in 1953 and educated in private schools, Benazir Bhutto graduated from Radcliffe College at Harvard University in 1973. Going on to Oxford for a master's degree, she displayed her budding political skills and was elected president of the Student Union in 1977. Meanwhile, her father had become prime minister of Pakistan in

1971, was ousted in a military coup in 1977, and was executed in 1979 on charges of conspiracy to commit murder. In and out of prison and house arrest, Benazir was not allowed to leave the country until 1984 but then returned to lead the democracy movement two years later. Her father's usurper, General Muhammad Zia ul-Haq, was killed in a mysterious plane crash in 1988, which also took the life of the U.S. ambassador Arnold Raphel, and the head of the U.S. military aid mission to Pakistan, General H.M. Wasson. Benazir was elected prime minister that year, served until her ouster in 1990 on charges of corruption and nepotism, was reelected in 1993, and ousted again in 1996, amidst more charges of corruption. During her two terms in office and since, what has come out portrays Bhutto and her husband Asif Ali Zardari as world-class thieves.

Upon taking office in 1988, Bhutto reportedly appointed 26,000 party hacks to state jobs, including positions in state-owned banks. An orgy of lending without proper collateral followed. Allegedly, Bhutto and Zardari "gave instructions for billions of rupees of unsecured government loans to be given to 50 large projects. The loans were sanctioned in the names of 'front men' but went to the 'Bhutto-Zardari combine.' "[52] Zardari suggested that such loans are "normal in the Third World to encourage industrialisation."[53] He used 421 million rupees (about £10 million) to acquire a major interest in three new sugar mills, all done through nominees acting on his behalf. In another deal he allegedly received a 40 million rupee kickback on a contract involving the Pakistan Steel Mill, handled by two of his cronies. Along the way Zardari acquired a succession of nicknames: Mr. 5 Percent, Mr. 10 Percent, Mr. 20 Percent, Mr. 30 Percent, and finally, in Bhutto's second term when he was appointed "minister of investments," Mr. 100 Percent.

The Pakistan government's largest source of revenues is customs duties, and therefore evasion of duties is a national pastime. Isn't there some way to tap into this major income stream, pretending to fight customs corruption and getting rich at the same time? Of course; we can hire a reputable (or disreputable, as the case may be) inspection company, have the government pay the company about a one percent fee to do price checking on imports, and get multimillion-dollar bribes paid to us upon award of the contracts. Société Générale de Surveillance (SGS), headquartered in Switzerland, and its then subsidiary Cotecna, the biggest group in the inspection business, readily agreed to this subterfuge. Letters in 1994 promised "consultancy fees," meaning kickbacks, of 6 percent and 3 percent to two British Virgin Island (BVI)

companies, Bomer Finances Inc. and Nassam Overseas Inc., controlled by Bhutto and Zardari. Payments of $12 million were made to Swiss bank accounts of the BVI companies.[54] SGS allegedly has paid kickbacks on other inspection contracts around the world. Upon being accused in the inspection kickback scheme, Bhutto sniffed, "I ran the government to the best of my honest ability. And I did it for nothing but acknowledgment and love."[55]

Then there was the 1994 deal to import $83 million worth of tractors from Poland. Ursus Tractors allegedly paid a 7 percent commission to another of Zardari's Caribbean companies, Dargal Associated. Bhutto waived import duties on the tractors, costing the Pakistani government some 1.7 billion rupees in lost revenues. Upon discovery of this scheme the Poles hastened to turn over 500 pages of documentation confirming the kickback.[56]

The Polish tractor deal was just a warm-up for the French fighter jet deal. After the U.S. government cancelled a sale of two squadrons of F-16s, Bhutto dangled a $4 billion contract for Mirages in front of the French—Dassault Aviation; Snecma, the engine manufacturer; and Thomson-CSF, producer of aviation electronics. Without missing a beat they allegedly agreed to pay a "remuneration" of 5 percent to Marleton Business S.A., yet another of Zardari's British Virgin Island companies.[57] This would have generated a tidy $200 million for the Bhutto-Zardari couple, but unfortunately for them she was driven from office before they could collect.

Ah, but the gold deal gave some comfort to these aspiring kleptocrats. Gold is culturally important in the Asian subcontinent, in particular as a way for women to accumulate wealth. Upwards of $100 billion is invested in this unproductive asset in Pakistan, India, and surrounding countries. Smuggling is big business. Ostensibly to regulate the trade, a Pakistani bullion dealer in Dubai, Abdul Razzak Yaqub, asked Bhutto for an exclusive import license. In 1994, yet another Zardari offshore company, M.S. Capricorn Trading, was created in the British Virgin Islands. Later in the year, Jens Schlegelmilch, "a Swiss lawyer who was the Bhutto family's attorney in Europe and close personal friend for more than 20 years,"[58] opened an account for Capricorn Trading at the Dubai branch of Citibank. According to a 1999 U.S. Senate report: "Mr. Schlegelmilch did not reveal to the Dubai banker that Mr. Zardari was the beneficial owner of the PIC [private investment company], and the account manager never asked him the identity of the beneficial owner of the account. . . . Shortly after opening the account in Dubai, Mr. Schlegelmilch signed a standard referral agreement with

Citibank Switzerland private bank guaranteeing him 20 percent of the first three years of client net revenues earned by the bank from each client he referred to the private bank."[59] In other words, Citibank was contracting to pay a finder's fee for millions brought in from dubious sources. Citibank went on to open three accounts in Switzerland for Zardari, with Schlegelmilch as the signatory.

In October 1994, Citibank records show that $10 million was deposited into Capricorn's Dubai account by Razzak Yaqub's company, A.R.Y. International Exchange.[60] In December, Razzak Yaqub received an exclusive import license and proceeded over the next three years to ship more than $500 million in gold to Pakistan. Additional deposits flowed into the Dubai and Swiss Citibank accounts, and funds also were shifted to Citibank Channel Island subsidiaries. The original ceiling on the accounts of $40 million was reached quickly.[61]

Toward the end of her second term, the Bhutto case took a bizarre turn. Representatives of the Pakistan Muslim League, an opposition party, met in 1995 with private investigators in London who offered documentary proof from an unnamed source of Bhutto's corruption, in return for a modest fee of $10 million. That deal was not consummated, but two years later, with Bhutto out of office and under investigation, the offer was reportedly concluded for $1 million.[62] The documents "appeared to have been taken from the Geneva office of Jens Schlegelmilch."[63]

In 2000 Pakistan's National Accountability Bureau, with the thankless task of investigating corruption, drew upon these documents and other sources and released details of assets and accounts belonging to Bhutto and Zardari. Even to jaded observers, the scale of their holdings was stunning: hundreds of properties, dozens of companies, and dozens of bank accounts. A partial listing of only foreign holdings reported by the National Accountability Bureau is provided in Table 3.4.[64]

Summarizing this and other documentation, the *New York Times* reported that the material included ". . . letters from executives promising payoffs, with details of the percentage payments to be made; memorandums detailing meetings at which these 'commissions' and 'remunerations' were agreed on, and certificates incorporating the offshore companies used as fronts in the deals. . . . The documents also revealed the crucial role played by Western institutions. Apart from the companies that made payoffs, and the network of banks that handled the money . . . the arrangements made by

Table 3.4 Foreign Assets Allegedly Belonging to Bhutto and Zardari

Country	*Properties/Companies*	*Bank Accounts*
United Kingdom	Rockwood Estate, Surrey, 20 room mansion, 355 acres, polo grounds; 4 London flats	Barclays Bank, 3 accounts; National Westminster Bank; Harrods Bank; Midland Bank
France	Normandy chateau, in Zardari's parents' name; Cannes properties	Crédit Agricole, 3 accounts; Banque Nationale de Paris; Banque La Henin
Switzerland		Union Bank of Switzerland; Barclays Bank (Geneva); Citibank (Geneva); Banque Nationale de Paris; Swiss Bank Corporation; Credit Suisse; Pictet et Cie; Banque Francaise du Commerce; Cantrade Ormond Burrus; Banque Pasha
United States	Wellington Club East, Florida; India Mound, Florida; 3 residential properties, Florida; Lapworth Investment, Florida; Intro Food, Florida; Dynatel Trading, Florida; A.S. Realty, Florida; Bon Voyage Travel, Florida	Barclays Bank, New York; Citibank, New York; UBS, New York
British Virgin Islands	Bomer Finance, Mariston Securities, Marleton Business, Capricorn Trading, Dargal Associated, Fargarita Consulting, Marvil Associated, Penbury Finance, Oxton Trading, Brinslen Investment, Climitex Holding, Elkins Holding, Minterler Invest, Silvernut Investment, Tacolen Investment, Tulerston Invest, Marledon Invest, Dustan Trading, Reconstruction and Development Finance, Nassam Alexander	

the Bhutto family for their wealth relied on Western property companies, Western lawyers and a network of Western friends."[65]

Even the Swiss finally had had enough. Seventeen bank accounts linked to Bhutto and Zardari were frozen. The two were charged with money laundering in connection with bribes received from the inspection company SGS and were convicted by a Swiss court in 2003, with fines and suspended prison sentences. This was short-lived; the decision was overturned and referred back to cantonal prosecutors upon appeal. Meanwhile, Zardari was in prison in Pakistan from 1996 to 2004 on assorted charges.

Bhutto, with her father executed, two brothers assassinated, her mother an amnesiac, her husband still troublesome, and she living in exile between London and Dubai, portrays herself as the victim: "I never asked for power. I think they [the Pakistani people] need me. I don't think it's addictive. You want to run away from it, but it doesn't let you go. . . . I think the reason this happens is that we want to give love and we receive love."[66]

Save your tears. In the global collection of displaced leaders, Benazir Bhutto may be the least sympathetic character of all.

Nawaz Sharif. While Benazir Bhutto hated the generals for executing her father, Nawaz Sharif early on figured out that they held the real power in Pakistan. His father had established a foundry in 1939 and, together with six brothers, had struggled for years only to see their business nationalized by Ali Bhutto's regime in 1972. This sealed decades of enmity between the Bhuttos and the Sharifs. Following the military coup and General Zia's assumption of power, the business—Ittefaq—was returned to family hands in 1980. Nawaz Sharif became a director and cultivated relations with senior military officers. This led to his appointment as finance minister of Punjab and then election as chief minister of this most populous province in 1985.

During the 1980s and early 1990s, given Sharif's political control of Punjab and eventual prime ministership of the country, Ittefaq Industries grew from its original single foundry into 30 businesses producing steel, sugar, paper, and textiles, with combined revenues of $400 million, making it one of the biggest private conglomerates in the nation. As in many other countries, when you control the political realm, you can get anything you want in the economic realm.

With Lahore, the capital of Punjab, serving as the seat of the family's

power, one of the first things Sharif did upon becoming prime minister in 1990 was build his long-dreamed-of superhighway from there to the capital, Islamabad. Estimated to cost 8.5 billion rupees, the project went through two biddings. Daewoo of Korea, strengthening its proposals with midnight meetings, was the highest bidder both times, so obviously it won the contract and delivered the job at well over 20 billion rupees.

A new highway needs new cars. Sharif authorized importation of 50,000 vehicles duty free, reportedly costing the government $700 million in lost customs duties. Banks were forced to make loans for vehicle purchases to would-be taxi cab drivers upon receipt of a 10 percent deposit. Borrowers got their "Nawaz Sharif cabs," and some 60 percent of them promptly defaulted. This left the banks with $500 million or so in unpaid loans. Vehicle dealers reportedly made a killing and expressed their appreciation in expected ways.

Under Sharif, unpaid bank loans and massive tax evasion remained the favorite ways to get rich. Upon his loss of power the usurping government published a list of 322 of the largest loan defaulters, representing almost $3 billion out of $4 billion owed to banks. Sharif and his family were tagged for $60 million. The Ittefaq Group went bankrupt in 1993 when Sharif lost his premiership the first time. By then only three units in the group were operational, and loan defaults of the remaining companies totaled some 5.7 billion rupees, more than $100 million.[67]

Like Bhutto, offshore companies have been linked to Sharif, three in the British Virgin Islands by the names of Nescoll, Nielson, and Shamrock[68] and another in the Channel Islands known as Chandron Jersey Pvt. Ltd.[69] Some of these entities allegedly were used to facilitate purchase of four rather grand flats on Park Lane in London, at various times occupied by Sharif family members. Reportedly, payment transfers were made to Banque Paribas en Suisse, which then instructed Sharif's offshore companies Nescoll and Nielson to purchase the four luxury suites.[70]

In her second term, Benazir Bhutto had Pakistan's Federal Investigating Agency begin a probe into the financial affairs of Nawaz Sharif and his family. The probe was headed by Rehman Malik, deputy director general of the agency. Malik had fortified his reputation earlier by aiding in the arrest of Ramzi Yousef, mastermind of the 1993 World Trade Center bombing. During Sharif's second term, the draft report of the investigation was suppressed, Malik was jailed for a year, and later reportedly survived an

assassination attempt, after which he fled to London. The Malik report, five years in the making, was released in 1998, with explosive revelations:

> The records, including government documents, signed affidavits from Pakistani officials, bank files and property records, detail deals that Mr. Malik says benefited Mr. Sharif, his family and his political associates:
>
> - At least $160 million pocketed from a contract to build a highway from Lahore, his home town, to Islamabad, the nation's capital.
> - At least $140 million in unsecured loans from Pakistan's state banks.
> - More than $60 million generated from government rebates on sugar exported by mills controlled by Mr. Sharif and his business associates.
> - At least $58 million skimmed from inflated prices paid for imported wheat from the United States and Canada. In the wheat deal, Mr. Sharif's government paid prices far above market value to a private company owned by a close associate of his in Washington, the records show. Falsely inflated invoices for the wheat generated tens of millions of dollars in cash.[71]

The report went on to state that "The extent and magnitude of this corruption is so staggering that it has put the very integrity of the country at stake."[72] In an interview, Malik added: "No other leader of Pakistan has taken that much money from the banks. There is no rule of law in Pakistan. It doesn't exist."[73]

What brought Sharif down in his second term was his attempt to acquire virtually dictatorial powers. In 1997 he rammed a bill through his compliant parliament requiring legislators to vote as their party leaders directed. In 1998 he introduced a bill to impose Sharia law (Muslim religious law) across Pakistan, with himself empowered to issue unilateral directives in the name of Islam. In 1999 he sought to sideline the army by replacing Chief of Staff Pervez Musharraf with a more pliable crony. He forgot the lessons he had learned in the 1980s: The army controls Pakistan and politicians are a nuisance. As Musharraf was returning from Sri Lanka, Sharif tried to sack him in midair and deny the Pakistan International Airways flight with 200 civilians on board landing rights in Karachi. Musharraf radioed from the aircraft through Dubai to his commander in Karachi, order-

ing him to seize the airport control tower, accomplished as the plane descended almost out of fuel. Musharraf turned the tables and completed his coup, and Sharif was jailed.

But Sharif had little to fear. This, after all, is Pakistan. Musharraf needed to consolidate his power with the generals, and Sharif knew details about the corruption of most of the brass. Obviously, it is better to tread lightly around the edges of your peer group's own thievery. So Musharraf had Sharif probed, tried, convicted, and sentenced to life in prison, but then in 2000 exiled him to Saudi Arabia. Twenty-two containers of carpets and furniture followed, and, of course, his foreign accounts remained mostly intact. Ensconced in a glittering palace in Jeddah, he is described as looking "corpulent" amidst "opulent" surroundings.[74] Reportedly, he and Benazir Bhutto even have an occasional telephone conversation, perhaps together lamenting how unfair life has become.

Military, Inc. The Pakistani military controls some of the largest business conglomerates in the nation and has monopolies in several areas of production and services. As chief of the army, Musharraf heads a vast empire of industrial, commercial, and real estate interests worth an estimated $5 billion.[75] A principal function of these businesses is to serve as a private piggy bank for the privileged military hierarchy.

Four foundations, originally created to provide welfare for retired soldiers, are now bloated enterprises employing tens of thousands and generating hundreds of millions in annual revenues. The largest is Fauji Foundation, *fauji* meaning "military." Each of the armed services has its own individual foundation: Army Welfare Trust, under Army GHQ; Bahria Foundation, under Navy HQ; and Shaheen Foundation, under Air Force HQ. The vast scope of these foundation holdings can be seen in the range of their subsidiary operations, as shown in Table 3.5.

As for the rest of the commanding heights of the economy, what the military does not own it controls. Active or retired officers have recently or still now head the National Highway Authority, the water and power agency, the tax collection agency, Karachi Electric Supply, the Employees Old Age Benefit Institution, the Federal Public Services Commission, the National Accountability Board, and much more.[76] Musharraf reportedly has appointed some 500 officers to positions as chairmen, directors, agency heads, and commissioners, permeating every aspect of the economy. You cannot

TABLE 3.5 PAKISTANI MILITARY FOUNDATION HOLDINGS

Foundation	*Holdings*
Fauji Foundation	Fauji Cereal, Fauji Poly Propylene Products, Fauji Sugar Mills, Fauji Oil Terminal, Fauji Cement, Fauji Corn Complex, Fauji Kabirwala Power Company, FONGAS, Fauji Jordan Company, Fauji Fertilizer Company, Mari Gas Company
Army Welfare Trust	Army Welfare Sugar Mill, Askari Housing Scheme, Army Welfare Shoe Project, Askari Welfare Rice Mill, Army Welfare Woolen Mill, Askari Welfare Pharmaceutical Project, Army Welfare Hosiery Unit, Askari Stud Farms, Askari Commercial Bank, Askari Fish Farm, Askari Commercial Enterprises, Askari Welfare Saving Scheme, Askari Power Limited, Askari Associate Limited, Askari Information Service, Askari Leasing, Magnesite Refineries Limited, Askari Aviation
Bahria Foundation	Bahria Construction, Bahria Bakery, Bahria Holdings, Bahria Catering and Decoration, Bahria Dredging, Bahria Security and Systems Services, Bahria Coastal Services, Bahria Travel and Recruiting Agency, Bahria Diving and Salvage, Bahria Complexes, Bahria Shipping, Bahria Town and Housing Schemes, Bahria Ship Breaking, Bahria Farming, Bahria Harbor Services, Bahria University, Bahria Deep Sea Fishing, Falah Trading Agency, Bahria Paints
Shaheen Foundation	Shaheen Airport Services, FM-100 radio channel, Shaheen Air Cargo, Shaheen Knitwear, Shaheen Air International, Shaheen System, Shaheen Aerotraders, Shaheen Complex

Source: Ayesha Siddiya-Agha, "Power, Perks, Prestige and Privileges: Military's Economic Activities in Pakistan," paper presented at the International Conference on Soldiers in Business, Jakarta, Indonesia, October 17–19, 2000. Also, interview with Ayesha Siddiya-Agha by the author, Washington, D.C., September 7, 2004.

turn around in Pakistan without putting money into service coffers. With what is almost certainly the largest holdings on the Karachi Stock Exchange[77] and vast holdings outside the exchange, the military owns, controls, and directs the economy of the country and is not about to give it up.

And what do rich generals do with their money? Why, they take it offshore, just like rich politicians and rich businesspeople. Court papers have listed innumerable generals, other officers, and their family members with

substantial foreign bank accounts. This is part of the reason why Nawaz Sharif was allowed to go into exile in Saudi Arabia; he knew their foreign holdings well.

Pakistan's pursuit and attainment of nuclear weapons and transfer of bomb-building components provides a frightening example of the many failings of the Pakistani state. A.Q. Khan stole centrifuge blueprints in Europe and then returned home to build a secret nuclear lab near Islamabad, supported by the notorious BCCI. According to a thorough *New York Times* report, Dr. Khan boasted, "My long stay in Europe and intimate knowledge of various countries and their manufacturing firms was an asset."

> Business executives and merchants, including German, Dutch and French middlemen, flocked to Pakistan to offer price lists for high-technology goods and learn what Pakistan needed. The multilingual Dr. Khan led the acquisition effort. His shopping spree spanned the world. "Africa was important because of the materials needed. . . . Europe was crucial for bringing in high-tech machines and components. Dubai was the place for shipments and payments."[78]

When Khan purchased components from his willing suppliers, he bought much more than needed by Pakistan alone, apparently with the early intent of selling nuclear materials to other countries. By the late 1980s he was supplying Iran, by 1991 North Korea, and at least as early as 1997 was in negotiations with Libya. The Libyan deal leaked, caused an international uproar, and Khan was forced out of the lab bearing his name. He made a public confession and was immediately pardoned by Musharraf and allowed to keep the millions in property and cash he had accumulated in Pakistan and abroad. Reports suggest that his daughter hastened out of the country with documents and a videotape in which Khan claims that "all the chiefs of army staff since 1977, including Musharraf, were aware of his actions."[79]

The bottom line on Pakistan is that ruling elites were and continue to be thoroughly corrupted, and western business and banking sectors have in the past and continue today to service their corruption. Billions of dollars have been siphoned abroad, millions of people are deprived and uneducated, drugs move freely, terrorism finds accommodation, and nuclear sales threaten global stability.

THE CRIMINAL COMPONENT: DRUGS, THUGS, AND TERRORISTS

Global crime is surging exponentially. Mechanisms for shifting illicit proceeds across borders are the key enabling factor.

Taking advantage of available techniques, hundreds of billions of drug dollars have been conveyed into U.S. and European deposits since the 1960s. Despite setbacks for the Cali and Medellín cartels in recent years and crop destruction at the behest of the United States, coca cultivation in Latin America appears to be holding steady. Colombia, with anti-government revolutionaries and pro-government paramilitaries both raking in revenues from trafficking, has been destabilized for decades. Other criminal cells specialize in transportation or money laundering, aiding the smuggling of cocaine and heroin northward through Central America, Mexico, Caribbean islands, and Cuba to North America and Europe. Mexican cartels easily get their money into California and Texas banks, while tax havens in the Caribbean continue to welcome illicit deposits. On the opposite side of the world, drugs coming out of North Korea, Pakistan, Afghanistan, and other Asian countries are similarly transported by cooperating syndicates smuggling their goods across the "stans," Russia, Iran, Turkey, and Eastern Europe into Western Europe and the British Isles.

The ease with which drug kingpins washed their profits whetted the appetites of other thugs, furthering the worldwide reach of crime in the 1980s and 1990s. Regional and international syndicates honed their skills in protection rackets, extortion, loan sharking, kidnapping, murder for hire, prostitution, alien smuggling, advance-fee fraud, art theft, counterfeiting of currencies and consumer products, trafficking in human and animal parts, and assorted villainies. Globalization has brought unprecedented opportunities to criminal syndicates, and they have responded more quickly than law enforcement agencies can begin to match.

Seeing how simple it was for others to do it, terrorists hopped onto the money-laundering bandwagon in the 1990s. With U.S. leadership and broad international cooperation, the network of bank accounts that provided wherewithal for the plots leading to September 11 was, to a reasonable extent, quickly rolled up; however, the ability of the next group to employ the same devices again has hardly been affected.

Drug kingpins, racketeers, and terrorists all draw from the bag of dirty-

money tricks to move their illegal proceeds across borders. Corporate executives using the same devices help keep open the doors to criminal funds.

Drugs

Drugs kill people and destroy nations. They kill people in countries where they are consumed, in countries through which they are trafficked, and in countries where they are grown and produced. We fight drugs by eradicating crops, destroying processing labs, and seizing shipments. But of all the global efforts made to combat drugs, the weakest link is our feeble anti–money laundering efforts. Basically, drug kingpins know that, once the sale is made, the cash is easy to move and legitimize.

Drugs are not just a minor irritant but a major global scourge. Of the world's population aged 15 and older, nearly one out of 20 is an abuser, as shown in Table 3.6.

When Peru and Bolivia cracked down on coca, Colombia increased its crop fivefold in the 1990s.[80] In the current decade, joint Colombian–U.S. eradication efforts have barely dented cultivation in that country, while Peruvian and Bolivian authorities now indicate that production is under-

TABLE 3.6 WORLDWIDE DRUG ABUSE

Abuse	*Number of Abusers*
Globally, all types, including users of multiple drugs	200 million
Cannabis, including marijuana and hashish	163 million
Cocaine	14 million
Heroin	10 million
Other opiates	5 million
Amphetamines	34 million
Ecstasy	8 million

Source: United Nations Office on Drugs and Crime, *Global Illicit Drug Trends 2003* (New York: United Nations, 2003), 101.

estimated in their countries. Growers have learned how to plant in smaller plots and under trees where helicopters, aircraft, and satellites cannot spot plants thriving beneath a loose canopy of foliage.

Opium poppy cultivation has been reduced in the infamous Golden Triangle of Burma, Laos, and Thailand, only to surge again in Afghanistan. Furthermore, cultivation has also spread to new growing areas in South America and Europe. Authorities hate to admit it, but the truth is global drug production is like an inflated balloon; you squeeze it in one place and it expands in another place.

Cannabis, from which marijuana and hashish are produced, is grown all over the world—in warm climates, cold climates, outdoors, indoors, backyards, and living rooms. Two-thirds of countries reporting to the United Nations Office on Drugs and Crime see an increase in consumption, making marijuana and hashish far and away the most heavily produced and widely consumed illicit drugs on the planet.

Synthetic drugs are soaring in use. Amphetamines are cutting into other drug markets. Production centers include China, Burma, North Korea, Australia, New Zealand, Belgium, Netherlands, Poland, Czech Republic, South Africa, Mexico, and the United States. Recipes are readily available on the Internet. In the current decade, tens of thousands of labs—everything from home kitchens producing a few ounces at a time to "super labs" capable of producing up to 10 pounds of methamphetamines a day—have been seized in the United States and Mexico.

Meth, available in powder, rock, or tablet form, is glorified with a variety of street names such as "crystal," "ice," "crink," "glass," "chicken feed" and "the poor man's cocaine." A versatile drug, it can be injected, ingested, smoked, or snorted. Another type of the drug, which is known as 3-4 methylenedioxymethamphetamine (MDMA), or "ecstasy," "go," or the "hug drug," is available for about $20 to $30 a pop, and school surveys in North America and Europe show that consumption is growing among younger users.[81]

The economics of trafficking explain why this line of work is so attractive. Take just two drugs for which data in metric measurements are reasonably reliable—cocaine and opiates, including heroin—as shown in Table 3.7.

The $35 billion wholesale value for opiates and nearly $9 billion for cocaine, received by drug cartels and kingpins, roughly suggests the amount of money that is laundered into the international financial system from these

Table 3.7 Economics of Drug Trafficking

	Cocaine	*Opiates*
Global plant cultivation	300,000 tonnes coca leaves	4,500,000 kg opium gum
Approximate growers' price	$1,000/tonne	$200/kg
Approximate value, growers	$300 million	$900 million
Global drug production	800,000 kg	450,000 kg
Approximate 1st stage producers' price	$1,000/kg	$3,500/kg
Approximate value, 1st stage producers	$800 million	$1.6 billion
Deduct drug seizures	(365,000 kg)	(76,000 kg)
Available for consumption	435,000 kg	353,000 kg
Approximate wholesale price	$20,000/kg	$100,000/kg
Total wholesale value	$8.7 billion	$35.3 billion

Source: Author's compilation and interpretation of data from United Nations Office on Drugs and Crime, *Global Illicit Drug Trends 2003* and International Narcotics Control Board, *Annual Statistics of Production, Manufacture, Consumption, Stocks and Seizures of Narcotic Drugs*, 9th ed., January 2003. The approximate wholesale prices for cocaine and opiates are intended to illustrate global averages and may be higher than prevailing prices in major metropolitan markets such as New York City.

two drugs alone. Retail values derived by street dealers are higher but are less likely to be shifted out of the country where the final sale is made.

The drug business has come close to repealing the laws of supply and demand. Look at the broad realities of the trade:

Eradication	10 to 20 percent of acreage.
Seizures	15 to 40 percent of supplies.
Wholesale prices to street vendors	Stable for years.
Confiscated drug proceeds	0.1 percent.

And the last item is the key. Anti–money laundering efforts don't work. Big-time drug dealers know that if they can convert their products to cash,

they can keep the cash 99.9 percent of the time. Losses of product up to that point are merely inconveniences but not deal breakers. Cartels and kingpins thrive because they win the end game. Countries fighting drugs falter because they lose the end game.

An active drug trade stimulates other forms of crime and usually is accompanied by political instability. A brief tour of Afghanistan followed by Colombia and Peru treated together will round out the picture.

Afghanistan

"We clearly have a possible 'narco-terrorist' state in the making in Afghanistan, with all that means for our short- and long-term strategic and security interests."[82] U.S. Congressman Henry Hyde was calling for a greater U.S. military role in combating drug trafficking in the recently liberated country.

Through coups, wars, and strife, drug production in Asia grew almost continuously for a generation. As Burma and Laos reduced opium poppy cultivation, Afghanistan took up the slack, increasing output fifteenfold since 1979. Under the Taliban, opium production peaked to 4,600 metric tonnes in 1999, almost all from irrigated fields, sometimes beautifully terraced on lush hillsides.

The following year, Mullah Omar, the Taliban leader, banned poppy cultivation. Why is unclear. One theory is that, because drugs are "haram," forbidden by Islam, the ban was intended to bolster the Taliban's thrust for diplomatic recognition from other Muslim states. Another theory is that, with large stocks of opium on hand, the Taliban simply wanted to drive up the price of continued sales, which they did—tenfold. Production in 2001 dropped to less than 200 tonnes. Then, after the Taliban were ousted, production soared back to more than 3,000 tonnes in 2002 and 2003 and was expected to exceed 4,000 tonnes in 2004.

The economics are enticing. A family cultivating poppies on as little as one acre can generate an income of $2,000 to $4,000. There are well over 200,000 acres under cultivation, producing a value to growers of $400 million to $800 million. More than a quarter million families are raising the crop, spread across 28 of Afghanistan's 32 provinces. Processing labs converting opium to morphine base, brown heroin, and white heroin are now appearing in many areas, adding value to the raw opium gum. According to

UN estimates, opium generates about $1.2 billion for Afghan growers and processors combined. A million local addicts consume part of the output. Another $1.3 billion accrues to local traffickers,[83] and then another $4 billion is earned by traffickers who take deliveries in Pakistan, Iran, Tajikistan, and other surrounding countries[84] for onward delivery, eventually reaching Russian and European markets at a wholesale value of $30 billion.[85]

Afghanistan today has four power centers: (1) the government headed by Hamid Karzai, with limited control beyond the capital Kabul, (2) a dozen warlords backed by militias numbering in the tens of thousands, (3) the Taliban who, with sympathetic tribal groups, influence about 30 percent of the country, primarily in the east bordering Pakistan, and (4) Al Qaeda, continuing to attract support from fundamentalists. Added to this volatile brew is the presence of strong foreign military forces—U.S., British, and others.

Karzai spoke faintheartedly of curbing poppy production in 2004, but opted instead to win popular election as president with the support of the warlords, mostly ex-mujahideen who had helped oust the Soviets. The warlords finance their militias and provincial control mechanisms largely through crime, including drug cultivation, processing and trafficking, and extortion from other traffickers. The Taliban's sway is in eastern provinces which account for some 30 percent of poppy cultivation.[86] And intelligence reports suggest that Al Qaeda has been taking delivery of up to 2,000 kilos of opium bimonthly, with a value delivered into Pakistan of more than $35 million annually. As a diplomatic source reportedly said recently, "Any operation that Al Qaeda or the Taliban could conceive of could be funded right now. In terms of their needs, [drugs are] an unlimited source of financing."[87]

Some modest steps forward have been taken for Afghanistan's 28 million people. The 2004 election was reasonably fair and peaceful, though voter turnout was limited. Four million children are in school, about one-third of them girls. Two-and-a-half million refugees have returned from neighboring countries. But neither a viable democracy nor a stable economy can be built on drugs, and how Afghanistan can be weaned from its national dependency is uncertain. Local warlords are already the functional equivalent of Colombian drug lords. The Taliban and Al Qaeda are hurt but not yet defeated. U.S. and British troops, focusing on terrorists, have hesitated to fight drug processors and traffickers at the same time, a policy that has

only begun to change in 2005. And no one wants the weak Afghan army to plunge the nation again into violence while trying to extend control throughout the country.

Over the past decade, the linkages between drugs, criminal syndicates, and terrorists have become unmistakably—and frighteningly—clear. The war on terror cannot be won without waging an equal war on drugs, and the war on drugs cannot be won without waging an equal war on drug money. Remember what I said earlier: When you get to the end game, converting product to cash, the drug kingpins and their terrorist allies win 99.9 percent of the time. This is dirty money at work.

Colombia and Peru

Drug trafficking in the Western Hemisphere has gone through an interesting metamorphosis over the past 30 years, essentially starting with several competing groups, then evolving into large integrated structures, and now shifting back to smaller franchise operations. The ease with which drug revenues are laundered gives the industry its staying power through these cycles, taking full advantage of the tried and proven holes in the global financial system.

Pablo Escobar intimidated, bribed, and murdered his way to the top of the Colombian drug trade in the 1970s and 1980s. Emerging as El Patrón among traffickers, he elevated Medellín drug lords into a cartel, cooperating at the top, and assuring an endless supply of drugs to western markets. Escobar was for a time perhaps the richest criminal in the world.

The violence of the Medellín cartel was also its undoing. In the 1980s a justice minister, a newspaper publisher, an attorney general, and a leading presidential candidate, Luis Carlos Galán, were assassinated. An Avianca flight was blown out of the air, killing 107. Even the national police agency was bombed. The government set about confiscating cartel assets—nearly a thousand properties, 367 airplanes, 73 boats, 700 vehicles, 1,200 guns, and tens of thousands of rounds of ammunition. Escobar was shot to death in 1993, and the Medellín cartel was broken.

Only to be replaced by the Cali cartel. Also formed in the 1970s, it was headed by Gilberto Rodriguez Orejuela, named the Chess Player for his strategic cunning, and younger brother Miguel Rodriguez Orejuela. In the early 1990s, with rising resentment of Medellín's violence, the Cali

group provided money to a shadowy lot known as PEPES (People Persecuted by Pablo Escobar), essentially hired killers who murdered Escobar's lieutenants and provided intelligence to the army and police on his activities and whereabouts.

The Cali cartel quickly became bigger than its rivals, controlling some 80 percent of cocaine shipments to the United States and Europe. It distinguished itself from its competitors by operating in a businesslike, hierarchical fashion, employing producers, chemists, truckers, pilots, accountants, bankers, wholesalers, and retailers, while also maintaining scores of politicians on the take. Regarded by the police as *los caballeros*, the gentlemen, cartel members invested heavily in Colombia, reportedly owning, for example, Drogas La Rebaja, the largest drugstore chain in the country and an ideal business for recycling laundered money.[88] The Cali cartel also formed close alliances with Russian and Italian mafias, pioneering the cooperation among criminal groups that now characterizes global racketeering.

Observing these growing connections, the Drug Enforcement Administration (DEA) mounted Operation Green Ice against the Cali cartel in 1992, resulting in some 200 arrests and seizures of more than $50 million in assets in the United States, the United Kingdom, Spain, and Italy. The DEA chief bragged that "We have damaged the cartel's financial operations and disrupted their cash flow."[89] A DEA chief of operations also noted that ". . . the major result . . . was the message it sent to the drug mafias—that the number of safe havens for their drug money is quickly dwindling."[90] If so, the cartel didn't notice. Its operations mushroomed over the next three years, conservatively reaching $8 billion annually in revenues, easily laundered into the global financial system.

The Rodriguez Orejuela brothers were finally captured in 1995 and became model prisoners enthusiastically participating in a jailhouse work-study program. This and probably a few million dollars contributed to their release in 2002, although they were recently extradited to the United States to face charges. But the Cali cartel had nevertheless been largely broken up.

Only to be replaced by dozens of smaller groups, decentralized and diverse and subcontracting major parts of their trafficking to independent producers, transporters, smugglers, wholesalers, and money launderers. This process has made anti-drug activities even more difficult than in the heyday of the cartels. General Rosso Jose Serrano, head of the Colombian National Police, said it well: "It is a whole new generation of traffickers who have

carefully studied and learned from the mistakes of the groups that went before them. They maintain an extremely low profile, they mix their licit and illicit businesses, they don't carry out terrorist acts and they operate in small, autonomous cells. They are much harder to fight than previous groups because they are much harder to find."[91]

Today, Colombia is a narco-state. As in Afghanistan, there are four competing power centers. These include left-wing guerillas, right-wing paramilitary groups, the Colombian army and police, and the drug traffickers. Incessant violence has blighted this beautiful country for more than 30 years, and drug dollars brought back from the United States and Europe finance all sides of the conflict. U.S. policy is, in a nutshell, hard on the producers and distributors of drugs but soft on the international structures that facilitate their illegal financial flows. And frankly, the smartest thing the drug traffickers can do is continue paying for chaos in Colombia, because out of chaos comes continued freedom of movement for clandestine criminal groups. Every line snorted in North America and Europe, every $10 for a dime bag of drugs, produces anguish for someone in this benighted country. Tax havens, secrecy jurisdictions, and money-laundering schemes make it worthwhile for everyone involved.

Now, drug lords and guerrillas find it useful to have friends in neighboring countries. Enter Vladimiro Montesinos, Peruvian spy master, CIA informant, and world-class thief.

Montesinos's father, a leftist intellectual, named his son Vladimiro Illych in honor of Lenin. Entering the army, Montesinos soon became a principal advisor to the prime minister in Peru's military government. Young and irritating to senior officers, he was eventually shifted to a remote posting. But, having already come to the attention of U.S. embassy officials, he was invited to Washington and, with forged travel papers, showed up at CIA headquarters in Langley, Virginia, in 1976. An early U.S. acquaintance enthused that Montesinos "is a firm friend of the United States, and the results of his visit will accrue benefits to both nations for many years to come."[92] But upon returning to Lima, the unauthorized trip, forged papers, and CIA visit got him sacked from the army and jailed for a year.

Studying law and qualifying for the bar, Montesinos found his niche defending Colombian drug dealers and murderous Peruvian army officers, honing his skills by bribing police, prosecutors, and judges and intimidating others who remained uncooperative. Accumulating influence, he wormed

his way into close contact with Peru's National Intelligence Service (SIN). And, most importantly, he represented the wife of aspiring politico Alberto Fujimori in several shady real estate deals.

As he was running for the presidency of Peru in 1990, Fujimori's own alleged tax evasion was about to be revealed by the opposition. Meeting with Fujimori, Montesinos assured the candidate that he would make the problem immediately disappear, which he did. Improbably, the son of Japanese immigrants was elected, and Montesinos was rewarded with the position of deputy head of SIN, over which he exercised total dominance.

Across the 1990s, Montesinos received and dispensed bribes and kickbacks in the hundreds of millions of dollars. Drug traffickers continued to be key allies. Up to 700 flights a year reportedly departed from Peru's Huallaga Valley and other areas, carrying coca leaves, paste, and refined product, both to neighboring processors and to U.S. markets.[93] The top dog in Huallaga was Demetrio Limonier Chavez, known as El Vaticano after he made a trip to Rome, who later after his capture confessed to paying Montesinos $50,000 a month to assure army protection of his flights.[94]

One of Montesinos's more notorious deals was supplying AK-47s to the Revolutionary Armed Forces of Colombia (FARC). In 1998 an international arms dealer, Sarkis Soghanalian, agreed with Montesinos to purchase 50,000 Bulgarian-manufactured automatic rifles from Jordan for delivery to the military in Peru. Amman authorities were sufficiently cautious to ask the CIA station chief in Jordan if the United States had any objection. With a U.S. nod of approval, the deal went ahead, paid in cash. But instead of being delivered to the Peruvian army, weapons were parachuted into Colombia. In 1999 four aircraft loads, almost 10,000 rifles, were dropped to the FARC military command. At least one source claims that additional flights into the following year dropped up to 30,000 more rifles to the FARC.[95]

What's a few thousand AK-47s when much bigger money is made on jet fighters? An arms-trafficking gang known as Los Gordos worked closely with Montesinos on several deals, reportedly utilizing a network of some 50 front companies. Through this ring, Peru bought helicopters, missiles, air defense systems, telephone tapping equipment, riot gear, bulletproof vests, and more.[96] A killing was made off decrepit Belarussian aircraft—36 MiG-29s and 18 Suckhoi-25s, plus spare parts and a radar system.[97] Worth about $120 million at best, this purchase was consummated at either $445 million

or $770 million, according to alternative sources. Allegedly, Montesinos's kickbacks were up to 50 percent, and the three principal partners in Los Gordos allegedly contributed $30 million each to Fujimori's 1995 reelection campaign.

And who were Montesinos's staunch supporters through the 1990s? Why, his close friends at the CIA, reportedly paying SIN, Montesinos's intelligence service, $1 million a year through the decade. This caused consternation within the DEA, which had long recognized Montesinos for the criminal and drug facilitator that he was. But the intelligence folks were steadfast: "At U.S. interagency meetings about U.S. policy toward Peru in the late 1990s and 2000, the CIA was the agency that spoke most forcefully on behalf of the maintenance of the U.S. relationship with Vladimiro Montesinos, and its position prevailed through approximately June 2000."[98]

Montesinos's grip on power finally began to unravel later that summer. In connection with the AK-47s parachuted into Colombia, Fujimori held an August press conference with Montesinos, praising his spy chief for breaking up an international arms smuggling ring. Knowing they had been duped by Montesinos, the Jordanians blew a gasket and undiplomatically suggested that, instead of dismantling the ring, Montesinos was the ring. A video was leaked by his enemies showing Montesinos bribing a congressman to change parties. It turns out Montesinos had thousands of videos implicating much of Peru's political class.

Montesinos escaped first to Panama in September 2000, then came back, then escaped again to Venezuela. Fujimori, after a few weeks of pretending he was cleaning up the mess, left town, too, sending his resignation as president back to Lima by fax from Japan. In mid-2001, Montesinos was captured in Caracas and returned to Peru, where he is incarcerated in the prison he built to hold members of Peru's Shining Path guerrilla movement.

Details of his financial skullduggery came gushing forth. Bank accounts and other financial arrangements were reportedly uncovered in the United States, Mexico, Panama, Bolivia, Uruguay, the Cayman Islands, Luxembourg, and Switzerland. Principal banks allegedly providing Montesinos or his front men with their services included in the United States, Citibank, Bank of New York, and Pacific Industrial Bank, and in Switzerland, UBS, Canadian Imperial Bank of Commerce, Crédit Agricole Indosuez, Crédit Lyonnais, Bank Leumi, FIBI Bank, Bank Adamas, and Bank CAI. In addi-

tion, Banco Wiese Sudameris in the Cayman Islands and in Uruguay and Banco Interamericano de Finanzas and Banco de Comercia in Peru allegedly provided services.

In November 2000, immediately following Montesinos's escape, Fujimori reportedly handed U.S. Ambassador John Hamilton in Lima a note with the following information, asking the ambassador to determine if this was Montesinos's account: "The Bank of New York, 51 West 51st Street, New York, New York, 10019. Telephone (212) 408-4194. In care of Bill Paying Department, Beverly Jones."[99] According to a declassified U.S. State Department cable, the ambassador was informed two days later by an unnamed source that "Montesinos's primary bank account is in New York and that, as of the first week in November, contained $146 million."[100]

Citibank in Miami reportedly had $18 million belonging to a Montesinos henchman.[101] Pacific Industrial Bank reportedly seized $38 million and returned it to Peru.[102] The Swiss froze numerous accounts and reportedly returned $77.5 million to Peru and held another $33 million pending legal clearances.[103] Perhaps all this was just part of his stash. As a U.S. official testified at a Senate hearing: "Intelligence information revealed that Montesinos had maintained a global network of bank accounts and front companies to move and hide hundreds of millions of dollars received from drug traffickers, defense contract kickbacks, embezzlement of public funds, and gun-running since the mid 1990s."[104]

As of mid-2004 Montesinos faced 70 charges, had been convicted on a half-dozen counts, was sentenced to 9 years in prison, and might get up to 20 years for selling those arms to the FARC. Some 40 other people were on trial for related charges as well.

Back in the land of his parents, Japan, Fujimori created a web site, www.fujimorialberto.com, claiming that he will run again for the presidency of Peru. Not very likely. Interpol has issued a Red Notice for his arrest, wanted for "assault, forgery, fraud, kidnapping, hostage taking, murder, organized crime."[105]

A Swiss banker said to me, "As long as tax-evading money is not on the same level as drug money, then we cannot curtail money laundering."[106] This may be an unwelcome comment to people who live off tax-evading money, but it happens to be correct. When we cultivate and facilitate hundreds of billions of dollars of illicit proceeds we do want, then it must come as no surprise that flowing by the same means are hundreds of billions of

dollars of illicit proceeds we don't want. When this is fully internalized, then the West can begin to curtail drug trafficking and other forms of global crime much more effectively.

Thugs and Racketeers

While drugs are the largest single component, they do not constitute the majority of cross-border crime. Much bigger than drugs is the combination of human trafficking, illegal arms trading, smuggling, counterfeiting, fraud, piracy, environmental offenses, and a host of other illicit pursuits. These activities have soared in the last 15 years, with the collapse of socialist economies and the acceleration of globalization.

Two key factors underpin the rapid growth in international crime: (1) alliances and agreements spanning national, regional, and ethnic divisions assure enormous profits for criminal syndicates choosing to cooperate rather than compete, and (2) the ease with which money is shifted among groups, laundered across borders, and transferred into the legitimate financial system is the primary facilitating mechanism that makes such operations so successful. Global crime is out of control and will remain so as long as dirty money flows effortlessly into respectable—particularly western—accounts.

A selective listing of some of the major types of crimes that involve cross-border activity and brief notes on their scope, origin, or direction only begins to suggest the magnitude of this phenomenon. (See Table 3.8.) Terrorism will be treated separately in the next section. Money laundering suffuses all of these pursuits.

These crimes generally have a lower risk level than drug trafficking. And because most have emerged as major concerns in recent decades, estimates of their magnitudes are in some instances still being formulated. Just the combination of counterfeiting and smuggling appears to exceed the drug business.

Along with narcotics, a huge revenue generator for criminal syndicates is human trafficking across borders and sexual exploitation in destination countries. This is the fastest growing form of cross-border crime and the ugliest aspect of globalization.

Within the subject of illegal migration, a distinction is made between those who are trafficked and those who are smuggled. Human trafficking refers to forceful recruitment or fraudulent inducement for the purpose of

Table 3.8 Cross-Border Criminal Activity

Type of Crime	*Scope, Origin, or Direction*
Human Trafficking	
Trafficking for prostitution and slavery, plus alien smuggling	600,000 to 800,000 annually; women, men, children, babies. Most for prostitution.
Organ smuggling	Unknown magnitude. South Africa, Brazil, and Israel implicated in organ extraction and smuggling.
Arms Trafficking	
Illegally-traded small arms	More than 1,000 small-arms manufacturing plants in nearly 100 countries. Legal trade, $4 billion. Illegal trade over $1 billion.
Illegally-traded heavy arms, both new and used	Estimated at $2 billion to $10 billion annually. Primarily out of former Soviet Union countries.
Nuclear, radioactive, chemical, and biological materials	Hundreds of attempts to sell nuclear materials have been reported in Germany, Italy, Switzerland, Poland, Romania, Hungary, Bulgaria, Slovakia, Russia, Tanzania, Dubai, Turkey, Iran, India, and elsewhere.
Counterfeiting	
U.S. currency	Most commonly, the U.S.$100 bill. Major counterfeiting operations in North Korea, Colombia, and Brazil. More than 30 forgers shut down in Colombia alone.
Travel documents	Fake passports and visas, essential for cross-border syndicates, produced in more than 100 countries.
Brand-name apparel, cosmetics, and toiletries	Primarily from Asia, Central America, Italy, and Egypt.
Software, CDs, videos	China a major source country.
Cigarettes	Estimated 200 billion counterfeit cigarettes sold annually. Plus billions of legitimately-manufactured cigarettes smuggled across borders annually to evade duties and taxes.

(Continued)

TABLE 3.8 *(Continued)*

Type of Crime	*Scope, Origin, or Direction*
Fake pharmaceuticals and vaccines	Estimated at $15 billion to $50 billion annually. China, India, and Southeast Asia are major sources. International Chamber of Commerce estimates counterfeiting of all above consumer goods at $450 billion annually.
Smuggling	
Cars; theft and delivery to other countries	Hundreds of thousands of vehicles annually. U.S., Europe, and Japan are sources. Eastern Europe, Russia, China, Latin America, and Africa are major destinations.
Gold, other precious metals, and gems	Gold into Asia. Conflict diamonds from Africa. Precious stones from South America.
Art, antiquities, and cultural items	Could be up to billions of dollars annually. Paintings stolen in Europe are often brought to Japan. Antiquities come primarily out of Middle East and China. In a single arrest, a 100-member gang was apprehended in Spain in 2002 with 200,000 artifacts.
Pornographic materials	Large markets in Japan and China.
Environmental	
Endangered species, especially large cats, rare birds, reptiles, and botanical specimens	Hundreds of thousands of live animals are exported annually. Together with animal parts, believed to be a multibillion-dollar trade. Southern Africa is an important source region.
Animal parts, especially rhino horns, elephant tusks, shark fins	Estimated one million elephants killed since the 1970s. Rhino population reduced by an estimated 90 percent in 30 years. Markets primarily in Asia.
Illegal logging	From Russia, Indonesia, Central and South America, and Africa. In the hundreds of millions of tons annually, valued at up to $15 billion.
Waste dumping, primarily metals, toxic chemicals, and radioactive materials	Tens of millions of tons shipped and sunk in oceans or dumped in developing countries annually.

Table 3.8 *(Continued)*

Type of Crime	*Scope, Origin, or Direction*
Fraud	
Credit cards; counterfeited, stolen, skimmed, and illegally used	Losses estimated at roughly 1 percent. Single counterfeiters produce thousands of cards daily.
Advance fee fraud, primarily for future services or payoffs	African scam artists generate millions annually.
Piracy	
On the high seas	325 piracy attacks in 2004. The Strait of Malacca between Singapore and Indonesia is one of the most perilous in the world.
In coastal waters, inlets, and ports	Nigeria, for example, loses an estimated 100,000 barrels of oil a day from theft and illegal bunkering.

exploitation. Victims are bought, kidnapped, or enticed with job offers, transported across borders, and coerced into prostitution or servitude. Human smuggling differs in that the individual chooses to be taken across borders for the purpose of illegal entry into another country. Once there, he or she may similarly be forced into servitude to pay off the cost of transportation and local protection. Trafficking involves human rights violations and is a crime against the person. Smuggling with its attendant illegal entry is considered a crime against the state. There is ample grey area between trafficking and smuggling, particularly as these two crimes often involve underage migrants receiving false promises of employment, leading instead to forced labor and sexual enslavement. The term "trafficking" is often applied to all forms of illegal human movements.

Cooperation between local gangs and international syndicates is clearly demonstrated in the human trafficking trade. Local recruiters obtain willing or unwilling victims. Transporters move them across borders and onto international routes. Corrupting police, immigration, border, and airport officials is a key part of the transporter's job. Channels and techniques used are often the same as those already proven safe in drug smuggling and arms trading. A network of overseers and informers protects the cargo and assures

its final delivery. Criminal syndicates usually take over in the destination country to force victims into prostitution or to collect smuggling fees. And then money laundering assures that every link in the chain is well rewarded for its portion of the enterprise.

In the U.S. State Department's estimate of 600,000 to 800,000 people trafficked across borders annually, 70 to 80 percent are females and at least a third of them are underage. An estimated 70 percent of all trafficked females end up being sexually exploited in conditions that deny them freedom. Other groups studying human trafficking estimate even higher annual numbers.[107]

Little girls and young women are bought cheap, reportedly in Nepal for $4, in West Africa for $14, in Central America for $25. Delivered to a brothel owner, a Malaysian reportedly might cost $5,000, a Thai $14,000, a blonde Russian "Natasha" perhaps $20,000. Criminal syndicates investing in human inventories expect to get high returns.

Out of Africa come an estimated 50,000 trafficking victims a year. Central American and Caribbean women have been found in the sex trade in France, Germany, Switzerland, the Netherlands, Austria, Portugal, Greece, and elsewhere. Mexican women are a favorite in Japan. Reportedly 75,000 Brazilian women are in forced prostitution in European Union countries. Women from Colombia are trafficked along drug paths leading all over the world.

Russia and other countries of the former Soviet Union may be the largest sources of human trafficking, estimated in the hundreds of thousands annually. The collapse of the USSR led to the "feminization of poverty" and has produced a massive outflow of women.[108] Most countries of South and Southeast Asia are supplying women to Japan and the Middle East. The CIA has estimated that some 50,000 women are trafficked for sexual exploitation into the United States annually, with source countries including Thailand, Vietnam, Malaysia, China, South Korea, the Philippines, Russia, Ukraine, Czech Republic, Poland, Hungary, Latvia, and most countries in the Western Hemisphere.

Drugs, girls, and guns are the stock in trade for a good part of global crime. Add to these the further panoply of counterfeiting, contraband, fraud, environmental damage, and international theft, secure all with powerful state sponsors and large multinational criminal syndicates, and the picture of this planetary menace begins to take shape.

Government sponsors or endorsers of overt criminal activity in recent years have included Russia, China, North Korea, Afghanistan, Pakistan,

Burma, Turkmenistan, Iraq, Belarus, Serbia, Sudan, Libya, Liberia, Peru, Mexico, Panama, many of the Caribbean and south Pacific islands, and others. Not at any former time have so many state actors crossed the line into criminal pursuits. In many more nations, police and security officials have been easily bribed to look the other way as criminals ply their trade.

But governments and officials are the smaller part of the problem. The larger part are the triads, yakuzas, mafias, cartels, posses, gangs, and assorted collections of hoodlums that have gained control of global crime. The extent of their activities underlines the damage done by global dirty money. Whittling away their hold will be a long and difficult effort.

A selective listing of major criminal groups and brief notes on their size and reach can begin to illuminate the threat from organized syndicates. (See Table 3.9.) Mafia and Japanese yakuza groups are typically hierarchical. Chinese triads are looser confederations of gangs.

Cross-border cooperation and easy money laundering have produced the fastest change in crime that has ever been witnessed. Yet it is a change that has registered only modestly on public consciousness. Drugs, once thought to be the principal global "bad," have been overtaken by a combination of other criminal activities that draw upon the experience of drug cartels but expand into everything else imaginable, ranging from sexual slavery to nuclear materials. One country, North Korea, and one criminal syndicate, the yakuza, only begin to illustrate the damage done.

North Korea

Take the worst that I write about in this chapter—money laundering, drugs, trafficking, racketeering, counterfeiting, arms trading, and terrorism—add the claim of nuclear weapons, wrap it all up in a package of political repression, gulags, executions, and starvation, and you get North Korea today. This is a country that "essentially functions as a state-level crime syndicate," according to U.S. Senator Peter Fitzgerald.[109]

Twenty-three million people on 46,000 square miles, poor soils, devastating floods, dependence on grain imports, and an insularity stretching back hundreds of years earning for this land the name Hermit Kingdom combine to produce what may be the most lethal brew in the nation-state system. Place on top a paranoid and unstable dictator, Kim Jong Il, the country's "Dear Leader," who likes alcohol, gambling, and Scandinavian women,

TABLE 3.9 MAJOR CRIMINAL GROUPS

Criminal Group	*Size, Base, or Extent*
Chinese—Triads and others	Chinese officials estimate that 150,000 gangs operate internally, with membership in the millions. Hong Kong officials estimate the city's gang population at 80,000, divided into 57 triads and other structures.
Sun Yee On	50,000 members, a traditional triad. Originally based in Hong Kong but allegiance now to China. Active in major cities in Europe, U.S., South Africa, and elsewhere.
Big Circle Boys	5,000 members, based in China. Derived from formerly imprisoned Red Guards. Active in U.K., Europe, U.S., Canada, and elsewhere.
14K	20,000 members. Also originally based in Hong Kong but now directed toward China. Active in Europe, U.S., Australia, the Philippines, Japan, Taiwan, and elsewhere.
Wo groups	Based in Hong Kong; operates as a triad. Includes Wo Hop To, Wo On Lok, and other groups. Active in Australia and elsewhere.
United Bamboo	20,000 members; based in Taiwan. Founded by sons of ex-Kuomintang army officers who fled China. Active in U.S., Europe, Canada, and Latin America.
Four Seas	5,000 members; based in Taiwan; active internationally.
Sung Lian	10,000 members; Taiwan.
Tian Dao Man	2,000 members; Taiwan.
Hundreds of other groups, most with a base in China	Including Red Sun in Europe; Wo Shing Wo in U.K., Europe, South Africa, and elsewhere; Wah Ching in California; Shui Fong in U.K., and many more.
Snakeheads	Usually loose gangs, often family oriented, involved in human trafficking.

Table 3.9 *(Continued)*

Criminal Group	*Size, Base, or Extent*
Japanese—Yakuza	
Yamaguchi-gumi	17,500 members, based in Kobe and Osaka, hierarchically organized. Into human trafficking, sex trade, drugs, gun running, real estate, and more. Activities in South Korea, Taiwan, the Philippines, Pacific islands, Europe, Canada, U.S., Mexico, and Central and South America.
Sumiyoshi-kai	6,200 members, Tokyo based, organized as a federation of gangs. Into drugs, human trafficking, sex trade, extortion, gambling, and more. Active in Hong Kong, Taiwan, the Philippines, Australia, and U.S.
Inagawa-kai	5,100 members, Tokyo based. Into gambling, drugs, loan sharking, and construction. Active in Hong Kong, South Korea, the Philippines, South America, and U.S.
Kyokuto-kai	1,700 members; Tokyo based.
Matsuba-dai	1,500 members; Tokyo based.
More than 1,000 additional gangs	Combined yakuza members and associates estimated at more than 80,000, plus linkages to tens of thousands more, particularly among immigrant Korean and Chinese communities.
Other Major Asian Criminal Groups	
Korean	Often yakuza-style organizations. Into drugs and gambling.
Filipino	Often closely linked to yakuza and triad groups. Into human trafficking and arms smuggling.
Thai	Drugs, prostitution, and human trafficking.
Vietnamese	Drugs, human trafficking. A reputation for violence, even in the U.S.
Cambodian	Drugs, illegal logging.
Laos	Drugs, illegal logging.
Burmese	Some 35 armed militias, into drugs, kidnapping, human trafficking, illegal logging, smuggling of endangered species, and more.

(Continued)

TABLE 3.9 *(Continued)*

Criminal Group	*Size, Base, or Extent*
Russian Mafias and Mobsters	12,000 groups, estimated 3 million criminals, 300 groups operating internationally in conjunction with syndicates in more than 50 countries, 300 percent increase in activities in 15 years. Russian Ministry of Internal Affairs estimated in late 1990s that 40 percent of private firms, 50 percent of banks, and 60 percent of state-owned enterprises were controlled by organized crime.[a] Various groups have merged, splintered, strengthened, and weakened over the past 15 years.
Solntsevskaya	5,000 members. Founded in 1980s in a Moscow suburb. Sometimes called "Brigade of the Sun." Allegedly headed by Sergei Mikhailov. Into drugs, human trafficking, prostitution, kidnapping, extortion, arms smuggling, car theft, excise tax fraud, banking fraud, and money laundering. International activities in Europe, Israel, Central and South America, and many cities in the U.S.
Ismailovskaya	1,000 members. Allegedly close to powerful Kremlin figures. Deep into corporate fraud, drugs, human trafficking, extortion, and money laundering, reportedly through scores of foreign shell companies. International operations in Europe South America, Mexico, Canada, and U.S.
Mogilevich Organization	Headed by Semion Mogilevich who, with an advanced degree in economics, is called "the brainy don." Into arms smuggling, drugs, prostitution, extortion, corporate and banking fraud, art theft, and suspected smuggling of nuclear materials. Operations in Europe, South Asia, South America, and major U.S. cities.
Victor Bout	Reportedly an ex-KGB officer, a major illegal arms trafficker since the early 1990s. Sources include Russia, other former Soviet Union countries, Eastern Europe, and allegedly Pakistan. Deliveries include small arms, machine guns, ammunition, mortars, armored personnel carriers, tanks, and helicopters to

TABLE 3.9 *(Continued)*

Criminal Group	*Size, Base, or Extent*
	conflict situations throughout Africa and to warlords and the Taliban in Afghanistan. Dozens of companies, 40 to 60 aircraft, up to 300 employees, headquartered at various times in UAE and Russia.
Other Russian Groups	
Moscow	Dolgopruadnenskaya, Podol'skaya, Kurganskaya, Lyuberetskaya, Leninskaya, Pushinskaya, Orekhovskaya, Taganskaya, Balashikhinskaya, Bortsovskaya, 21st Century Association.
St. Petersburg	Tambovskaya, Kazanskaya, Malyshevkaya
Chechen gangs	Obshina, Abdulkardyrova, Tsentralnaya, Ostankinskaya.
Eastern European Groups	Among the most aggressive and violent are ethnic groups from Georgia, Armenia, Moldova, Albania, Slovenia, Croatia, Kosovo, Bosnia-Herzegovina, and Serbia. Activities include drugs, human trafficking, prostitution, protection rackets, car theft, bank robberies.
Italian Organized Crime	Law enforcement in Italy and U.S. has somewhat reduced mafia dominance, only to have other criminal groups proliferate. Italian mafias estimated at 25,000 members and perhaps 250,000 affiliates worldwide. Into drugs, smuggling, arms dealing, kidnapping, human trafficking, counterfeiting, bribery, and money laundering. Largest is the Sicilian Mafia, followed by Camorra based in Naples, 'Ndrangheta based in Calabria and Sacra Corona Unita in the Puglia region. In the United States, La Cosa Nostra cooperates with criminal syndicates from all over the world.
Nigerian Groups	Estimated 500 gangs active in 80 countries. Into drug smuggling, advanced fee frauds, credit fraud, some human trafficking, and money laundering.

[a]Russian Organized Crime (Washington, D.C.: Center for Strategic and International Studies, 1997), 25.

plays 18 holes of golf at 38 under par, and allegedly possesses the world's largest collection of Daffy Duck cartoons, and this is more than enough to keep us awake at night.

An unidentified North Korean defector testifying before a U.S. Senate committee in 2003 reported that "Dear Leader's" father, Kim Il Sung, started the country on the path of drug cultivation as early as the 1970s in Yangkang and Hamkyung provinces. The latter area had been used years ago by the Japanese colonial government to grow poppies. Collective farms in several towns were pressed into cultivation of "broad bellflowers," with the opium gum output sent to government labs for processing into heroin. By the 1990s this was big business, supervised by imported Thai experts. In 1997 the government allegedly ordered all collective farms to cultivate poppies, as additional processing facilities were established and guarded by state security agents.[110]

Methamphetamine production reportedly was added in 1996, following heavy rains that affected poppy crops. Usually produced from ephedrine, which is subject to trade regulations, North Korea may be experimenting with a benzene-derived product that would have unlimited production potential.[111] With an estimated 2.2 million users in Japan alone, Asia's largest meth market is just a short boat trip away.

Diplomats, agents, and masquerading businessmen all have been used to distribute North Korean drugs worldwide. Seizures from diplomatic pouches and from travelers' suitcases, briefcases, clothes, shoes, and more have been made in South Korea, Japan, China, Taiwan, Russia, India, Laos, Nepal, Sweden, Germany, Zambia, Ethiopia, Egypt, Venezuela,[112] and Mexico.[113] North Korean ships have been detained, searched, and found with drugs in Japan, Indonesia, Australia, and South Korea. A five-day, high-seas chase off the shores of Australia in 2003 netted tens of millions of dollars in heroin, along with the ship's crew of 34, including a political secretary of the Korean Workers' Party.[114]

Responding through a translator to questions at the Senate hearing in 2003, a North Korean defector said the following:

Senator Fitzgerald: The poppy fields that you described, did you personally see those fields?

Former Official: Yes, numerous farms, myself, with my naked eyes.

Senator Fitzgerald: Were you personally involved in trafficking heroin, as a high-ranking officer in the North Korean Government?

Former Official: Yes, there was a time that I was directly involved in . . . the trafficking myself. . . .

Senator Fitzgerald: Were you directed by your superiors in the North Korean Government to traffic in the drugs you trafficked in or were you doing that on your own?

Former Official: There is nothing in North Korea a person can do voluntarily to help the regime. And especially speaking of production and selling, trafficking drugs, and processing or growing poppies and processing poppies into heroin, these are all done on the state level, as a state business. . . .[115]

North Korea's drug trafficking skills are used for counterfeiting and smuggling many other items as well. Diplomats and agents have also been caught in various countries with illicit cigarettes, liquor, gold, pirated CDs, diamonds, ivory, endangered species, animal parts, electronic goods, fake brand-name apparel, and more.

North Korea's wide-ranging drug and smuggling businesses bring government agents into frequent relationships with other organized crime elements: Japanese yakuza, Chinese, Hong Kong, and Taiwanese triads, Russian mafias, and Thai gangs. In the meth trade with Japan, for example, North Korea acts as the producer and wholesaler, and yakuza gangs function as retailers. In some cases, Japanese and Taiwanese vessels meet North Korean ships in open seas and take deliveries of multimillion-dollar drug shipments.

With a strong resume in domestic crime and global smuggling, it is little surprise that North Korea combines these skills to facilitate its primary source of export earnings: arms trading. Beginning in the 1980s with SCUDs, North Korea reportedly has exported more than 500 missiles to Libya, Syria, Egypt, Yemen, the United Arab Emirates, Iran, and Pakistan. Revenues from missile sales in just one year, 2001, were estimated at $560 million.[116] In return for missile technology, Pakistan provided North Korea with uranium enrichment technology, lending credibility to the fear that North Korea has successfully produced nuclear weapons. Furthermore, evidence arose in 2004 indicating that North Korea had exported uranium hexafluoride back to Pakistan, which can be converted to weapons-grade material, and had offered and perhaps provided bomb-making blueprints to Libya and Iran. Who else purchased nuclear components and designs from this rogue state?

Missile sales, unfortunately legal, and drug trafficking and all manner of smuggling, thoroughly illegal, produce hard currency earnings for North Korea well in excess of $1 billion a year.[117] But this certainly isn't enough money for Kim Jong Il and his coterie of henchmen, so they resort to the simplest solution of all: printing more.

North Korea has one of the most sophisticated counterfeit currency operations in the world. In the 1970s the regime allegedly imported from Europe various models of printers, along with currency inks. Observing the improving quality of output, Bruce Townsend of the U.S. Secret Service commented: "In the last 14 years, 14 additional variations (referred to as circulars) have been identified and linked together either through forensic or investigative associations. The manufacturers of this family of counterfeit notes utilize complex and expensive printing methods such as intaglio and typographic. The sophisticated printing method is evidence of a well-funded, ongoing, organized criminal enterprise, with a significant scientific and technological component."[118]

Major parts of Kim Jong Il's illicit empire allegedly are controlled by a murky group called Division 39, with operating companies, trading houses, Pyongyang and Macau banks, and until recently the Golden Star bank in Vienna. According to reports, the Korean Workers' Party Central Committee oversees Daesong General Bureau Division 39, which in turn controls Korea Daesong Bank, which directed Golden Star.[119] The Austrian Interior Ministry's 1997 annual report noted that: ". . . the only European branch of the North Korean state bank might have played a significant role in different dubious North Korean activities. This bank has been repeatedly linked to money laundering, distribution of counterfeit money, and involvement in illegal trade with nuclear material. In this context, Vienna has to be regarded as the center of North Korean financial deals and transactions in Europe."[120]

Again in 2002, the Austrian Interior Ministry's report stated that: ". . . since 1982 North Korea has maintained a bank in Vienna. From the beginning, intelligence and security agencies repeatedly linked the bank to money laundering and financing of proliferation deals. There has never been concrete proof . . ."[121]

Austrian authorities are notoriously lax on money laundering matters. Pressure from the United States finally got their attention, and Golden Star closed in 2004. Perhaps an important contribution came from another recent North Korean defector, Kim Dok Hong, who reportedly served for 17

years on the Central Committee. His message was simple: With a financial assault on Division 39 companies, "you can shut down Kim Jong Il."[122]

No story about North Korea is complete without commenting on the enormity of the human tragedy occurring in the countryside. An estimated 600,000 to 1,000,000 people died in the famines of the 1990s,[123] and some experts believe the figure could be as high as 2.5 million. Between 100,000 and 300,000 people have crossed the 877-mile border into China.[124] Perhaps another 200,000 are imprisoned in gulags and often worked to death. Torture, forced abortions, medical experiments, gassing, and grisly executions[125] appear to be common in six or more enormous penal colonies and innumerable other labor camps and political stockades.[126] Life expectancy has fallen and infant mortality has risen. There have been repeated reports of cannibalism, both of those dying of natural causes and of others murdered for their—I hate to say it—food value.

North Korea presents the twenty-first century with a completely criminalized Stalinist regime, fielding a million-man army, likely possessing nuclear weapons, apparently exporting nuclear materials, growing and trafficking drugs, producing and selling missiles, and counterfeiting currency and laundering it all over the world, while at the same time repressing millions of its people, generating a sense of desperation unparalleled in Asia in recent decades. The dilemma for the West is the link that connects nuclear capabilities and criminal pursuits. While we seek a solution to the North Korea problem, the impact of this regime's global criminal activities could be with us for years to come.

Yakuza

If racism is the original sin of America and caste the original sin of India, then gangsterism may be the original sin of Japan. Perhaps no other modern state has such a deep and troubling legacy with organized crime.

After centuries of internal conflict, two contenders for power and 160,000 combatants led by samurai warriors met in 1600 in the Battle of Sekigahara, as important to Japan as Gettysburg is to the United States and Waterloo to Europe. The cunning head of eastern forces, Ieyasu Tokugawa, emerged victorious, minor rivals were soon subdued, and the relatively peaceful Edo Period followed for more than 250 years.

Peace was good for the unified country but bad for the samurai. Some

became merchants and bureaucrats, but others resorted to roving banditry as masterless samurai, or *ronin*, ennobled in the movie *Seven Samurai*. To defend against them, other groups of toughs formed, called *machi-yakko*, or servants of the town. Glorified in legend as chivalrous defenders of the weak, they eventually descended into subgroups of gamblers and street peddlers and, later, collections regarded simply as hoodlums. Living on the edges of society, the term *yakuza* became attached to such gangs, referring to the numbers eight, nine, and three, which is a hand held by losers in a popular card game.

Ultranationalists began to capture the imagination of Japan in the late 1800s, advocating militarization and foreign expansion. They found natural allies in secret criminal societies, which soon played important roles as intelligence gatherers, provocateurs, and assassins in the occupation of Korea, in the Russo-Japanese War of 1904–1905, and later in the conquest and plunder of Manchuria and China. Bonds between far right-wing politicians and yakuza thugs solidified, while at the same time factions of radicals and conservatives developed within the military. By the outset of World War II, these two tracks were still evident in the Japanese armed forces, and a third force, an independent yakuza with rightist political links, was no longer tolerable. Many gang members found themselves either in uniform or in jail.

The U.S. occupation of Japan from 1945 to 1952 contributed to rebuilding yakuza strength. From black-market distribution of rationed goods, to control of docks, trucking, and massive new construction projects, to blunting the ambitions of immigrated Chinese and Koreans, yakuza gangs reasserted their might. As Mao's communists took over China and Japanese leftists threatened the democratic transition, U.S. occupiers, cooperating Japanese politicians, and both sides' intelligence and police services found yakuza thugs especially useful in putting down Red sympathizers. Long-time yakuza observers David Kaplan and Alec Dubro noted: "The money, the favored treatment, and the privileged relationships accorded to rightists and their gangster allies by U.S. officials created a corrupt power structure that would last for decades. The yakuza now resumed their role in Japanese politics—providing money and muscle—in a stronger position than ever."[127]

A pivotal figure in yakuza resurgence was Yoshio Kodama, ex-spy and profiteer in China. After the war, while held as a suspected war criminal in Tokyo, he entrusted his considerable fortune to a right-wing cohort, who fi-

nanced the establishment of the Liberal Party. Merging with the Democratic Party in 1955, the resulting LDP has continued to rule Japan from a foundation built in part on criminal money.

Released from prison in 1948, Kodama was promptly recruited by U.S. intelligence and for the next 35 years moved at the highest levels among yakuza bigwigs, right-wing politicians, and U.S. businessmen. Among corporations that came calling on Kodama was Lockheed Aircraft. Anxious to sell Starfighter jets, Tristar airliners, and Orion anti-submarine planes, Lockheed paid more than $12 million to Kodama over 20 years, most of it in yen notes, much of which he used to bribe politicians and defense and airline officials. When the scandal broke in 1976, it led to passage of the Foreign Corrupt Practices Act in the United States the following year, barring bribes to foreign government officials. Japanese ex-prime minister Kakuei Tanaka was convicted in 1983 of accepting more than $2 million of Lockheed's bribe money, while earlier press reports alleged that more than $250 million of illicit money had been passed through dummy corporations to his LDP faction.[128]

Today, yakuza ranks are estimated at about 80,000, among more than a thousand gangs spread across the Japanese islands and dozens of other countries. This gives organized crime a far heavier presence in Japan than in any other industrialized democracy. The largest syndicate, Yamaguchi-gumi, is based in Kobe and Osaka, has a membership of about 17,500, and in recent years has operated thousands of businesses in most of Japan's prefectures. The next four largest syndicates are headquartered in Tokyo and have a total membership of some 15,000. Combined criminal revenues are estimated by cowed police officials at $10 billion and by other analysts at vastly higher figures.

The range of yakuza activities in Japan is breathtaking, mixing illegally-derived revenues with semilegitimate businesses across the economic spectrum. Trillions of yen are generated from both usual and unique forms of crime.

Drugs. Before World War II, the yakuza controlled importation of opium and heroin from China. Frenetic years of economic expansion in the post-war occupation period produced a huge market for methamphetamines, with China, Taiwan, and South and North Korea providing pills and powder from dozens of labs. By the 1980s, meth may have accounted for half of

yakuza income, in the tens of billions of dollars, making Japan easily one of the world's largest consumers of the drug.

Human Trafficking. This is the seamiest side of Japan's attachment to yakuza syndicates. In the 1960s and 1970s, as income levels grew and commercial and tourist travel soared, yakuza gangs launched sex tours, taking businessmen on wild jaunts to Taiwan, the Philippines, South Korea, Hong Kong, Malaysia, Indonesia, Thailand, the United States, and elsewhere. Prostitution and sexual slavery grew all over Asia, with estimates of sex workers put at 700,000 in Thailand, 300,000 in the Philippines, 200,000 in South Korea, and more in other countries.[129] Europeans were soon attracted to these fleshpots as well. Protests in several nations, particularly by church and women's groups, curtailed blatant sex tours in the 1980s, a challenge which the ever-resourceful yakuza met by reversing the trade and bringing women and young girls instead to Japan. Whether enticed with promised jobs or purchased outright from destitute families, tens of thousands of women are flown every year into Japan from other parts of Asia, Latin America, and Eastern Europe, usually admitted on visas as "entertainers," stripped of their identifications and forced into prostitution in brothels and clubs. They are the central elements in Japan's estimated $80 billion sex industry,[130] now believed to employ as many as 150,000 non-Japanese.[131] Men are also imported for sexual service. The U.S. State Department has condemned this traffic, stating in a 2004 report: "The Government of Japan does not fully comply with the minimum standards for the elimination of trafficking. . . . The government should pursue efforts to prosecute the powerful organized crime figures behind Japan's human trafficking. . . . Japan could do much more to protect its thousands of victims of sexual slavery . . ."[132]

Unpaid Loans. Perhaps the murkiest part of yakuza involvement in Japanese business has to do with the "bubble economy," which began in the 1990s, and the amount of unpaid loans owed by criminal groups. As land, buildings, and corporate shares rose to dizzying heights in the 1980s, banks and developers flush with paper profits often turned to criminal syndicates to clear urban and farm areas for new real estate projects. Leveraging off of their growing connections in the banking sector, many yakuza groups and their hundreds of related construction companies went into property development themselves. Financial institutions, desperate to put massive cash re-

sources to work, reportedly made heavy advances to deals known to have yakuza affiliations, often through *kigyou shatei*, front companies for mob activities. Even respected Nomura Securities and Nikko Securities were found to have knowingly participated with other firms in loans of more than $2 billion to Inagawa-kai companies, one of the country's largest criminal syndicates.[133]

Then in the early 1990s the bottom fell out of Japanese asset values. Banks were left with trillions of yen in nonperforming loans, yakuza borrowers refused to pay, and bankers trying to collect found that they were taking their lives in their hands. In the early 1990s, a vice president of Sumitomo Bank was assassinated, and a vice president of Hanwa Bank was murdered. In 2000 the president of Nippon Credit Bank was found asphyxiated after fighting was heard in his hotel room. Another half dozen banking officials have similarly died in recent years under mysterious circumstances. As one observer commented, "The banks are still afraid of foreclosing on some companies because they are afraid of what the yakuza will do to them."[134] The *Far Eastern Economic Review* goes on to report: "Many Japanese politicians are reluctant to address the yakuza's role in the bad-debt crisis because they rely on gangsters for help raising campaign funds and fending off intra-party rivals. 'There's not a single Diet member who doesn't know his local yakuza boss . . .' "[135]

Bad debts at Japanese banks have been variously estimated to range from $150 billion to $1.5 trillion or even more. How much of this is yakuza related is unknown, but some observers suggest as high as 30 percent to 50 percent. Clearly, yakuza criminal syndicates have a significant if undetermined measure of responsibility for a dozen years of stagnation in the second largest economy on the planet, a stagnation that earned the name "yakuza recession" and affected growth across the whole world.

Besides these principal activities, yakuza groups are into many other criminal, legitimate, and indistinguishable ways of generating millions, including corporate shakedowns threatening to disrupt annual meetings or distribute unfavorable publicity, protection rackets preying on tens of thousands of businesses, murder for insurance, import-export, casinos, professional sports, loan sharking, gambling, counterfeiting, pornography, bid rigging, waste disposal, guard services, fish markets, armored-car and ATM heists, merchandise thefts, stock manipulation and financial fraud, and even book shops, art galleries, and hospitals. Money laundering, of course, keeps

it all going, which unfortunately, due to lax regulation, is accomplished with comparative ease.

Furthermore, the yakuza have greatly extended their international reach. Japanese and Korean gangs cooperate in amphetamine manufacture, smuggling, and distribution. Japanese gangs residing throughout Asia supply women and young girls for the Japanese sex trade, and trafficking routes often parallel well-worn paths that bring drugs out of Colombia, Brazil, Burma, Laos, and elsewhere. The Russian mafia cooperates in supplying women and weapons. Pacific island nations have a strong yakuza presence in hotels and casinos, and Australia is feeling the onslaught. Yakuza groups reportedly are heavy investors in Hawaiian real estate. Gang members are frequently spotted on the West and East coasts of the United States, often purchasing cheap firearms to be smuggled into Japan and sold for fat profits. Particularly in California, alliances with Vietnamese and South Korean gangs, Chinese triads, and U.S. mafias have solidified in recent years.

Legislation adopted in the 1990s gives Japanese police greater powers in fighting crime. But, as the *Far Eastern Economic Review* again reported, "Since Japan launched its yakuza crackdown a decade ago, serious crime has soared by 70 percent."[136] In other words, the world's oldest criminal syndicate, facing mounting pressure, yet operating with growing sophistication appears to have extraordinary staying power and bright prospects in this rapidly globalizing twenty-first century.

Transnational crime, whether perpetrated by syndicates or governments, has grown far too large to be defeated by ordinary police methods. Curtailing illicit financial flows is the key to curbing this global scourge, and in this effort, capitalism has the major role to play.

Terrorists

Whatever line may have once separated drug traffickers, criminal syndicates, and terrorist groups is now becoming increasingly blurred. Terrorists very often resort to crime and cooperate with criminals in generating money, obtaining arms and explosives, and moving operatives. And criminals are not averse to using terrorist tactics and random violence in pursuit of revenues.

As explained in the preceding sections, criminal gangs tend to specialize in particular skills and cooperate with each other across borders. Drugs and drug revenues, for example, may be handled by a dozen

groups, each performing some part of the task from production to transportation to sale to laundering. Each element in the chain is linked by a common motivation—profit.

Terrorist groups exhibit somewhat less cooperation because they are not necessarily driven by a common motivation, instead each usually pursuing a rather narrow agenda. Financing may be shared among terrorist groups, and training may be offered to sympathizers. Communication and laundering networks link some organizations, but specialization among many groups, each contributing to a single attack, is infrequent. The need for secrecy in planning, mobilizing, and executing terrorist operations precludes such extensive cooperation as characterizes global criminal activities.

If there is any commonality in the agendas of various terrorist groups it generally flows from a strong antagonism toward or a sense of disaffection from the broader society. This can be rooted in political, religious, ethnic, cultural, or economic conditions, each grounded in a sense of separation so strong as to justify killing or being killed in pursuit of group objectives.

How does capitalism fit into this picture? In two ways. First, enormous disparity, both economic and political, characterizes our shared world, and disparity, however caused or perceived, promotes among some powerful feelings of alienation and fatality. Capitalism can do a much better job of giving everyone a stake in prosperity, ameliorating part of the tendencies toward dissociation. Second, capitalism maintains the structure of tax havens, secrecy jurisdictions, dummy corporations, mispricings, fake transactions, and more, which terrorists utilize in the same way as criminal syndicates. As the U.S. State Department reported, "The methods used to move money to support terrorist activities are nearly identical to those used for moving and laundering money for general criminal purposes."[137] In other words, the structure that facilitates crime, corruption, and tax evasion equally facilitates terrorism.

Just as we have state supporters of crime, as discussed earlier, we have state sponsors of terrorism. In 2004 the United States had six countries on its sponsors list: Libya, Sudan, Iran, Syria, North Korea, and Cuba. Iraq, included the previous year, got a temporary pass because the United States ousted Saddam and took over the country's administration. An aging Muammar Qaddafi is trying to rehabilitate Libya's reputation by giving up weapons of mass destruction, curtailing terrorists inside the country's borders, and providing major financial support to the continent's African

Union political grouping.[138] Whatever reasons exist for including Cuba among sponsors of terrorism are tenuous at best. And then governments that terrorize their own populations are overlooked, such as Burma, Sudan, Liberia, Sierra Leone, Zimbabwe, Turkmenistan, and others.

By mid-2004, the U.S. government had designated nearly 400 organizations and individuals as terrorists. Terrorist incidents are in the hundreds annually, and deaths run from several hundred a year to the staggering blow delivered against the United States in 2001, costing nearly 3,000 lives in a single day.

Recognizing that the distinction among criminal gangs, terrorist groups, and, for that matter, guerrilla armies, is not always clear, a brief review of some of the more violent terrorist organizations as shown in Table 3.10 underlines the extent of their activities across the globe.

I have said it several times: Crime and terrorism are related. When western nations overlook or facilitate the flow of criminal money, terrorists merely step into these same well-worn paths to move their money. They, the terrorists, have not invented a single new way of generating and transferring resources. Available techniques are all laid out for them, ready for the picking.

Terrorists have three means of obtaining money. They can earn it, steal it, or beg for it. Each of the three has brought them millions of dollars.

Terrorists own businesses. Particularly preferred are retail stores that generate cash, import-export firms that provide cover for arms and drugs, remittance systems sending money across borders, and even banks that provide some legitimate services while shielding transfers of terrorist funds. Aum in Japan runs computer stores, and Al Qaeda has received millions from cooperating banking operations.

Then there are hundreds of ways to make money illegally. Bank robberies utilize terrorists' expertise, for example, pulled off by ETA in Spain. Kidnapping and extortion are favorite devices among Colombian groups. Protection rackets and community taxation are simply thefts by other names, often used in the Philippines and South Asia. Many types of fraud are available—credit card, insurance, medical payments, and more—promoted, for example, by Middle Eastern cells in the United States. Smuggling, also drawing on terrorists' skills, is a favorite technique all over the world, avoiding excise taxes or customs duties and selling at fat profits. Counterfeiting or buying and reusing counterfeit currencies brings several

Table 3.10 Terrorist Organizations around the World

Groups with Estimated Operatives Numbering 1,000 or More	*Areas*
Aum Shinrikyo	Japan, Russia
Communist Party of Philippines/ New People's Army	The Philippines
Hamas	Israel and Palestine Occupied Territories
Hezbollah	Middle East, with cells in Asia, Africa, Europe, South and North America
Jemaah Islamiya	Indonesia, with cells in Malaysia, Singapore, Thailand, and perhaps the Philippines
Kurdistan Workers Party	Turkey
Lashkar-Tayyiba	Kashmir and India, with bases in Pakistan
Liberation Tigers of Tamil Eelam	Sri Lanka
Mujahedin-e Khalq Organization	Iran, from Iraq
National Liberation Army (ELN)	Colombia, Venezuela
Al Qaeda	South and Southeast Asia, Middle East, Europe, and U.S.
Revolutionary Armed Forces of Colombia (FARC)	Colombia, with forays into neighboring countries
United Self-Defense Forces of Colombia (AUC)	Colombia
Groups with Estimated Operatives in the Hundreds	*Areas*
Abu Nidal Organization	Middle East
Abu Sayyaf Group	The Philippines
Al-Aqsa Martyrs Brigade	Israel and Palestine Occupied Territories
Ansar al-Islam	Iraq

(Continued)

TABLE 3.10 *(Continued)*

Groups with Estimated Operatives in the Hundreds	*Areas*
Armed Islamic Group	Algeria
'Asbat al-Ansar	Lebanon
Basque Fatherland and Liberty (ETA)	Spain and France
al-Gama'a al-Islamiyya	Egypt
Harakat ul-Mujahidin	Kashmir, with bases in Pakistan
Islamic Movement of Uzbekistan	Uzbekistan, Afghanistan, Tajikistan, Kyrgyzstan, and Pakistan
Jaish-e-Mohammed	Kashmir, India, and Pakistan
Palestinian Islamic Jihad	Israel and Palestine Occupied Territories
Palestine Liberation Front	Middle East
Popular Front for the Liberation of Palestine	Israel and Palestine Occupied Territories, with bases in Syria and probably Lebanon
Popular Front for the Liberation of Palestine—General Command	Israel, Palestine Occupied Territories and other parts of Middle East
Real IRA	Northern Ireland, Ireland, and U.K.
Salafist Group for Call and Combat	Algeria
Sendero Luminoso (Shining Path)	Peru

Middle Eastern terrorist organizations to the tri-border region of South America, where Brazil, Argentina, and Paraguay meet. And terrorist groups parallel criminal syndicates in trafficking drugs and arms. Many terrorist cells are expected to be self-supporting, with theft, fraud, and smuggling offering easy money-making opportunities.

Finally, after running through all the legal and illegal ways that funds can be generated internally, terrorists turn to that tried and true financing technique known to every good businessperson by its initials OPM—other people's money. Governments, as already mentioned, write checks: Libya,

Syria, Iran, Pakistan, Sudan, and the PLO. Masquerading humanitarian charities divert millions to terrorist organizations. And individual sympathizers, often among ethnic groups in foreign countries, send contributions amassing to millions. Al Qaeda and Palestinian terrorists certainly prospered from other people's money in recent years.

When it comes to cash, terrorists and criminals are two peas in the same pod. Al Qaeda, which earned, stole, and cajoled hundreds of millions of dollars, and Iraq, which made billions from manipulating oil prices, illustrate the point.

Al Qaeda

Afghanistan, characterized by drugs, crime, corruption, war lords, and political chaos, served as the incubator hatching Al Qaeda and its thousands of terrorist warriors. Drawn to repel Soviet invaders in the 1979–1989 Afghan war, Osama bin Laden ran Mektab al Khidmat, or the Services Office, which recruited, trained, and equipped foreign volunteers to join Afghan mujahideen fighters. Supported by Pakistan, Saudi Arabia, and the United States and making effective use of shoulder-fired missiles against helicopters and aircraft, the mujahideen heaped mounting losses on Soviet forces, leading to their announced intention to withdraw in 1988 and complete withdrawal the following year. Bin Laden, with thousands of highly trained and motivated fighters now at his beckoning, formed Al Qaeda in 1988 and established relationships with other radical Islamist groups.

The son of a billionaire Saudi contractor, bin Laden returned to his country, Saudi Arabia, in 1989 and laced into the royal family for corruption and religious deviance, resulting in his house arrest in 1991. Whether pushed or eased into exile, he departed that year back to Afghanistan and then relocated to Sudan, attracted by the ruling party's Islamic ideology. Al Qaeda, which means "the Base," found a home in Khartoum, the capital, and the sprawling deserts of Africa's biggest country, with nearly a million square miles and ample room for terrorist training facilities. The organization gave arms to Sudan's National Islamic Front, and in return the Sudanese government gave land, hospitality, and construction contracts to bin Laden and passports to Al Qaeda operatives.

Bin Laden, perhaps at first utilizing some inherited money, made a number of investments in Sudan, reportedly in construction, trucking, im-

porting and exporting, farming, cattle breeding, tanning, furniture manufacturing, currency trading, and, allegedly in the newly-formed Al Shamal Islamic Bank. Business was conducted under such names as Ladin International, Taba Investment, Al-Hijra Construction, and many more. Other investments reportedly included a car dealership, ostrich farm, and shrimp boats in Kenya, gemstone trading in East and later West Africa, bakery and honey shops in several countries in the Middle East, forestry in Turkey, and, it is believed, shipping, with vessels registered under several flags of convenience. How financially successful these investments were is unknown. What is known is that bin Laden, already an effective fundraiser, turned increasingly to other people's money in the 1990s.

Resources made their way to Al Qaeda from charities, foundations, financial institutions, wealthy individuals, mosque collections, and governments or quasi-government organizations. Some of the charities and foundations that allegedly provided funds to or had links with Al Qaeda, whether intentionally or unintentionally, and were placed on the U.S. terrorists' list include the following: Al Haramain Islamic Foundation, Holy Land Foundation for Relief and Development, Wafa Humanitarian Organization, Al-Rashid Trust, Afghan Support Committee, Benevolence International Foundation, and Rabita Trust. In addition, scores of individuals are alleged to have contributed to Al Qaeda.[139]

Over two decades, the Saudi Arabian government probably distributed upwards of $75 billion to other countries promoting its conservative brand of Islam, Wahhabism, with contributions to schools, hospitals, and charities. Some of this undoubtedly reached Al Qaeda coffers.[140]

Under pressure from the U.S. government, Sudan asked bin Laden to decamp in 1996. He left his investments behind, picked up his organization, and returned to Afghanistan, eventually reconstituting his financing stream and buying his way into the good graces of the radical Taliban movement with arms and money badly needed in their fight for control of the fractured country. Meeting Al Qaeda's cash flow requirements of roughly $30 million a year took on greater urgency.

One group allegedly offering assistance was Al Taqwa Trade, Property and Industry Company Limited, set up in the late 1980s, utilizing basic steps outlined in the Dirty-Money User Manual. It was incorporated in Liechtenstein, Europe's most intractable soul of discretion, where the firm's legal requirements, if you can call them that, were duly handled by a registry

office known as Asat Trust. It operated out of Lugano, Switzerland, a town of some 30,000 with one of the world's higher concentrations of money launderers. Its owners lived a few minutes away in Campione d'Italia, that little enclave surrounded by Switzerland that offers lax Italian residency rules for launderers working in Switzerland. And it had its own bank in the Bahamas, Bank Al Taqwa, giving it access to correspondent accounts with respectable financial institutions in many countries.

Al Taqwa, which means "Fear of God," was formed and managed by Youssef Mustafa Nada, born in Egypt and a member of the Muslim Brotherhood since the 1950s. His principal associate was Ali Ghaleb Himmat, who served as executive director. Both lived in the United States in the late 1970s and early 1980s, part of the time in Silver Spring, Maryland, on the outskirts of Washington, D.C. And both easily obtained Italian citizenship upon moving to Europe and creating Al Taqwa.

Over time, Al Taqwa developed an impressive list of shareholders, reportedly 745 names long, many subsequently investigated by the U.S. Treasury Department. At a point it became necessary to put a Swiss citizen on the board. Ahmed Huber was a natural choice, formerly Albert Huber before converting to Islam in the 1960s. He is allegedly an avowed admirer of Adolf Hitler and Ayatollah Khomeini and a staunch Holocaust denier. Huber and his Al Taqwa colleagues deny any connection to financing terrorists. Nevertheless, he travels the world speaking to radical Muslims and Aryan youths and has been quoted saying, "We are making a link between Islamic movements and the New Right in Europe."[141] "Muslims and Nazis [are] involved in the same fight."[142] Now there's a frightening thought!

Al Taqwa operated out of a small apartment in Lugano, with four people making financial transfers by computers through correspondent bank accounts. For Hamas alone, Al Taqwa reportedly handled as much as $60 million a year. Some clients' accounts were identified by number only. Youssef Nada, the managing director, had relationships with many Muslim leaders, allegedly including Saddam Hussein. Reportedly, Al Taqwa received money Saddam extracted from kickbacks on UN Oil-for-Food contracts. Nada was also linked to the SAAR network of charities and foundations operating in Virginia. In total, over the 12 to 14 years of its operations, Al Taqwa is believed to have handled hundreds of millions of dollars, some of it for terrorist groups.

In the month after 9/11, Swiss authorities investigated Al Taqwa and

found nothing out of the ordinary. Meanwhile, Nada had already begun changing the names of his companies. A bit of additional intelligence provided by the United States led Swiss and Italian authorities to take another look at Al Taqwa and its operators living in Campione d'Italia, finally freezing its accounts in late 2001. However, the Swiss suspended their investigation into the company in 2005, despite speculation that the money-shifting network may still be functioning. Al Taqwa and its associated companies, as well as Nada, Himmat, and Huber, have all been placed on the U.S. terrorists list.

The point bears repeating: Al Taqwa, operating in tax havens and secrecy jurisdictions with dirty money and disguised accounts, did not invent any new ways of moving laundered proceeds for Al Qaeda or other terrorist groups. It simply took advantage of the structure that is used every day by criminals, corrupt government officials, and commercial tax evaders, the structure that also well serves terrorists in spreading mayhem and death.

Much has been made of the fact that the perpetrators of 9/11 needed only some $400,000 to $500,000 to pull off their attack. This is misleading, since it took an organization built with hundreds of millions of dollars and years of preparation to organize, train, house, feed, indoctrinate, arm, transport, and position terrorists to carry out their crime. Years of shifting large sums of illicit proceeds around the world underlay the 9/11 operation.

When the attackers were identified as primarily Saudi nationals, attention turned to that country's widespread support of fundamentalist movements and loose financial controls. Saudi officials proved extraordinarily reluctant to pursue intelligence leads offered by the United States, until Al Qaeda's attacks became a threat to the royal family personally and to regime stability. Cooperation in sharing operational and financial intelligence is now improved, if still only marginally satisfactory. As a task force sponsored by the Council on Foreign Relations concluded: "Saudi Arabia has taken two or three important steps to improve its capability to cooperate on these matters with the United States, for which it should be commended. A hundred more steps and Saudi Arabia may be where it needs to be."[143]

As the United States and cooperating countries worked to seize funds and close bank accounts, Al Qaeda reportedly shifted assets into diamonds and gold. In fact, the process had begun well before 9/11. In 1999 the U.S. Treasury Department froze assets belonging to the Taliban—$217 million in gold and cash at the Federal Reserve Bank of New York and another $34 million in U.S. commercial banks. In the same year, Al Qaeda was formally

designated by the U.S. State Department as a terrorist organization. The message for terrorists was clear: Remove assets from the legitimate financial system as fast as possible.

If demand deposits, CDs, and negotiable instruments are no longer safe, two basic options remain—currency notes and commodities. Al Qaeda probably put some of its resources into gems and precious metals. An absorbing account of paying cash for conflict diamonds is offered in *Blood From Stones: The Secret Financial Network of Terror*, by Douglas Farah, formerly West African correspondent for the *Washington Post*. Farah details his observations of how Al Qaeda, Hezbollah, and other terrorist groups bought diamonds from thugs across Africa. Particularly in West Africa, Charles Taylor in Liberia, Foday Sankoh in Sierra Leone, and others sold bags of rough diamonds to Muslim terrorists, South African mercenaries, and U.S. profiteers, then used the proceeds to purchase guns and munitions, delivered by the Russian arms merchant Victor Bout, that killed an estimated 200,000 in these two benighted countries alone. At least one diamond dealer in the greater Washington, D.C., area participated in this scurrilous business.

The 9/11 Commission Report published in 2004 is a detailed and well-written document. However, in a chapter entitled "What To Do: A Global Strategy," the commission erroneously concludes that "Obvious vulnerabilities in the U.S. financial system have been corrected."[144] That must be music to Al Qaeda's ears, because the truth is just the opposite. The structure that supports the flow of dirty money—mispricing, transfer pricing, dummy corporations, tax havens, secrecy jurisdictions, the legal deposit of many forms of criminal proceeds, and virtually all forms of tax-evading proceeds—all of this is intact, used every day by thugs and cheats and remains available to terrorists. Any thought that "obvious vulnerabilities" have been corrected fails to recognize how obvious U.S. vulnerabilities are to others. Al Qaeda is likely to take advantage of such flawed thinking again.

Iraq

When President George W. Bush labeled Iraq part of his "axis of evil," he neglected to mention the many western corporations trading with the enemy and the many respectable financial institutions handling funds for Saddam Hussein and his clique. In Iraq we had a world-class thief who used the tried and proven dirty-money package to expand his evil regime: false pricing,

fake transactions, dummy companies, and laundering techniques. How many people—civilians and combatants, including Iraqis, Americans, British, Italians, and others—have been killed by munitions bought with proceeds derived from illegal transactions?

The Iraqi oil industry was nationalized in the early 1970s. Saddam emerged as the most powerful man in the country in the mid-1970s and assumed the presidency in 1979. With billions of barrels of proven reserves and millions of barrels of daily production now under his personal control, he required oil purchasers to pay a 5 percent kickback into his coffers. Japanese buyers, considered "easier to deal with," had to pay 7.5 percent.

Saddam also began setting up a structure of cronies operating trading companies in every major country in Europe and also in the United States and Canada. These companies were heavy buyers of goods shipped to Iraq, and they also paid commissions to Saddam, rarely less than 5 percent and usually in the 10 percent to 35 percent range. Peril awaited foreign-based Iraqi buying agents who got too greedy and tried to profiteer at Saddam's expense. Upon returning to Baghdad for routine consultations, they were sometimes hanged.

To handle all the money coming in, Saddam set up a string of companies and accounts in tax havens and secrecy jurisdictions, including Panama, the Netherlands Antilles, Switzerland, Luxembourg, Liechtenstein, the Channel Islands, the Isle of Man, Cyprus, and Gibraltar. Furthermore, Saddam or his immediate henchmen opened bank accounts, set up foundations, and even established family pension funds that received billions of dollars, no questions asked, from all sorts of remitters who were obviously not in any known legitimate business. Accounts were operated in the United States, United Kingdom, France, Switzerland, Germany, Liechtenstein, Austria, Greece, Cyprus, Tunisia, Egypt, Lebanon, Jordan, the United Arab Emirates, Japan, and elsewhere. In fact, transfers were made out of the Iraqi Central Bank account with the U.S. Federal Reserve Bank of New York directly into Swiss bank accounts under the control of the dictator. By the end of the 1980s, money stashed in Switzerland and elsewhere for Saddam, his family, the Iraqi Baath Party, and the intelligence service known as Mukhabarat has been estimated at some $20 to $40 billion. Of this, $7 billion was alleged to be in gold—700 tons of gold! Two family pension funds allegedly held $1.6 billion.

I have reviewed hundreds of pages of confidential documents on Sad-

dam's overseas structure and the businesses and banks that cooperated in filling his coffers. Suffice it to say that many, many individuals, multinational corporations, and financial institutions buying from or selling to or banking for Iraq supported his rip-offs.[145]

In 1990 the Simon Wiesenthal Center issued a report listing more than 60 German companies that had provided "unconventional technologies" to Iraq for missiles, nuclear components, chemical production systems, biological warfare, and other applications. Among those named were Siemens, Thyssen, Ferrostaal, M.A.N., Sigma Chemie, Karl Kolb, and Carl Zeiss.[146] Allegedly, some of this surreptitious trade was carried on with falsely-declared exports and fake end-user certificates.

During the Iran–Iraq war from 1980 to 1988, Iraq often utilized Jordan as a sourcing country. Armaments and munitions were sold to Amman, which promptly transferred them to Iraq. Allegedly, commissions on arms deliveries were paid to a member of the Jordanian royal family in amounts of $25 million, $70 million, $200 million, and more.

The world was shocked to see Saddam invade and annex Kuwait in 1990. This was perhaps the greatest heist since World War II and its immediate aftermath, as Iraqis made off with thousands of cars and trucks, hospital and telecommunications equipment, computers, gold, antiquities, and Kuwaiti dinars. The dinars were offered at heavy discounts to Kuwaiti princes waiting out the war in Egypt, hoping to use the money at face value when they got their country back.

As coalition forces in Operation Desert Storm pushed Saddam out of Kuwait in February 1991, the Iraqi Central Bank reportedly transferred $5.2 billion to Amman. From there funds were distributed to various foreign entities controlled by Saddam, to be used specifically to evade trade sanctions and rearm Iraq.

In the wake of the Persian Gulf War and the imposition of trade sanctions, the Iraqi people suffered. Saddam intentionally worsened their plight for political ends. Reacting to conditions in the country, the United Nations Security Council passed Resolution 986 in 1995, establishing the Oil-for-Food program. This set up a mechanism for petroleum exports and humanitarian imports approved by the UN. A year later, the first oil sold under the program flowed out, and in March 1997, the first food shipments came in.

Initially, major oil companies purchased Iraqi crude under the plan. But in November 2000 Iraq demanded a kickback of about $1.20 per barrel,

then $0.50 per barrel, then $0.40 a barrel, to be paid directly to the Iraqi Central Bank. Incredulously, the UN sanctions committee approved $0.30 a barrel in December 2000, legalizing a mispricing scheme that violated its own procedures.[147]

Major oil companies balked at paying kickbacks but soon gladly purchased oil from smaller firms paying kickbacks. Eventually such firms were reported to number more than 250,[148] including many that had never before touched the oil business. As one legitimate buyer reportedly said, "Everyone and his dog is trading Iraqi oil."[149]

Earlier I wrote about a small tanker that loaded oil legitimately, repainted its waterline at night, secretly added half again to its load, and then departed the harbor the next day with its extra cargo unnoticed. If you are going to use this type of fakery, why do it on a modest scale? A Dutch oil buyer, Trafigura, allegedly bought 1.8 million barrels of Iraqi oil from a French trader, Ibex Energy, loaded it onto a Liberian-registered tanker at the Mina al-Bakr offshore terminal at the northern end of the Persian Gulf, obtained approval as required for the transaction from UN inspectors, and then secretly loaded an additional 270,000 barrels before steaming away. The buyers of the crude were reportedly Koch in the United States and PDVSA in Venezuela, and at least parts of the payments wound up, not in the UN's Oil-for-Food account, but in Swiss and Lebanese banks.[150]

Besides subverting so-called legal oil sales through the UN, Saddam's regime made even more money by smuggling oil to neighboring countries. These sanctions-busting sales were condoned by the UN and by western powers. Anxious purchasers included Turkey, Syria, Jordan, and even former enemy Iran, all pouring billions into Saddam's till.

Russian tankers loading oil in Iran were caught by the U.S. Navy with oil originating in Iraq. In 2000 the *Volgoneft-147*, jointly owned by a Russian company SovFinAmTrans partnering with a U.S. company Transcisco Industries, was boarded and found with Iraqi crude purchased by a British Virgin Islands firm, Primstar.[151] Another tanker owned by Novorossiisk Shipping carrying a cargo owned by Royal Dutch/Shell was intercepted with 100,000 barrels of alleged Iraqi crude out of its 500,000-barrel total load, costing Shell a $2 million fine.[152]

Besides making illicit money in every possible way from its oil exports, Iraq likewise made money from kickbacks on its imports, again under the noses of UN overseers. The established supply procedure allowed Iraqis to

negotiate purchase prices and delivery arrangements, while the UN paid for approved contracts. However, imports outside the Oil-for-Food program streamed into Iraq, as monitors from Lloyd's Register and then from the Swiss firm Cotecna physically checked only a fraction of cargoes at just five points of entry into the country.

A 2002 General Accounting Office (GAO) report to the U.S. Senate on Iraqi financial machinations estimated that, in connection with UN-authorized imports, "the commission is five to 10 percent of the commodity contract, with the funds paid directly to officials connected with the Iraqi government."[153] This is entirely consistent with kickback levels common in many developing and transitional economies and is also a rate of mispricing with which many exporting companies are quite comfortable.

Through 2002, the UN took in some $67 billion in Iraqi oil revenues and paid or committed $38 billion for purchases of humanitarian supplies. An updated 2004 GAO report states that, "From 1997 through 2002, we estimate that the former Iraqi regime acquired $10.1 billion in illegal revenues—$5.7 billion in oil smuggled out of Iraq and $4.4 billion in surcharges on oil sales and illicit charges from suppliers exporting goods to Iraq through the Oil-for-Food program."[154] According to a U.S. Department of Defense review, an estimated 48 percent of imports through the UN program were overpriced by an average of 22 percent.[155] Applying weighting factors and multiplying these two figures indicates that Iraq's total visible imports bill was overpriced by about 9 percent. This is the first time I have seen a government source perform the kind of research and calculation that I have been doing for years: percentage of trade mispriced and the percentage by which it is mispriced.

Saddam's overseas structure for generating illicit revenues was functioning from the 1970s onward and received billions in additional support funds in the 1990s. UN diplomats and bureaucrats in New York were ill-equipped to spot and control what goes on in the seamy underside of global trade every day. Worse, some important figures in New York and elsewhere apparently succumbed to temptations dangled by Iraq, allegedly accepting vouchers for purchase of crude oil at discount prices.[156] Saddam's import and export manipulations were accomplished with western facilitation. The chance that the UN's Oil-for-Food functionaries, operating with little western support and with a great deal of Saddam's finagling, could effectively curtail this process was zero.

After the Iraqi regime was driven from power by coalition forces in April 2003, U.S. soldiers found hundreds of millions of dollars in U.S. currency hidden at several locations in Baghdad. The initial haul was $650 million, shortly followed by another discovery of $112 million, and eventually amassing, along with other assets, to more than $900 million. Most of the U.S. currency was neatly shrink-wrapped with identifications confirming that it had originated from three banks of the U.S. Federal Reserve system. The Fed uses authorized commercial banks to distribute new U.S. currency and retrieve old notes. Tracing currency serial numbers, it was found that the notes recovered in Baghdad had been allocated to UBS in Zurich, Bank of America in Zurich, HSBC in London and Frankfurt, and the Royal Bank of Scotland in London.[157] Digging first into UBS, Fed officials discovered that, contrary to strict U.S. regulations and the bank's contractual obligations, UBS had distributed U.S. currency to prohibited buyers, including Iran, Libya, Serbia and Montenegro, and Cuba, some of which seems to have made its way to Iraq. UBS had been filing false returns with the Fed for eight years and, even after the investigation had begun, further attempted to conceal its actions. The Fed hit UBS with a $100 million fine and cancelled its currency distribution contract. Perhaps the other offending banks will be sanctioned as well.[158]

When a multibillion-dollar institution lies to central banks, falsifies records, ships currencies to barred governments, and indulges in systematic cover-ups, then the global financial system has some very serious problems. It's no wonder that rogue regimes that terrorize their citizens and neighbors find it so easy to sustain themselves with illicit proceeds. Dirty money put Saddam Hussein back in business, murdering his own people, and, it was thought, threatening the world with weapons of mass destruction. The United States and its coalition partners fought a second war with Iraq, in part because the structure of false pricing, fake transactions, dummy corporations, tax havens, and secrecy jurisdictions had allowed Saddam to rearm. And western collaborators fully participated, putting the services of the global dirty-money system again at his disposal. As a returning Iraqi said, "It was very cruel to aid a dictator and his regime when all of you knew what the money was and where it was going. Instead of letting his resources dry up, you let the dictatorship last longer."[159]

The earlier question bears repeating: How many people lost their lives from armaments and munitions purchased with Saddam's illicit rev-

enues, revenues that we helped provide? Estimates run in the hundreds of thousands. But the key point is not the accuracy of an estimate; the point is to make it clear that dirty money buys death for untold numbers of people.

GLOBAL COMMERCE AND TAX EVASION: COIN OF THE REALM

"Forget it! The present supplier handles the managing director's kickbacks in Europe."

I was in a developing country together with my local agent, and we were calling on potential customers for linerboard, which is the heavy kraft paper used to manufacture corrugated boxes. My firm, working closely with several U.S. mills, bought and sold thousands of tons of this trade item annually. We went to see the managing director of a large packaging producer, and he brought his purchasing manager into the meeting. After a tour of the factory and some pleasant conversation back in the boss's office, he gave us an idea of what kind of price and terms we would have to meet to be competitive. We quoted a good bit lower price, agreed to the same terms, and guaranteed shorter delivery times. He seemed pleased, saying he would consider our offer, and we shook hands and departed, optimistic about future business. As we were about to reach the parking lot, the purchasing manager came running after us and delivered his "Forget it" line. Free trade thwarted again.

I have seen exactly this kind of situation hundreds of times, where cooperative and confidential arrangements exist in export and import transactions, with illegal kickbacks built into every shipment. Once initiated, false pricing usually continues unabated, because altering or stopping the over- or under-billing risks losing the feature of invisibility. When solidified, such alliances between buyers and sellers are impossible to break, undermining the fabric of competitive capitalism.

In Ecuador, for example, the managing director of a substantial company meets annually with his employees, and the story is usually the same: "It's been a tough year, there's severe pressure on selling prices, imported raw materials and machinery are getting more costly, the company cannot afford to increase wages or benefits, we all have to work harder in hopes of better

times soon." Meanwhile, with the help of entrenched foreign suppliers, he and one or two of his top officers are salting away a half-million dollars a year in a Miami bank account, and no one can lever into this tight-knit little fraternity.

Let me repeat: I'm all for free trade. Provided it's legal. It's the illegal components of trade that I oppose—the use of trade to move illicit flight capital, to evade taxes, to stifle competition, and to defraud employees and mislead investors. As an Indian businessman put it to me, this is "straight theft, even if you are stealing it from your own company."[160]

Manipulation of trade takes many forms, as laid out in the Dirty-Money User Manual. Exports and imports of goods and services are falsely priced, referred to as mispricing in unrelated-party transactions and as abusive transfer pricing in related-party transactions. Not only are prices subject to manipulation, but also quantities, qualities, weights, and measurements. And transactions can be completely faked, with money easily flowing to pay for trade that never existed.

About 65,000 multinational corporations operate across borders. Trade within corporations comprises some 50 to 60 percent of global commerce. The remaining 40 to 50 percent is trade between unaffiliated parties. And an estimated 50 percent of all global commerce passes through tax havens and secrecy jurisdictions at some point between seller and buyer.

Much of this global trade is falsely priced. This serves to eliminate taxes, avoid regulations, and accumulate wealth secretly. A few examples (Table 3.11) of items and invoiced prices into and out of the United States, drawn from the work of Professors Simon Pak and John Zdanowicz, will make the point. Besides the excellent work of these two gentlemen, I also have trade data on thousands of transactions, with buyers and sellers identified.

Recall the advice offered in the Dirty-Money User Manual: Anything that can be priced can be mispriced. False pricing is done every day, in every country, on a large percentage of import and export transactions. This is the most commonly used technique for generating and transferring dirty money—money that breaks laws in its origin, movement, or use. False pricing is cooperation among the world's powerful for exploitation of the world's weak. The fact is, for almost every illegal dollar, euro, pound, peso, ruble, or other currency that moves out of poorer countries by this means, there is a

TABLE 3.11 INVOICED PRICES OF SELECT ITEMS

	Exports from U.S.	
Item	*Destination Country*	*Price per Unit*
Bulldozers	Mexico	$527.94
ATM machines	El Salvador	$ 35.93
Missile/rocket launchers	Bolivia	$ 40.00
Television antennas	China	$ 0.04
Aluminum ladders	Japan	$ 4.40
Forklift trucks	Jamaica	$384.14
Clinical thermometers	Germany	$ 0.05
Car seats	Belgium	$ 1.66
	Imports into U.S.	
Item	*Originating Country*	*Price per Unit*
Flashlights	Japan	$ 5,000.00
Ink-jet printers	Colombia	$179,000.00
Syringes	Switzerland	$ 2,306.00
Wrenches	France	$ 1,089.00
Toothbrushes	United Kingdom	$ 5,655.55
Hacksaw blades	Germany	$ 5,485.00
Razor blades	India	$ 461.00
Tweezers	Japan	$ 4,896.00

Source: Simon J. Pak and John S. Zdanowicz, "U.S. Trade with the World: An Estimate of 2001 Lost U.S. Federal Income Tax Revenues Due to Over-invoiced Imports and Under-invoiced Exports," working paper from the Center for International Business Education and Research, Florida International University, Miami, Florida.

western trader, manufacturer, or financier that directly or indirectly facilitates its receipt.

The business of global tax evasion takes many other forms as well. As the economist Vito Tanzi says, "Tax evasion prospers when society condones it."[161] A popular technique in recent years is transferring copyrights, logos, trademarks, patents, and other such intangibles to offshore subsidiaries in

tax havens. Revenues derived from licensing or selling these corporate assets to other subsidiaries and affiliates can accumulate in the haven tax free. Then, millions piling up in the tax-haven subsidiary can be loaned to the parent company, upon which interest is paid back to the subsidiary. The interest payment is tax deductible; the interest income received in the haven is again tax free.

Many business owners in developing and transitional economies have set up holding companies in tax havens and secrecy jurisdictions. The local owners exchange their shares in the local company for shares in the offshore company. All of a sudden the business has foreign owners, and profits flow abroad. U.S. and European companies are now doing the same thing, referred to as "inversion." Bermuda is a popular place to set up the new parent company, with the domestic operating company functioning as a subsidiary. Profits accumulate in the tax haven, and tax collections are minimized in the principal country of operation.

Free trade zones have been badly abused. Usually expected to provide duty-free importation, minor fabrication or conversion, and then re-exportation, many such trade zones have instead become routes for smuggling into the countries where they are situated and to regions beyond.

False pricing and tax havens can be put together for major savings. A simplified example is illustrated in Table 3.12. The net result is the company has an initial production cost of $1,000, a final selling price of $1,500, and a profit of $500. No taxes of any significance are incurred, and, in fact, a loss carry-forward of $500 has been created to offset future taxes. These kinds of transactions are entirely routine.

The outcome is the legitimization of illegitimacy. The combination of mispricing, transfer pricing, tax havens, dummy corporations, shielded foundations, secrecy jurisdictions, flee clauses, the whole gamut of techniques and structures that support dirty money, affords a quasi-legal veneer over a system that revels in its ability to walk on the edge and get away with subterfuge, disguise, and theft. Just like drug dealers, criminal syndicate heads, terrorist organizers, and corrupt government officials, corporate executives add their support to maintenance of the system.

Earlier I wrote that I have never known a multinational, multibillion-dollar, multiproduct corporation that did not often use transfer pricing to move tax-evading money between parent, subsidiaries, and affiliates. "Trans-

TABLE 3.12 HOW TO SUCCEED IN BUSINESS WITH FALSE PRICING AND TAX HAVENS

Parent Co. *Country A*			*Subsidiary Dummy Co.* *Tax Haven B*			*Subsidiary Sales Co.* *Country C*	
Production costs	$1,000						
Selling price	$1,000	→	Buying price	$1,000			
			Selling Price	$2,000	→	Buying price	$2,000
						Selling price	$1,500
Profits	$0		Profits	$1,000		Profits (Loss)	($ 500)
Taxes	$0		Taxes	$0/negligible		Taxes offset/loss C/F	

fer pricing by multinationals is the same as smuggling by citizens," in the view of a Japanese economist.[162] Yet, this is the way international business is done. It has become a central element in global strategies. And, before corporate executives and their advisors leap to defend these actions as within the law, consider the possibility that abusive transfer pricing is a felony offense, as laid out in the next chapter. This is an area in which corporations must begin to exercise extreme caution, in order to protect officers and employees from any possibility of criminal actions, whether caught and charged or not.

Referring primarily to the United States, Robert Kuttner could have equally directed the following to the whole of the western world:

> It's one thing to believe that low tax rates are good for economic growth. It's quite another to collude in tax evasion. The former is the subject of a fair debate between liberals and conservatives. The latter undermines the rule of law and the transparency that we preach to the rest of the world. Today, corporations can book the same income differently in different countries. International tax planning is part of the same corporate culture of creative accounting that led to the Enron Corp. scandal.
>
> Conservatives and liberals alike ought to favor consistent tax enforcement. For every dollar owed but not collected by the IRS, either taxes must rise or budget deficits must widen, sending interest rates higher and placing a heavy burden on our children to pay down the debt.

> You would also think, given worries about terrorists' laundering money, that the Administration would welcome closer international information-sharing among banking and tax authorities. But evidently tax favoritism for corporations and high-bracket individuals trumps even antiterrorism.[163]

Beyond legal issues and beyond domestic interests is the question of western capitalism's relationship to the rest of the world. Falsified pricing, haven and secrecy structures, and the illicit movement of trillions of dollars out of developing and transitional economies break the social contract, however it may be defined, that Adam Smith incorporated into the core of the free-market system. The following pages demonstrate some of these concerns with illustrations drawn from Congo, commercially exploited for many years, and China and Russia, transitional economies with the greatest illegal outflows of money ever seen.

Congo

As the forces of decolonization swept Africa in the 1950s, Belgium granted independence to the Congo on June 30, 1960, and the country immediately descended into chaos. Colonel Joseph Mobutu, commander of the Congo army and acting with CIA encouragement, temporarily took over the government in September. After he relinquished control, rebellions erupted, mercenaries poured into the vacuum, and the central government teetered, leading Mobutu to return to power in 1965 and declare himself president. Having learned his lessons well from studying the Belgian colonialists, Mobutu, already a millionaire from foreign bribes, launched one of the most incredibly venal regimes of modern times. Congo sank into what has been called "the gloomy vision of a Hobbesian state of nature."[164] A council of local prelates characterized commerce in their country as "organized pillage for the profit of the foreigner and his intermediaries."[165]

Indeed, there was much to pillage. Besides copper and gold, Mobutu's Congo, the size of the United States east of the Mississippi River, was a major producer of diamonds, cobalt, tin, tungsten, zinc, silver, uranium, lead, iron ore, coal, manganese, and a bit of oil. Congo also had a reasonable agricultural base and exported rubber, timber, palm oil, coconut, coffee, cocoa, and tobacco. Mobutu profited directly from export transactions, by receiv-

ing kickbacks into his foreign bank accounts from local producers and by commandeering shipments from state-owned companies for payment into his accounts. Take just diamonds as an example: Tens of millions of stones were exported at prices as low as $8.55 per carat, with the rest of the value paid to Mobutu abroad.[166] But as Jonathan Kwitny, a reporter for the *Wall Street Journal*, wrote: "The hard Western currency that pays for all [these] goods stays outside the country. It goes into the pockets of Western businessmen. . . . The elite may bring a few million dollars of the stolen wealth back into Zaire in the form of Mercedeses, and other goods for their private use. But the development capital their countrymen need to pull themselves into the twentieth century never makes it home."[167]

Not only did Mobutu and his rotating clique of sycophants tap export proceeds for their foreign bank accounts, they indulged in almost every conceivable form of self-enrichment. Bribes were elicited for special and even routine services. Bribes were demanded from foreign companies for incorporation papers, licenses, and permits. Bribes were even paid by the U.S. government. Roger Morris, an ex-National Security Council official in Washington, estimated that Mobutu personally got perhaps $150 million from the CIA just through the mid-1970s.[168] Mobutu also pocketed CIA money he was supposed to pass to Angolan rebels in the 1980s.[169]

In 1971 Mobutu changed the name of his country to Zaire and the next year dropped the Joseph from his own name and rechristened himself as Mobutu Sese Seko Kuku Ngbendu waza Banga, which means "the all-powerful warrior who, because of his endurance and inflexible will to win, will go from conquest to conquest leaving fire in his wake." The last part of his self-anointment proved entirely accurate.

In 1973 Mobutu began transferring ownership of foreign-owned businesses to local citizens, meaning himself and other senior party and government officials. Some 1,500 to 2,000 enterprises were taken away from expatriate farmers, transporters, shop owners, and small manufacturers, with predictably disastrous results for the local economy.

Mobutu is sometimes credited with inventing banking from home. He often would pick up the telephone and order transfers from central bank reserves into his own overseas accounts or delivery of sacks of foreign currencies to his several places of residence. Budgeted presidential allowances represented some 15 to 20 percent of government expenditures, but

Mobutu frequently drew much more for "other goods and services," in the hundreds of millions of dollars a year.[170]

Then, of course, there was an unending stream of bilateral foreign aid and World Bank and International Monetary Fund (IMF) money, as well as private sector loans from nearly a hundred foreign banks. After a point in the 1980s, every loan and grant was made with full awareness that proceeds were either wholly or partially diverted to Mobutu's pocket, yet so great was the desire to assure that Zaire stayed in the western orbit that the money never slowed for a quarter of a century.[171] In 1982 a retired German central banker, Erwin Blumenthal, who had earlier been assigned by the IMF to Zaire's central bank, reported that ". . . the corruptive system in Zaire, with all its wicked and ugly manifestations, will destroy all endeavors . . . towards recovery and rehabilitation of Zaire's economy." Bluntly, he concluded that there is ". . . no—I repeat no—prospect for Zaire's creditors to get their money back in any foreseeable future."[172]

Like most other tyrants, Mobutu brought the bulk of his money to the West. After only a decade in power he reportedly had substantial real estate holdings—chateaux, villas, buildings, apartments—in Belgium, Switzerland, Italy, Spain, France, Ivory Coast, and Senegal and a vast hunting preserve in Central African Republic. An opposition group estimated that he had $125 million in Swiss bank accounts.[173] But to be entirely fair, he did not take all his wealth out of Zaire. He also accumulated some 14 plantations and 8 related properties in the country, grouped under the name CELZA,[174] reportedly employing 25,000 people and making him, owning some 132,000 head, the biggest cattle rancher in the country.[175] He also became a principal owner in the Banque de Kinshasa and reportedly had indirect shareholdings in the local affiliates of U.S. and European companies, including Unilever, ITT, Gulf Oil, Pan Am, Volkswagen, Peugeot, and Renault.[176] Mobutu's fortune has been estimated at $4 billion by the mid-1980s.[177] In 1988, wanting to appear more modest, he stated for the record in an interview with U.S. Congressman Mervyn Dymally: "Clearly, I would be lying if I said I do not have a bank account in Europe; I do. I would be lying if I said I do not have considerable money in my account; I do. Yes, I have a fair amount of money. However, I would estimate it to total less than $50 million. What is that after twenty-two years as head of state of such a big country?"[178]

Jonathan Kwitny once again summarized the situation well:

> Still, despite poverty, misery and injustice, the people of Zaire can be grateful to the people of the United States for one thing: we have kept their country from communism. What is less widely considered, but equally true, however, is that we have also kept it from capitalism—or at least from anything that might remotely resemble a free market. And therein lies a key to many of the world's problems. The free market is demonstrably the most bountiful economic system on earth. And it has become the odd role of the United States of America to deny that system to hundreds of millions of people the world wide.[179]

Stricken with cancer, Mobutu's grip on his country weakened in the mid-1990s. Laurent Kabila, initially supported by Che Guevara in the mid-1960s (who soon departed in disgust), fomented trouble in the east. Together with troops from Uganda and Rwanda, Kabila's 50,000-man army swept across the country in seven months, taking Kinshasa on May 17, 1997. Mobutu fled, while his son, Captain Kongulu Mobutu, lingered long enough to kill turncoats willing to negotiate surrender. Mobutu died in exile in Morocco later in the year. The Swiss froze his bank accounts, supposedly containing only a little more than $3 million. Zaire reverted to its former name, the Democratic Republic of the Congo.

Democratic it was not. Kabila suspended political parties, had a falling out with his Rwandan and Ugandan interlopers, saw his country lapse into war again and, after less than four years in power, was assassinated in early 2001. Congo descended again into chaos, as competing powers set out to grab its resources—Rwanda, Burundi, Uganda, Zimbabwe, Angola, and assorted local ministates. Several groups viciously settled scores from the genocide that convulsed the Great Lakes region in 1994. An estimated three million people died in eastern Congo during the four years at the turn of the century, with perhaps another one million dying since then.

In one of the most courageous pieces of work I have ever read, a United Nations team, with principal members drawn from Egypt, the United States, Senegal, Belgium, and Canada, investigated the illegal exploitation of natural resources in the Congo.[180] The panel interviewed hundreds of people in the region and in Europe and the United States and thanked in

particular those "Congolese individuals who put their lives at risk in order to provide the Panel with information."[181] Carefully documenting an elite network of political, military, and commercial interests that "benefits from instability in the Democratic Republic of the Congo," their report asserted that just one part of this den of thieves "transferred ownership of at least US$5 billion of assets from the State mining sector to private companies under its control in the past three years with no compensation or benefit for the State treasury . . ."[182] The report describes various collections of thugs "linked to the armies of Rwanda, Uganda and Zimbabwe and the Government of the Democratic Republic of the Congo" who "have built up a self-financing war economy centred on mineral exploitation."[183] Illicit proceeds are generated through "organized systems of embezzlement, tax fraud, extortion, the use of stock options as kickbacks and diversion of State funds conducted by groups that closely resemble criminal organizations."[184] Set out in detail are the allegedly illicit activities of government ministers and military officers from several countries, toughs from throughout the region, suspect entrepreneurs overseas such as George Forrest in Belgium, arms dealers including the notorious Russian Victor Bout and his henchman Sanjivan Ruprah, and Lebanese diamond traders based in Antwerp with reported links to Hezbollah and Amal. Front companies in the region are named, including their ownerships through shell companies based in the Channel Islands and British Virgin Islands.

Take just one mineral, coltan, as an example. Coltan is an ore made of columbium (properly known as niobium) and tantalum. Congo has perhaps 60 percent of the world's reserves of coltan, from which tantalum is refined for use in cell phones, laptops, PlayStations, avionics, and atomic energy applications. The UN report speaks of prisoners, indentured laborers, and conscript workers forced to exploit coltan sites under extreme conditions, working under Rwandan army officers functioning as *comptoirs*, or buying and marketing syndicates. According to the report, Rwanda-controlled *comptoirs* forced "captive labor" to work coltan sites. Captive labor? In the twenty-first century, were the worst excesses of the mid-twentieth century being repeated in a dark corner of the globe?

The report named 54 ministers, military officers, politicians, ambassadors, parliamentarians, intelligence officials, chairmen, stockholders, managers, and businesspeople it recommended should be slapped with financial restrictions and travel bans. Twenty-eight mining, trading, and transporting

companies were recommended for financial sanctions. And it named 85 corporations based in Europe, the United States, Canada, Africa, Asia, and Caribbean tax havens that it alleged were in violation of OECD guidelines for multinational enterprises.

In the latter years of my career I have asked a lot of very sensitive questions in a lot of very squirrelly places. I give high fives to the people who did this work. The sad part is much of the issue remains unchanged. Some corporations and individuals loudly protested their innocence, the western world moved on to other concerns, and the Congolese continue today to be drained, ripped off, threatened, brutalized, and killed.

China

True or false? With its booming economy, soaring per capita income, huge inflows of foreign investment, and large hard-currency surpluses, China need not worry about dirty money.

False. Pervasive domestic corruption and massive outflows of illegal proceeds threaten China's hope for peaceful transition to a sound market economy. Instability is the one thing that China cannot risk. Every other nation that illegally ships immense amounts of its wealth offshore is eventually destabilized. There's no reason to believe that China is an exception.

Minxin Pei, a China expert at the Carnegie Endowment for International Peace in Washington, writes: "Corruption since the mid-1990s has become intolerable. The blending of a semi-reformed economy, authoritarian politics, decentralisation and burgeoning links to the outside world has allowed corruption to mutate into a voracious and dangerous strain. . . . Corruption in authoritarian regimes tends to amplify systemic risks and undermine the rulers' legitimacy." He goes on to suggest that China may already be in "the late stages of regime decay."[185]

The *Economist* presents an equally sober assessment: "Scholars in China are beginning to suggest what was once heretical: that the country suffers from 'systemic corruption.' . . . [I]t would be hard to find any leader whose associates and family members are beyond suspicion."[186]

The Chinese Academy of Social Sciences extended its courtesies to me, arranging appointments and providing translators on two occasions as I researched corruption in and capital flight out of China. On the second trip, after one day of interviews the academy-designated translator was replaced

by a young woman from the Central Committee of the Chinese Communist Party. She was perfectly bilingual and as far as I could tell across the next several days translated both sides of conversations accurately. I assume the Central Committee was interested both in what I was asking and what I was hearing. As well they should be, because in China the ripoffs are done by the Reds themselves.

According to one source, researchers in China have reportedly estimated that perhaps 80 percent of communist officials are guilty of corruption.[187] With party membership recently pegged at 64 million, this would suggest that 51 million are compromised. In recent years more than three-quarters of a million party stalwarts have been disciplined for corrupt practices. That is the good news. The bad news is this leaves an estimated 50 million still getting away with their financial shenanigans.

And the money they are stealing is staggering. IMF statistics for China show "errors and omissions," which is only a partial indicator of illegal outflows, at $127 billion during the eight years from 1993 to 2001.[188] Because this measure is limited to what can be recorded, it probably covers no more than half of illicit flight capital during the period. The problem is understood at the highest levels of government: "One official source quoted Zhu Rongji, the premier, as saying in an internal meeting recently that capital flight during 2000 and 2001 amounted to Rmb550bn [$66 billion] and Rmb600bn [$72 billion] respectively, equal to about one-third of total government revenues."[189]

Estimates of fraudulent funds coming out of China are always in the hundreds of billions of dollars. My own inquiries lend credence to numbers averaging in the range of roughly $20 billion to $40 billion annually since 1990. If these orders of magnitude are accurate, then China has illegally transferred offshore upwards of $300 billion and perhaps as much as twice this figure in the past decade-and-a-half. This rivals, maybe even exceeds, Russia. Illicit outflows have continued strongly in the current decade, even though the incomplete errors and omissions figures show some of it coming back. If there is any country in the world where I could be significantly underestimating illegal outflows, it is indeed China.

The official *People's Daily* outlines the usual strategy of escaping with illegal funds as follows: "[M]ost of the criminals behind various forms of capital flight have turned out to be government officials or senior executives of China's state-owned enterprises. . . . Typically the officials transfer money

into accounts abroad opened either by branches of their company, business associates or overseas relatives. 'The usual way for a corrupt official to escape is to send the wife and children abroad first, transfer illegal assets out of China and then flee when the time is ripe.' "[190]

Mispricing and transfer pricing of imports and exports: This is the primary mechanism used by Chinese and foreign firms, and Chinese firms disguised as foreign firms, to move billions offshore. One analysis found that Chinese exports were underpriced by an average of 17 percent and imports were overpriced by around 9 percent.[191] These are considerably higher percentages than I utilize in further estimates laid out in Chapter 4. Another indicator of transfer pricing is loss operations. Out of nearly 400,000 companies with foreign investment, some 60 to 65 percent showed negative profits and paid no income taxes in the period from 1996 to 2000.[192] The Chinese government is attempting to crack down on transfer pricing, but, with officials of state-owned and private companies actively participating in the process, it's a distant goal.

Like many others, Chinese businesspeople have learned how to set up overseas offices and dummy corporations. Exports are made at low prices to wholly-owned foreign affiliates, and imports are received from these affiliates at high prices. Profits accumulate in the foreign company, while the local firm putters along as one of the hundreds of thousands of losing businesses. A foreign entity buying and selling—and keeping all the profits—is standard operating procedure in the game of global financial skullduggery.

These entities and their related dummy corporations also are used to channel money back into China as foreign direct investment (FDI), a process called "round tripping." Perhaps as much as 50 percent of FDI going into China is, in fact, Chinese money that came illegally out, disguised itself as a foreign company, and returned, giving the appearance of a joint venture with overseas partners. Now that such an investment link supposedly has been created, dividends, fees, and royalties can continue to flow outward forever. By this mechanism, Hong Kong, the British Virgin Islands, and the Cayman Islands have accounted in some years for as much as 45 percent of FDI into China, while the United States accounted for around 10 percent.

Another key device drawn from the dirty-money user kit is asset stripping. Managers of state-owned enterprises (SOEs) spin off productive assets for little or nothing into affiliated companies owned by themselves, family members, or cronies. This leaves unproductive assets and usually large debt

burdens in the SOEs. Thus the state gets ripped off, and state-owned banks either continue making loans to losing SOEs or write off loans defaulted on by bankrupt SOEs. In recent years, "a large chunk of state assets simply disappeared in the process of transferring the SOE-attached collectives into private or completely autonomous collective enterprises."[193] This "large amount" (estimated by one researcher at $3.7 trillion!) has been moved from state to private hands at zero or minimal prices.[194] Weak SOEs are left owing around $600 billion to $700 billion in loans they cannot service. These nonperforming loans could be as much as 30 percent, or in the estimates of some experts as much as 50 percent, of all bank lending, meaning that many depository institutions would be technically bankrupt. In other words, party officials and enterprise officers have become very rich, and the people are left holding the bag.

The disturbing story in China is the very wide range of government officials and enterprise managers who are corrupt and use the mechanisms for creating and moving dirty money for personal enrichment. China is often praised for its controlled transition to market economics. The truth may be just the opposite: As corruption becomes institutionalized, the long, drawn-out transition process risks spiraling beyond control. A few examples drawn from China's encyclopedia of fraud make the point.

Bank of China. We might as well start at the top. Wang Xuebing is a former president of the Bank of China (BOC), likewise former president of the China Construction Bank, also former chairman of China International Capital Corporation, an investment banking venture with Morgan Stanley Dean Witter, and an alternate member of the 15th Central Committee of the Communist Party of China. Fluent in English and accustomed to the finer things of life, he cut a wide swath through earlier assignments in New York, Hong Kong, and Beijing. That is, until he was removed in 2002 from all his positions and exposed for embezzlement and corruption.

Wang ran BOC's New York branch from 1988 to 1993. An eight-year scheme in the 1990s generated suspect loans reportedly totaling $326 million.[195] Following a two-year investigation the U.S. Treasury's Office of the Comptroller of the Currency fined Bank of China $10 million for unsound banking practices.[196] In one of these schemes John Chou and his wife Sherry Liu, living large in a mansion in New Jersey, borrowed a total of $34 million, which they shifted around the world, reportedly to Hong Kong, the

United Kingdom, Singapore, Switzerland, and the Cayman Islands. BOC repeatedly added to the mounting unpaid loan balances. Allegedly, a Chinese municipal SOE was a partner in laundering schemes. After paying the $10 million fine, BOC sued Chou and Liu and won a $35 million judgment, and the couple also faced indictment in Manhattan in 2004. Other schemes at BOC's New York branch may have been even bigger.

Beijing authorities apparently concluded that embezzlement from BOC in New York, and also perhaps from Los Angeles and Hong Kong, could not have gone on without Wang's knowledge. His career was finished, and he was tried and sentenced in 2003 to 12 years in prison.

State Administration of Foreign Exchange. The acronym SAFE should not remotely imply that China's hundreds of billions in foreign exchange reserves are safe in the hands of the state administrative body. On the contrary, a "black hole" in China's reserves has never been explained.

During the late 1990s, as inflows of foreign direct investment and trade surpluses swelled to around $70 billion to $90 billion a year, foreign exchange reserves grew by less than $10 billion a year. Flight capital accounts for much of the gap but not all. Some of the gap seems to have arisen from direct misuse of reserve funds. "Questions over what happened to billions in 'missing' reserves remain unanswered to this day. . . . Officials at several government-owned banks in China . . . have confirmed they have in the past received funds from the reserves in transactions that were not made public."[197]

Zhu Xiaohua was director of SAFE in 1992 and 1993 and later head of China Everbright Bank in Hong Kong from 1996 to 1999. Amid allegations of corruption, loan scandals, and tax evasion at Everbright, Zhu was recalled to Beijing and promptly disappeared from view for three years.

Li Fuxiang, former head of foreign exchange trading at Bank of China in New York, was director of SAFE from 1998 to 2000. He seems to have committed suicide by jumping out of a seventh-floor window at a Beijing hospital. Apparently the arrest of Zhu and his subsequent interrogation unnerved Li.

Among other allegations, Zhu and Li were suspected of funneling some $200 million of state reserve funds from SAFE through China Everbright to invest in a Shanghai international investment company. As the global intelligence firm Stratfor summarized: "Li's death comes amid reports that he was recently called to assist in the investigation of former

SAFE head, Zhu Xiaohua, and that Li himself may have been under investigation for irregularities perpetrated by SAFE. With even the most reform-minded among China's economic policymakers facing charges of corruption and mismanagement, the nation's economic policy is approaching total disarray."[198]

In August 2002 Zhu was subjected to a one-day trial in Beijing's Number One Intermediate People's Court. Found guilty of taking $500,000 in bribes while at China Everbright, he was sentenced to 15 years in prison. This was, in all likelihood, the very least of his transgressions, but the most that China's leadership would allow to be publicly exposed.

The Kaiping Case. In the biggest embezzlement in China's history, the Bank of China admits that $483 million was stolen, and investigators think the figure may be as high as $725 million. In its drive to modernize, BOC integrated more than a thousand computer centers into one unified accounting system in October 2001. When they threw the switch—oops—there was nearly $500 million less than the total that had been reported by branches in the past. The problem was traced to the Kaiping branch in Guangdong province. Three days later, three local managers beat it out of town, escaped to Hong Kong, fled to Canada, and then worked their way to Las Vegas in the United States, where they had forwarded some of their money in advance.

Xu Chaofan became manager of BOC's Kaiping branch in 1993, while still in his 20s. After five years in that position he was promoted to a BOC management job at area headquarters in Guangzhou. Two co-conspirators, Yu Zhendong and Xu Guojun, continued to run the Kaiping branch. Between them they had concocted schemes to bleed the bank of cash and transfer most of their take out of China.

Xu Chaofan bribed others to set up cooperating companies in Hong Kong.[199] To get cash into these companies, a favorite technique was lending money to state-owned enterprises, which for a bribe would transfer the money to his Hong Kong entities as payments for fake orders of raw materials.

Xu's Hong Kong front companies, called "window companies" in China, reportedly opened accounts at Standard Chartered Bank, UBS, HSBC Broking Securities, ING Bank, and Fortis Bank.[200] Millions were invested in stocks and real estate in Hong Kong and in Macau. Stocks alone

were reportedly worth some $100 million at their peak during the 1997 "red chip" boom prior to the British handover of Hong Kong to China. Afterwards, the value of Xu's portfolio plummeted, as he seems to have had a knack for picking bad investments.

In 2001 Xu and his accomplices began transferring money to the United States: $200,000 to Citibank in San Francisco and $10.5 million to casinos in Las Vegas.[201] Upon fleeing China using fake travel documents, they also made large deposits at the Vancouver and Richmond branches of the Royal Bank of Canada, the Canadian Imperial Bank of Commerce, and the Hong Kong Shanghai Banking Corporation.[202]

Chinese authorities asked for U.S. cooperation. Xu was arrested in San Francisco in December 2000 for passport fraud. He was then taken to Las Vegas where in 2004 he pleaded guilty to misappropriating public funds, a crime in the United States under the Patriot Act. FBI and Immigration officials handed Xu over to authorities at the Beijing airport in April 2004. As of this writing, his two partners in crime are still on the run, probably in the United States or Canada.

The biggest embezzler in Chinese history, plying his craft for more than a decade, was 41 years old when he was returned to face punishment. Bank of China is probably wondering how many more young managers are ripping off the people's money.

Po Sang Bank. "Possibly the largest money-laundering case ever prosecuted anywhere."[203] Hong Kong court proceedings in 2004 were off to a dramatic start. The territory's Independent Commission Against Corruption put a figure of up to HK$50 billion (US$6.4 billion) on the indicted ring's haul.

Complex transactions? Sophisticated techniques? Hardly. This group simply packed up currency notes in mainland China and hauled them to a moneychanger, Guardecade, in Hong Kong. Three mainland syndicates used couriers to smuggle billions in criminal proceeds and corporate embezzlement across the border. Plastic bags full of notes, in reportedly 29 different currencies,[204] were delivered and converted into Hong Kong dollars. Guardecade then deposited the HK dollars at Po Sang Bank.

But you can't just walk in with HK$50 million or so a day without raising suspicions. You need the services of branch manager Lam Yiu Chung. Lam entered the deposits into the bank's own suspense account, a temporary

facility used internally by the bank to deal with discrepancies or pending clearances. In due course, balances would be transferred to Guardecade's Po Sang bank account. From there, distributions were made to some 1,300 other bank accounts in Hong Kong and around the world, belonging to the mainland criminals and embezzlers.[205]

Authorities got wind of the operation and arrested 39 people, including Lam, two other bank officers, 14 owners and employees of Guardecade, and others. Detailed examination of records of only 35 days of activity revealed that HK$3.2 billion (US$410 million) had been handled. And the operation had been going on for more than five years!

Lam and five others were indicted, and in July 2004 Lam alone was convicted of corruption and given a light sentence of one year in prison. Po Sang in the meantime merged as a unit into the Bank of China (Hong Kong). China's relationship with Hong Kong—"one nation, two systems"—well serves every criminal and embezzler on both sides of the borders.

There are hundreds of additional stories that can be told about assorted perversities in the Chinese economy. Bruce Gilley writing in the *Far Eastern Economic Review* summarized officially published figures as follows:

- Fifty percent of the contracts signed in China are fraudulent in some respect.
- Economic corruption costs up to 17 percent of the country's annual GDP.
- Tax evasion accounts for 50 percent of taxes due in the private economy.
- Counterfeit goods and substandard goods account for 40 percent of all products made in China.
- Two-thirds of the biggest state firms produce false accounts.[206]

He Qinglian, author of the book *China's Pitfall*, says: "The emergence of the 'government-underworld alliance' shows that progress toward a civil society ruled by law is no more likely an outcome for our country than a descent into a 'mafia model.' . . . The systemic corruption in which pursuit of private interest undermines society's legal system and public morality will inevitably kill [China's] reform before it matures. . . . When you have develop-

ment that is built on the premise that people will pursue their interests at the cost of . . . property and lives of others, is it really worth it?"[207]

Systematic corruption, regime decay, high growth, and massive capital flight will not long coexist within the same borders. How China resolves these dilemmas will be felt across the entire globe. Western countries must ask themselves a basic question: Facilitating and accommodating hundreds of billions of illegal dollars pouring out of China—is it worth it?

Russia

Russia has suffered what appears to be the greatest theft of resources that has ever occurred in a relatively short period of time, estimated at $200 billion to $500 billion during the 15 years from 1989 to 2004. Most analysts put the annual outflow of dirty money into western accounts at $20 billion to $30 billion a year. Only China rivals this level of larceny.

One of the best studies of the magnitude of illegal capital flight out of Russia is "The Diagnostic Assessment of Russian Corruption: The Sociological Analysis," undertaken by the Institute for Information and Democratization based in Moscow. It summarizes as follows:

> [L]oss resulting from illegal—corruption-elicited—capital flight, with 1988 as a starting point, averages some $20 billion per annum; other estimates place it at $24 to $25 billion per annum, therefore accumulating to $300 to $350 billion in 12 years. If one were to include the loss resulting from customs corruption—another $20 to $25 billion annually—as well as that due to the Central Bank, the tax system and export currency control, then the grand total for the same period would effortlessly climb to $400–$500 billion. Of this amount, probably some $300 billion rests in western and offshore accounts.[208]

The biggest component of such sums arises from underpricing of resource exports out of Russia by the business sector. The next major component arises from the activities of Russian criminal gangs (to the extent that they can be distinguished from the business community) in shifting profits earned in drug and human trafficking, extortion, and arms trading. Finally, elements of the Russian government have likewise been involved

in stripping the wealth of the state. Using the standard package of falsified trade documents, offshore subsidiaries, dummy corporations, and disguised bank transactions, Russians relied on active cooperation or benign neglect emanating from western corporations and financial institutions to facilitate virtually the whole of this lawless transfer. Through much of the 1990s, Moscow was crawling with foreigners helping set up schemes to shift money out of the country.

The underpricing of exports from Russia has gone through three phases. First, in the late 1980s and early 1990s, the assets of the Russian state were being taken over by entrepreneurs, the richest among them later called oligarchs. During this period exports of oil, gas, gold, diamonds, aluminum, nickel, tin, zinc, pulp, timber, and other resources were sold primarily to European buyers, and, in many if not most cases, kickbacks were paid into corporate and personal accounts of the Russian exporters in Switzerland, Germany, France, the United Kingdom, Spain, Cyprus, and elsewhere.

While such arrangements were very cozy, Russian exporters soon figured out that they would prefer to control the whole of the fleecing process, rather than rely on cooperation from buyers abroad. Thus was ushered in the second phase of mispricing, with Russian firms setting up their own offices in Europe to buy their own exports and then resell to foreign buyers. When you are buying from yourself, you can pay any price you want. Hundreds of subsidiaries and affiliates of Russian companies sprang up in Europe and the United States. Exports were sold to these entities at cheap prices and then resold to foreign buyers at world market prices. Take oil, for example. Russian oil priced for sale internally at $10 a metric ton was instead sold to the exporter's foreign subsidiary at $10 a metric ton and then resold to foreign buyers at the world market price of $120 a metric ton.[209] In such cases, the $110 per metric ton profit margin was kept entirely in the bank account of the foreign subsidiary. In some cases, even the $10 domestic price was not remitted back to Russia, meaning that 100 percent of the revenues from such exports were kept out of the country and nothing was brought back. This process, particularly in handling oil and gas exports, accounted for hundreds of billions of dollars disappearing permanently out of Russia.

The third and current phase of trade mispricing started around 1997 when the Russian Central Bank began modestly enforcing regulations on remittance of foreign earnings. At this point, retention abroad of 100 percent of export proceeds became more difficult. Russian exporters settled into the

tried and proven mechanism of routinely underpricing commercial invoices, so that whatever had to be brought back into the country would still not represent the whole value of the export. This is the process that maintains today: underpricing of exports sold to foreign buying offices owned by the exporters, so that even though some remittance is required, it does not represent the real transaction value.

With a view to ascertaining what was legal or illegal for Europeans and Americans in facilitating mispricing schemes, a privately commissioned study concluded the following:

> The research poses the question whether it was illegal for a foreign citizen to come to Russia and participate with a Russian in a scheme to evade Russian taxes. This question is still the issue of the day since there is no shortage of firms that advise Russian businesses on offshore corporation setup and similar issues. Since there were no regulations that would explicitly prohibit mispricing of trade, parties involved in money-laundering schemes could only be prosecuted for violations of related regulations such as tax evasion or bribery. Foreign businesspeople or bankers could have been charged along with Russian officials or businesspeople for these violations. In this case, bankers and consultants could have been tried as "held-liable" accomplices for the crimes.[210]

The Russian Central Bank, a respectable institution at the height of the Soviet era, virtually presided over the outflow of wealth in the 1990s. Mikhail Gorbachev signed a presidential decree in 1990 mandating that 40 percent of "currency income derived from export operation" had to be sold to a designated government bank for rubles at an exchange rate set by another government bank.[211] This decree was almost universally ignored. In 1992, Boris Yeltsin signed another presidential decree raising the required repatriation of export earnings to 50 percent.[212] Again, ignored. The central bank devolved responsibility to commercial banks for informing exporters of the requirement for remittance of foreign proceeds. If exporters ignored the admonition, banks had ". . . no obligation to report exporters who don't bring back their export proceeds."[213]

In 1999 Yeltsin signed another presidential decree raising the remittance requirement to 75 percent of foreign earnings,[214] and the central bank put more teeth into regulation of this decree. This brought on the current state

of affairs, with exporters drawing their commercial invoices to show only a part of the real value of the shipment, so that repatriation of the stated amount is still less than the total value.

So, the central bank has now strengthened oversight requirements placed on commercial banks processing export transactions. But who owns these commercial banks? Why, the exporters themselves! In the beginning of 1988 only four banks existed in the whole of the Soviet Union. By 1996 there were some 2,600 in Russia itself. Large and medium-sized Russian manufacturers and traders set up their own "pocket" banks to handle their own trade documents to export to their own overseas buying offices. The bank executive telling the corporate executive to bring back his export proceeds to Mother Russia is the one-and-the-same executive talking to himself. Little wonder then that exports in the tens of billions of dollars continue to go out of Russia annually at a fraction of their true value.

The looting of Russia was accomplished by people using techniques already well established in other countries. Most were driven by almost unimaginable levels of greed, while some attempted to justify their actions on what was, in their view, best for the country.

In the early 1990s, many Americans, Europeans, and Russians themselves believed that the only way to prevent communism from returning to Russia was by getting capital and property out of the control of the state. Among young reformers in the government, Anatoly Chubais took up the task of creating the State Privatization Committee, Gosudarstvennyi Kommitet Imushchestva (GKI), which he quickly established in 1992 with offices in every region of the country. To make his privatization program politically acceptable, he agreed that managers and workers would be allocated shares in their companies for purchase at nominal prices. In addition he gave vouchers worth 10,000 rubles (about $25) to an estimated 144 million Russians, everyone born by September 2, 1992, which could be used to buy reserved shares, invested in mutual funds, or traded for other property. Instead of spreading the benefits of ownership, what happened was the opposite. Vouchers found a market and were gobbled up into increasingly narrow hands. And factory directors bought shares belonging to their workers, often using money embezzled from the factory itself. Concentration of ownership further contributed to the massive shift of wealth out of the country.

In her excellent book, *Sale of the Century: Russia's Wild Ride From Communism to Capitalism*, Chrystia Freeland reports later remarks by Chubais: "They steal and steal and steal. They are stealing absolutely everything and it is impossible to stop them. But let them steal and take their property."[215] Chubais was committed to privatization no matter the cost.

Another Russian architect of the transition to a market economy, who had advised Gorbechev and went on to become a frequent counselor to Yeltsin, lamented to me: "Never could I imagine we would pay such an enormous price. Some sacrifices were inescapable. But the cynicism and rapaciousness of some of our people was unimaginable. The price was not worth it."[216]

Another eyewitness to the drama laid part of the responsibility on foreign economists who were offering assorted remedies: "Western advisors were clueless as to what people could be up to, how corrupt they could be. They were caught up in their own mindset, unable to see the corruption as serious and pervasive as it was."[217]

Take Vladimir Kadannikov, for example, the Red Director of one of Russia's largest works, and couple him with Boris Berezovsky, a mathematically astute, cunning manipulator. Kadannikov's empire was Avtovaz, producer of the Lada automobile. Berezovsky allegedly approached Kadannikov with a scheme to set up a separate selling arrangement for Lada cars, to be known as Logovaz. This was nothing more than a means of transfer pricing. Logovaz bought cheap from Avtovaz and sold dear to the Russian public and, for hard currency, into the export market. Avtovaz teetered toward bankruptcy, yet was always bailed out by the Russian government, while Logovaz reaped hundreds of millions in profits.[218]

If you can get away with it once, why not twice? Berezovsky lifted his eyes higher, toward Aeroflot, the state-owned airline. The idea was not to buy the creaky, capital-intensive business but instead to grab hold of its cash flows. Using a Swiss company, Andava, which was making money out of the Avtovaz/Logovaz rip-off, he brought in William Ferrero, former head of Volvo Group Finance-Europe, as manager.[219] Berezovsky then installed one of his partners into Aeroflot's management, and, *voilà*, Aeroflot began transferring 80 percent of its revenues to Andava for proper cash management. What about those bothersome presidential decrees and central bank regulations requiring that a portion of foreign exchange earnings

be repatriated to Russia? Berezovsky got a government license exempting Aeroflot from such foolishness. And, not content to be handling 80 percent of Aeroflot's foreign ticket sales, he went on to set up a company to collect Aeroflot's earnings from foreign airlines for overflight rights across Russia and a second company to pay Aeroflot's bills while charging usurious interest rates.

How about stealing a large part of Russia's oil and gas industry and transferring it to the United States? Gazprom was created in 1989 by Viktor Chernomyrdin to bring much of the Russian gas industry into one monopoly, with himself as chairman. A 40-percent shareholding was retained by the state, with Chernomyrdin empowered to vote these shares in stockholders' meetings. Another 15 percent was sold to management and workers, and the company retained the power to approve all private sales and purchases of Gazprom stock in the future. Chernomyrdin thus made himself into the premier capitalist in the country, presiding over more than 300,000 employees and 30 percent of known global gas reserves.

In 1992 Gazprom created Itera, an affiliated company in Jacksonville, Florida. Since then, through a series of asset-stripping deals, properties and profits have been siphoned off to Itera. For example, gas with a Russian domestic price of $2 to $4 per thousand cubic meters has reportedly been sold at that price to Itera in the United States, which then resold it as it was flowing through Russian pipelines to other former Soviet republics for anywhere from $30 to $90 per thousand cubic meters. Itera collected the hard currency from other ex-Soviets, and Gazprom lost billions of rubles in the process.[220]

In another transaction, Gazprom and Itera set up a joint venture called Purgaz to handle certain gas producing properties in Russia. Gazprom soon transferred half its interest in Purgaz to Itera for no apparent reason and later allegedly sold another 32 percent of its Purgaz interest to Itera for the wonderful price of $1,200. At this point it's not just revenues that are flowing to Jacksonville; it's ownership of Russian gas fields and producing facilities.[221]

Not only did Gazprom sell to Itera at low prices; Itera sold to Gazprom at high prices. Gas produced in Turkmenistan was reportedly sold to Itera, which sold it at a substantially higher price to Gazprom, again stripping Gazprom of profits.[222] Who negotiated this deal? Why, the manager of Gazprom, on Itera's behalf.

Were these just transfer pricing arrangements between parent and subsidiary? Not a chance. More than 60 percent of Itera was reportedly owned by two equity funds overseen by a trust company, Van Doorn FSI Limited, based in Jersey, one of the Channel Islands."[223] Who owns these "equity" funds is not a matter of public record.

Gazprom allegedly transferred billions of dollars in profits and properties to Itera through the Yeltsin years, and even under Putin the drainage may have continued at the rate of billions annually.[224] Itera Group NV, now the parent company registered in the Netherlands Antilles, holds interests allegedly in some 130 companies, not only in the oil and gas industry but also in metals, construction, chemicals, and other businesses.[225] If you like asset stripping, this is one for the record books.

Now, Russian Central Bank executives watching all this skullduggery may have been feeling a bit left out. So perhaps they asked themselves what entities they had offshore that could be used for creative ends. As it turns out, Eurobank is a Russian Central Bank subsidiary based in Paris, with a reported 23 percent of its shares owned by "Russian companies and private individuals."[226] Better yet, Eurobank is the majority owner of Fimaco, Financial Management Company, Ltd, located in Jersey. Furthermore, Fimaco is a co-owner of Evrofinance Bank back in Moscow which deals in short-term Russian government bonds, known as GKOs. The linkage between the Russian Central Bank in Moscow and Fimaco in Jersey and Evrofinance back in Moscow offered wonderful opportunities.

According to reports, the central bank sent billions of dollars to Fimaco beginning in the early 1990s. This in itself might not be problematic if Fimaco was merely to hold such funds. What makes it problematic are three other aspects of the transactions. First, Fimaco was entitled to a management fee of 0.06 percent of the funds, and, being a Jersey-based entity, there is no adequate way to account for millions of dollars of such fees. Second, IMF loan proceeds were funneled to Fimaco. Whether all the funds were ever brought back to the central bank is unclear, but what is clear is that Russia then misstated to the IMF the amount of its reserves, breaking a cardinal rule of transparency in dealing with the IMF. Third, Fimaco is widely believed to have sent money back to Evrofinance in Moscow to invest in the GKO market, which at times was paying as much as 200 percent interest. Converting foreign reserves to rubles removes that amount from foreign reserves and puts the Russian Central Bank in the business of manipulating

Russian government bond prices. Furthermore, what happened to Fimaco's profits earned from investing in GKOs remains unclear.

As the story became public, the Russian government commissioned PricewaterhouseCoopers (PwC) in June 1999 to audit the central bank's transactions. In its report, PwC attempted to trace the flow of IMF funds but ultimately admitted, "We have not been provided access to Ost West Handelsbank [the recipient of a large part of the $4.8 billion IMF tranche]."[227] Robert Rubin, U.S. Treasury secretary, said that some of the IMF's loan of $4.8 billion "may have been siphoned off improperly."[228] Michel Camdessus, then managing director of the IMF, accused the Russian Central Bank of lying about its financial condition, but went on to suggest later that no misuse of funds had been firmly established. Four weeks after PwC's report appeared confirming that the IMF's $4.8 billion could not be adequately traced, the IMF approved another loan to Russia of $4.5 billion.

Dirty money out of Russia into the United States provided one of the biggest financial scandals ever. Lucy Edwards, vice president of Bank of New York, and her husband Peter Berlin, both Russian-born and naturalized U.S. citizens, laundered an estimated $7 billion to $10 billion for Russian mobsters and tax evaders. Berlin set up several companies—Benex, Becs, Lowland, and others—each with accounts at Bank of New York. When transfers came in from Moscow to these accounts, Berlin, using computers in a Queens flat, gave instructions for the money to be sent on to other accounts around the world.

In 1995 Lucy Edwards was approached by principals of a Moscow bank, DKB, who requested that Benex open a separate account at Bank of New York utilizing micro/CASH software, enabling Benex to initiate and execute wire transfers. By this means, DKB, and later a second Moscow bank named Flamingo, were able to transfer cash into and out of Benex without a U.S. license. Over a six-year period extending to 1999, Benex, Becs, and Lowland handled some 160,000 wire transactions, each one earning a fee for Berlin and Edwards, accumulating to millions.

The feds began watching these accounts in September 1998, and the story broke in August 1999. Edwards was fired from the bank, and in October she and her husband and an accomplice were indicted for conspiring to take deposits illegally and for transferring money without a license. Interestingly, they were not indicted for money laundering, because to make

that case it must be proven that the source of the money stemmed from one of the few predicate offenses under U.S. anti–money laundering legislation, and, without the cooperation of Moscow authorities, this could not be accomplished.

Now here is the twist to the tale. Bank of New York was lightly rapped on the knuckles for "deficiencies" in its anti–money laundering procedures. The bank's share price, after a small dip, nearly doubled in six months. Berlin and Edwards pleaded guilty in February 2002 but since then they have not been sentenced. Their escapade could not be made as a money-laundering case at all, and it has quietly slipped from view.

What Berezovsky did in diverting revenues to his own pocket and what Gazprom did in asset stripping were repeated by many other oligarchs, corporations, and pretenders. What central bankers did in ripping off the state was repeated by countless other functionaries. What happened at Bank of New York was repeated by many other large banks.

Some observers justify the oligarchs' actions in Russia as simply a robber-baron phase, similar to what the United States went through in the 1800s. But there is a fundamental difference. The robber barons kept their money in America. The oligarchs took their money out of Russia. When I asked one of these zillionaires in Moscow a few years ago if any of this money was coming back into Russia he dismissed the ridiculous notion with a flick of his wrist and said, "None, none!"[229]

Stephen Cohen in his book, *Failed Crusade: America and the Tragedy of Post-Communist Russia*, laments as follows: "The nation's economic and social disintegration has been so great that it has led to the unprecedented demodernization of a twentieth-century country."[230] It is indeed ironic that, at the moment of its global triumph, capitalism lapsed into a perverted, nightmarish orgy of robbery, collusion, and deceit, with ex-communist states and western corporations and financial institutions cooperating in the plunder.

Was there a point at which western governments and international financial institutions should have pushed to curtail resource shifts out of Russia? For those who wanted to prevent communism from returning by getting capital and property out of the hands of the state, this was largely accomplished by 1994 or 1995 and finished with the reelection of Yeltsin in 1996. But then the bleeding of wealth from Russia into western coffers continued unabated for the rest of the 1990s and indeed continues today.

Could the West have done anything to curtail the deterioration of Russia's economy from, say, 1995 or 1996? Yes. Nonremittance of export proceeds was the most frequently and blatantly used technique for stripping Russia of wealth. A centuries-old instrument is readily available to deal with this problem, to assure that export proceeds are brought back: the confirmed, irrevocable letter of credit. This is an arrangement between two banks, one representing the buyer and the other representing the seller. In the simplest illustration, the buyer's bank opens a letter of credit guaranteeing payment to the seller's bank for the shipment upon arrival. That letter of credit is confirmed to the seller by the seller's bank, guaranteeing payment to the seller. In other words, two banks step in between, and, on the strength of the credit rating and reputation of the buyer's bank, usually in Europe or North America, the banks assure that payment for the shipment will be remitted to Russia and will be deposited to the seller's account.

Who should have insisted on adoption of such standard commercial norms by Russian exporters? Certainly the IMF, in its loan negotiations with the Russian government, had the capacity to do so. In its inimically diplomatic manner, the IMF should have raised the issue in one meeting, asked for a working plan requiring export letters of credit in a second meeting, insisted on adoption of L/C procedures in a third meeting, and withheld the next tranche of loans in a fourth meeting.

Russian businesspeople and bankers did not invent any new ways of taking illegal money out of their country. They simply stepped into well-established techniques and channels. At the same time, equally well-established instruments could have curtailed—not stopped, but sharply curtailed—the long-term damage being done to the Russian economy, damage that may take a generation or more to recoup, damage that postpones, if not imperils, democratic capitalism in the country well into the twenty-first century.

With Russia I conclude Chapter 3, "Dirty Money at Work." For each tale presented, many others are available and many more may emerge in the future, every one unique and at the same time illustrative of a disturbing global pattern.

I set out in this chapter to paint a word picture of criminal, corrupt, and commercial dirty money, some of the damaging impact these illicit flows have on developing and transitional economies, and the active participation of western countries in promoting and facilitating the fullest possible range

of financial subterfuges. Money laundering, tax havens, secrecy jurisdictions, dummy corporations, mispricing, transfer pricing, falsified transactions, fake swaps, concentration accounts, fraudulent foundations, and an assortment of gimmicks combine to wreak unnecessary havoc on the lives of billions of people. Whether it's moving the ill-gotten gains of corrupt government officials, or the proceeds of drugs, racketeering, human trafficking, counterfeiting, fraud, illegal arms dealing, smuggling, or any of the other myriad forms of global crime, or whether it's generating and shifting terrorists' funds, or whether it's companies and individuals breaking laws and evading taxes, all make use of the same techniques and mechanisms, varying only in degree of preference for one bit of skullduggery over another. Appreciating the range across which global capitalism has become embroiled in illegal dealings is an essential part of the story I am telling and a necessary introduction to understanding the depth of the problem.

CHAPTER 4

MAGNITUDES AND MISUNDERSTANDINGS

"THIS IS a number no one wants to know." Jack Blum, the most aggressive American lawyer chasing dirty money, is lamenting with me the lack of official attempts to estimate illegal financial flows. Because hundreds of billions are known to stream annually out of other countries into western coffers, U.S. and European governments are guided by the old adage, "Mum's the word."

HOW MUCH MONEY?

There is no place in international financial statistics where you can find "dirty money" or "laundered proceeds" or "flight capital" or "trade mispricing" or any account remotely suggesting such figures. Most illicit flows are either disguised or invisible, as shown in the Dirty-Money User Manual, and therefore hard data are nonexistent.

There are two ways to produce assessments of global dirty money: top down and bottom up. By top down I mean approximating dirty money as a percentage of global GDP. By bottom up I mean constructing a total from component parts added together.

First, the top-down approach. In 1998, Michel Camdessus, then managing director of the IMF, said in a speech in Paris that "estimates of the present scale of money laundering transactions are almost beyond imagination—2 to 5 percent of global GDP would probably be a consensus range."[1] I was delighted that, finally, someone had mentioned a figure.

Applied to global GDP of approximately $32 trillion, this would indicate a range of roughly $640 billion to $1.6 trillion annually.

IMF officials have declined to clarify whether Camdessus's statement was limited to the worst of criminal and corrupt money or was also intended to include the commercially tax-evading component. This gets into a definitional question that has affected commentary on these issues for years. "Dirty money" and "laundered money": Are they the same thing?

In my use of the terms, the answer is no. "Laundered money" is money that breaks anti–money laundering laws. For many countries this is limited to drug proceeds and terrorist financing and a few other categories. More on this later in the chapter. But seldom does anti–money laundering law include tax-evading funds, the commercial component I have written about extensively, as a major part of the dirty-money phenomenon. In other words, laundered money is narrowly defined as some of the criminal and corrupt money. The designation cannot properly be applied to proceeds that are not specified in anti–money laundering legislation. "Dirty money" is the whole of illicit proceeds, a much larger sum. If it breaks one country's laws in its origin, movement, or use, then it's dirty money, regardless of whether it's singled out as laundered in another country's laws.

With this clarification, let's go back to the IMF's figure of $640 billion to $1.6 trillion for laundered money. If this was not intended to include the commercial component, which is almost certainly the case, then the larger dirty-money figure would easily rise to the range of $1 trillion to $2 trillion annually. Furthermore, the context of Camdessus's address implies that he was talking about cross-border flows, not what remains inside national jurisdictions. Thus, $1 to $2 trillion annually can be taken as a rough estimate of global dirty money.

Do such numbers make sense? One way to get a feel for this is to examine offshore assets. Merrill Lynch/Cap Gemini Ernst & Young produces an annual *World Wealth Report*, based on high-net-worth individuals with liquid financial assets of $1 million or more. Data from 2002 and 2003 are shown in Table 4.1. From 1996 to 2001, offshore liquid holdings of high net-worth individuals rose from $5.5 trillion to the $8.5 trillion figure shown. This is a rate of increase of $600 billion per year.

The data in this survey do not include offshore holdings of individuals with investible liquid assets below $1 million, and corporations, which reportedly pass more money through tax havens than individuals.[2] Nor does

TABLE 4.1 HOLDINGS OF HIGH NET-WORTH INDIVIDUALS OFFSHORE ($1 MILLION OR MORE), IN US$ TRILLIONS

Area	*Total Holdings*	*Percent Offshore*	*Amount Offshore*
North America	$ 7.4	34%	$2.5
Europe	$ 8.8	31%	$2.7
Asia	$ 5.7	30%	$1.7
Latin America	$ 3.6	31%	$1.1
Middle East	$ 1.1	27%	$0.3
Africa	$ 0.6	33%	$0.2
Total World	**$27.2**	**31%**	**$8.5**

Source: Merrill Lynch/Cap Gemini Ernst & Young, *World Wealth Report*, various years.

the study make any effort to distinguish between what was sent offshore legally or illegally. Nevertheless, adding corporate offshore holdings at least equal to personal holdings and those of smaller net worth individuals to the preceding yearly increase of $600 billion could easily double or triple the annual flow to some $1.5 to $2 trillion. The portion of this that is corrupt, criminal, or commercially tax evading, the latter including all mispricing and abusive transfer pricing, easily should fall within the order of magnitude of upwards of $1 trillion a year.

A second compilation is provided by The Boston Consulting Group using $250,000 in listed securities and cash deposits as its threshold for high net-worth individuals. The group's 2003 *Global Wealth* report provides the information summarized in Table 4.2. With a higher global figure of $38 trillion, this analysis produces considerably higher percentages held offshore by the developing and transitional economies of Asia and the Middle East, Latin America, and Europe ranging from 20 percent to 70 percent.

A third and very interesting set of figures on global money laundering and projections of its expected growth has been produced by Celent Communications, summarized in Table 4.3. In Celent's use of the term, money laundering refers to criminal proceeds. Celent's figure for 2005 approaches $1 trillion a year.

In summary, the top-down approach supports the IMF's criminal money laundering "consensus range" of $640 billion to $1.6 trillion, and

TABLE 4.2 HOLDINGS OF HIGH NET-WORTH INDIVIDUALS ($250,000 OR MORE), IN US$ TRILLIONS

Region	*Total*	*% Held Offshore*
North America	$16.2	Less than 10%
Europe	$10.3	20% to 30%
Asia-Pacific and Middle East	$10.2	Japan, less than 10% Asia not incl. Japan, 30% Middle East, 70%
Latin America	$ 1.3	Above 50%
Total World	**$38.0**	

Source: Winning in a Challenging Market: Global Wealth 2003, The Boston Consulting Group.

adequately suggests a larger figure for all dirty money, reaching perhaps to $2 trillion annually or higher.[3]

Now, can similar figures be developed from the bottom up? Can the individual components of criminal, corrupt, and commercially tax-evading money be approximated and totaled?

I have for several years estimated global cross-border dirty money at well over $1 trillion annually and the flow out of developing and transitional economies at roughly $500 billion annually. In arriving at these estimates,

TABLE 4.3 ANNUAL MONEY LAUNDERING BY REGION IN US$ BILLIONS

Region	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
Americas	$313	$323	$328	$335	$341	$350
Asia Pacific	$246	$254	$254	$270	$280	$292
Europe	$230	$233	$234	$236	$238	$241
MEast/Africa	$ 38	$ 39	$ 40	$ 41	$ 43	$ 44
Total World	**$827**	**$849**	**$856**	**$882**	**$902**	**$927**

Source: Anti–Money Laundering: A Brave New World for Financial Institutions, Celent Communications, September 2002. The author, Dr. Neil Katkov, kindly made available spreadsheets supporting data in the report.

the criminal component is compiled from the work of others, while the corrupt and commercial components come from my own investigations.

First, criminal money. Global organized crime is estimated to have annual revenues of around $1.5 trillion.[4] Drugs are a large part of this figure, but the cumulative total of other activities exceeds the drug trade.

Estimates of the street value of global drug sales start at about $400 billion annually and go far upward from there. Most of the street value stays in the country where the drugs are consumed. The proportion that is involved in cross-border financial flows is on the order of 15 to 30 percent of the street value, or $60 to $120 billion. In Chapter 2, I estimate that just cocaine and opiates trafficked out of growing regions generate upwards of $40 billion in wholesale values, and marijuana and methamphetamines easily increase this figure to $60 billion, lending credence to the low-end estimate.

Counterfeit goods resemble drugs in that only a portion of global values constitute cross-border financial flows. These items include videos, CDs, DVDs, computer software, cosmetics, pharmaceuticals, jeans, handbags, and more. The Counterfeiting Intelligence Bureau of the International Chamber of Commerce estimates counterfeiting at five percent or more of world merchandise exports.[5] The OECD lifts its estimate to as high as seven percent.[6] With current world merchandise exports at $6.5 trillion, this would suggest that the total value of counterfeit goods is on the order of $325 billion to $455 billion annually. Interpol places its estimate at $450 billion annually.[7] As with drugs, estimating 15 to 30 percent as the portion of value that is laundered and applying these percentages to a consensus estimate of around $400 billion of total value produces figures of roughly $60 billion to $120 billion of illegal money entering the financial system from trade in counterfeit goods. The greater part of this business, probably more than three-fourths, emerges from Asia into world markets. At the low end, this indicates $45 billion coming out of developing and transitional economies.

Counterfeit currency is a special category, much of which is the U.S. $100 bill. North Korea and the tri-border region of South America are big in the business. The numbers, however, are fairly small, perhaps $1 billion on the low side and probably no more than $3 billion to $4 billion on the high side, virtually all of it crossing borders.

Human trafficking is estimated by several sources at $10 billion to $12 billion annually.[8] Virtually all of this flow, as discussed in Chapter 3, comes out of poorer countries.

The illegal arms trade is especially difficult to estimate, because in recent years Russia and ex-Soviet states have been dumping large stocks of surplus arms on world markets, as well as delivering newly manufactured weapons to clandestine buyers. The *Small Arms Survey* in 2003 estimated global illegal sales of this portion of the trade at $1 billion annually.[9] Illegal sales of conventional weapons are a black hole in arms data but are estimated by several sources at $2 billion to $10 billion annually. Conservatively, for small arms and conventional weapons together, a low-end figure of $3 billion is suggested, ranging as high as $10 billion.

Smuggling of items other than arms and counterfeit goods is another large uncertainty. Cigarette smuggling is big business, with tobacco manufacturers themselves sometimes found to be complicit. UN statistics put global exports at $16 billion.[10] The proportion of legitimately exported cigarettes that are then illegally imported into other countries has been estimated at some 25 percent, or $4 billion. In addition, the transportation cost and a slice of usually hefty customs duties not paid adds to cross-border flows of money arising from cigarette smuggling, probably bringing the take from this activity into the $5 to $10 billion range.

Unrecorded oil sales out of Saudi Arabia (believed to be ongoing for years), Russia, Nigeria, Angola, perhaps still Iraq, and elsewhere easily push upwards to 500,000 barrels a day, valued at some $8 billion annually. Most of this ends up deposited abroad, adding to laundered funds entering the financial system.

Illegal timber trade is estimated at 10 percent of the legitimate trade of $150 billion a year, putting this business at $15 billion annually, emerging from the Amazon Basin, Central America, Africa, Russia, and Southeast Asia.[11] Of the $15 billion export value, perhaps $5 billion enters the global financial system annually. Smuggling of endangered species may be overestimated at $8 billion a year.[12] Conflict diamonds and other gems smuggled out of Africa and Asia add millions a year to distant accounts.

The cross-border traffic in stolen goods has surged. Cars heisted in Western Europe are taken east, in North America are taken south, and in Japan are taken to other Asian countries. This trade is easily in the range of $10 to $20 billion annually. Interpol puts art and antiquities theft as the fourth largest criminal activity, with one estimate placing a value of $5 billion a year on stolen *objets*.[13]

Combining just cigarettes, oil, timber, endangered species, gems, cars,

and art and antiquities produces an estimate for the cross-border value earned from smuggling of roughly $35 to $80 billion a year. And, of course, smuggling is a rich and varied field encompassing much more than this narrow compilation.

Organized criminal activity in other forms not included earlier is also huge. Criminal income in the United States derived from fraud, prostitution, loan sharking, illegal gambling, larceny, burglary, robbery, and other types of crimes is close to 1 percent of GDP.[14] Europe and Japan are easily within the same range, and developing and transitional economies are much higher. Nevertheless, taking 1 percent of global GDP as a minimal estimate produces a figure for such activity of roughly $320 billion, and applying the 15 to 30 percent cross-border range to this figure indicates that perhaps $50 billion to $100 billion is laundered from these sources.

Second, corrupt money. In 1997 I conducted 335 interviews with central bankers, commercial bankers, government officials, customs officers, tax collectors, economists, sociologists, lawyers, security personnel, and others. This included the United States and in addition I traveled to 23 other countries: Venezuela, Brazil, Argentina, Nigeria, South Africa, Kenya, Egypt, the United Kingdom, France, Germany, Switzerland, Belgium, Poland, Ukraine, Russia, Saudi Arabia, Turkey, Pakistan, India, Indonesia, the People's Republic of China, South Korea, and Japan. One object of this exercise was to accumulate informed estimates of cross-border flows of corrupt proceeds, taken as local bribes remitted abroad or as bribes paid abroad.

It's the cross-border flows that interest me, not the total of global corruption. Corruption that stays within a country is bad enough, but at least it tends to get recycled locally, even if only in the lifestyles of greedy officials. Corrupt proceeds that are transferred out or paid out of the country are a complete loss to the local economy, and little of it ever comes back. It's what goes out and stays out that has been the focus of my inquiries, because this is by far the more destructive part of the corruption phenomenon.

Based on my 1997 work, I developed an estimate of corrupt proceeds transferred out of just 20 developing and transitional economies of $20 to $40 billion annually. Included in this estimate are Russia, China, Ukraine, Nigeria, Indonesia, Venezuela, Argentina, Iraq, Egypt, Turkey, Saudi Arabia, Pakistan, India, Côte d'Ivoire, Kenya, Algeria, Mexico, Belarus, Kazakhstan, and Turkmenistan. A great many more countries could have been added to the list.

Corruption is by far the smallest of the three components of cross-border dirty money. However, it has an influence on a society well beyond its size. A country that is corrupt at the top also will have large criminal and commercial components of dirty money. There is no such thing as a nation with corrupt leaders and officials on the one hand and low levels of crime and tax evasion on the other hand. Government corruption creates a permissive environment, and this magnifies criminal activities and financial shenanigans in the rest of the economy.

Third is the commercially tax-evading money arising through (1) mispricing, (2) abusive transfer pricing, and (3) a broad range of generalized fakery, the catalogue of methods covered in Chapters 2 and 3. Getting a handle on this requires asking people—carefully—what they are doing.

Mispricing

In the early 1990s, I undertook a project to examine the amount of mispricing in international trade between unrelated parties, which I first observed in Africa in the 1960s and have seen all over the world ever since. My company conducted 550 interviews with presidents, managing directors, or deputy heads of trading companies in 11 countries: the United States, the United Kingdom, France, Netherlands, Germany, Italy, Brazil, India, South Korea, Taiwan, and Hong Kong.

We used local languages in all interviews, which usually lasted an hour or longer. We gave respondents a written assurance of anonymity, and no record was maintained of individuals' names or their companies. We used survey forms with 85 specific questions, and answers were recorded in both tabular and verbatim form. We asked respondents about trading relations with any two countries, both of which they were permitted to select from two different continents, so it was apparent that our queries were not focused on any particular country. Questions covered the entire range of what is encompassed in international trade transactions: negotiating, ordering, purchasing, shipping, paying and handling claims. Within these questions, mispricing in order to generate kickbacks into foreign bank accounts was treated as a well-understood and normal part of transactions. Because kickbacks were accepted as routine and discussed openly, because respondents could select the trading-partner countries they wanted to talk about, and because their anonymity was guaranteed, we recorded good data on a sensitive

subject. In addition to this procedure, I have also taught other economic intelligence methodologies to security officials.

The results of this survey did not surprise me. For Latin America, between 45 and 50 percent of foreign trade transactions were revealed to be falsely priced, with Argentina, Brazil, and Venezuela all falling within or close to this range. Levels of mispricing in these falsified transactions averaged more than 10 percent. Multiplying these two percentages produces an estimated mispricing component for Latin American trade between unrelated parties of 5 percent.

For Africa, 60 percent of trade transactions were indicated to be intentionally mispriced by an average of more than 11 percent. This produces an estimated mispricing component for African trade between unrelated parties of about 7 percent. Nigeria significantly exceeded the norm of 7 percent.

Another method for checking false pricing is to take a sample of commercial invoices for imports and exports and negotiate as an interested buyer or seller for the same goods and quantities. This is a costly procedure but can be very revealing.

I have rechecked my figures in the Middle East and Asia, confirming the 5 to 7 percent range of mispricing commonly observed. What has been happening in the former communist countries, however, far exceeds this mispricing level. The simple truth is, thousands of companies provide helpful mispricing services to tens of thousands of their overseas customers in hundreds of thousands of transactions moving billions of dollars into western accounts.

Transfer Pricing

Falsified pricing is not only a feature in trade between unrelated parties. Exactly the same device is used in transfer pricing between parent, subsidiary, and affiliate companies. As discussed in Chapter 3, transfer pricing is used by virtually every multinational corporation to shift profits at will around the globe. While I have independently investigated mispricing between unaffiliated companies, I have not done a formal investigation of transfer pricing between affiliates. I have, however, observed enough transactions, seen enough exaggerated intracompany prices, asked enough questions in dozens of countries, and collected and reviewed more than enough trade data to

have every reason to conclude that, on a global scale, abusive transfer pricing between affiliated entities greatly exceeds mispricing between unaffiliated entities. Nevertheless, to be conservative, I take the percentage level of abusive transfer pricing between related parties as equal to the level of mispricing between unrelated parties—5 to 7 percent—even though I have many indications that it is substantially higher.

Imports and exports into and out of developing and transitional economies currently total approximately $4 trillion a year. Multiplying this figure by the 5 to 7 percent average range of variant pricing produces a total for falsified pricing of $200 to $280 billion a year, shifting money out of these countries into western accounts by this mechanism. This in my judgment is a low range. Others who have considered these issues think it is way short of the mark.

Fake Transactions

Billing and receiving payment for goods and services never delivered is a frequently used technique for generating dirty money. Illegal transfers devoid of authenticity have sucked billions out of the former Soviet Union just in the past 15 years. The billions coming out of Russia into the Bank of New York and other European and U.S. banks are included in this category of fake transactions. It is not proper to put these sums into the criminal category because the criminal origin for such fake transactions is seldom established.

Fake or vastly exaggerated charges for services, royalties, patents, trademarks, advertising, consulting, management contracts, software updates, insurance policies, and countless other subterfuges are common. The whole business of asset stripping is included in this category. Swapping shares with offshore companies and swapping real estate in fraudulent transactions is here. I put illicit countertrade into this category, since it is barter trade rather than invoiced trade that underlies most of these deals.

Other observers think that such pure fakery now significantly exceeds the low-end estimate of $200 billion for mispricing and abusive transfer pricing I have estimated globally. Correspondent banking relationships have become so porous that wire transfers in the billions now fly around the world without a particle of underlying reality or financial oversight. Nevertheless, I am not yet satisfied that purely fictitious transactions with no goods and services delivered exceed the false pricing attached to goods and

services delivered. Hence, my own figures put nonpricing illegal transfers lower than pricing transfers.

With these explanations, Table 4.4 summarizes my bottom-up summation of global dirty money. Rounding down, I put the global total at $1 trillion a year and the portion of this coming out of developing and transitional economies at $500 billion a year. I think these numbers are conservative, as do others who have reviewed them.

But before we leave this section, three further questions bear asking. The $500 billion coming illegally out of developing and transitional economies is about 8 percent of their combined GDP. Does this seem too high? No, for

Table 4.4 Cross-Border Flows of Global Dirty Money in US$ billions

	Global		*Developing and Transitional Economies*	
Dirty Money	*High*	*Low*	*High*	*Low*
Criminal				
Drugs	$ 200	$ 120	$ 90	$ 60
Counterfeit Goods	$ 120	$ 80	$ 60	$ 45
Counterfeit Currency	$ 4	$ 3	$ 2	$ 1
Human Trafficking	$ 15	$ 12	$ 12	$ 10
Illegal Arms Trade	$ 10	$ 6	$ 4	$ 3
Smuggling	$ 100	$ 60	$ 40	$ 30
Racketeering	$ 100	$ 50	$ 30	$ 20
Sub Total	$ 549	$ 331	$238	$169
Corrupt	$ 50	$ 30	$ 40	$ 20
Commercial				
Mispricing	$ 250	$ 200	$150	$100
Abusive Transfer Pricing	$ 500	$ 300	$150	$100
Fake Transactions	$ 250	$ 200	$200	$150
Sub Total	$1,000	$ 700	$500	$350
Total	**$1,599**	**$1,061**	**$778**	**$539**

two reasons. First, much of this money never appears in GDP. It departs without being recorded in national statistics. (More on this in Chapter 5.) And second, these economies have the weakest legal structures. This facilitates unrecorded economic activity in the corrupt, criminal, and commercial components of dirty-money flows.

From poorer countries, what is the accumulated total of illegally derived money shifted to the West? There is a Nobel Prize awaiting anyone who can answer this question. At the very minimum, I would take the estimated $500 billion a year, multiply it by just 10 years, and produce a figure of $5 trillion. In fact, outgoing transfers have been a reality for far longer than 10 years, and a better estimate is probably a great deal higher.

What about inflows of foreign investment, foreign aid, and remittances sent home by family members living abroad: Doesn't this offset the illegal money moving out of poor countries? No; for many if not most developing and transitional economies it does not. And even for those that may at the moment have a modest net inflow, this does not justify or excuse the illegal outflows. Illicit offshore transfers damage poorer countries, regardless of any other economic factors.

One trillion dollars total; $500 billion out of developing and transitional economies. These are my estimates. I look forward to additional figures from others in the future.

A FAILURE RATE OF 99.9 PERCENT

Several years ago I called upon U.S. Treasury Department officials for a discussion, on background, concerning the amount of dirty money coming into the United States and the portion of this amount caught by anti–money laundering laws and enforcement efforts. They put the illicit inflows into the country from other nations at roughly $250 billion a year. They then said that in a really good year, seizures of drug and criminal money in cash and in bank accounts might capture $250 million of laundered funds. I made a quick calculation: U.S. anti–money laundering efforts by their estimates succeed 0.1 percent of the time and fail 99.9 percent of the time. In other words, total failure is just a decimal point away.

In 2001, U.S. figures showed that seized money-laundering assets had risen to $386 million.[15] Of course, the total amount of laundered money

coming into the United States is also believed to be rising, and most people following these questions, including me, think this yearly figure is above the modest $250 billion offered by Treasury. Thus, the 99.9 percent failure rate shows little if any trend toward declining.[16]

Even worse, an official of the Swiss central bank added a digit and placed the percentage failure rate for his country at 99.99. Likewise, a German compliance officer at a major bank quoted figures suggesting the same level of failure for his country.[17] To put it simply, anti–money laundering efforts do not stop the deposit of laundered money.

How can this be? We frequently read and hear about drug busts, cash seizures, and frozen terrorist finances. Aren't we succeeding in the global fight against dirty money? Not even close. And by the end of this chapter you will appreciate why. Some of the gross misunderstandings surrounding this subject need to be cast aside.

WELL-INTENTIONED EFFORTS

The United States initiated steps in the 1970s and 1980s to combat money laundering, aimed primarily at the proceeds of the drug trade. The Racketeer Influenced and Corrupt Organizations Act (RICO) was passed in 1970, giving law enforcement officials stronger powers to go after drug cartels and criminal mafias. The Bank Secrecy Act (BSA) also was passed in 1970, misnamed because it, in fact, encroaches upon rather than preserves bank secrecy. This act did not outlaw money laundering as such but did place record-keeping and reporting requirements on financial institutions. Many banks both widely ignored and legally contested these requirements into the 1990s, until the U.S. Supreme Court established that BSA demands were constitutional.

Over a period of years the Treasury Department has imposed regulations requiring currency transaction reports (CTRs), which eventually established a filing threshold of anything more than $10,000 on cash transactions, and international transportation of currency and monetary instruments reports (CMIRs), requiring travelers to declare movements of more than $10,000 in cash or equivalents across U.S. borders. CTRs and CMIRs kicking in at this level (sometimes even lower) have played a powerful role in curtailing smurfing, forcing many drug dealers with tens of millions to pack up their stacks of currency and truck or ship them across borders.

Money laundering was made a federal crime for the first time in 1986 with adoption of the Money Laundering Control Act. This was followed by a "prosecution improvements" act in 1988 that authorized money laundering "sting" operations and provided for fines and penalties of anyone facilitating money laundering, including negligent bankers.

Several additional steps rounded out U.S. efforts in the 1990s. The Treasury Department established its Financial Crimes Enforcement Network (FinCEN) in 1990. Two years later the Annunzio-Wylie Anti–Money Laundering Act became law, requiring banks to file suspicious activity reports (SARs) on large or unusual transactions that suggest the possibility of criminal activity.[18]

In the late 1990s an annual National Money Laundering Strategy was authorized, requiring participation by many branches of the U.S. government in formulating and implementing anti–money laundering efforts. This has been a useful instrument, tying together the work of several departments and agencies.

One of the important outcomes of U.S. activity has been stimulation of international interest in combating money laundering. A provision of the 1986 Money Laundering Control Act required the chairman of the Federal Reserve Board, at that time Paul Volker, to meet with G-10 central bankers in order to begin focusing global attention on money laundering. Growing from these consultations, the G-7 heads of state and government agreed in 1989 to form the Financial Action Task Force (FATF), housed at OECD headquarters in Paris, to coordinate anti–money laundering programs globally. Taking its cues from the United States, FATF focused its early efforts almost exclusively on the proceeds of drug trafficking, tiptoeing around corrupt money and burying consideration of tax-evading money.

In 1990 FATF drew up 40 recommendations laying out the scope of money laundering, provisions for due diligence by financial institutions, recordkeeping norms, suspicious activity reporting, cross-border currency monitoring, creation of national financial intelligence units, and standards for international cooperation. In 2001, eight additional recommendations were added, targeted specifically at curtailing terrorist financing. Together, these are known as the "40 + 8" recommendations, setting terms for the global fight against money laundering. A ninth focusing on cross-border movements of cash was added in 2004.

UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances. Came into force in 1990. Requires states to establish as criminal offenses the cultivation, manufacture, transport, sale, and possession of narcotics.

International Convention for the Suppression of the Financing of Terrorism. Came into force in 2002. Requires all states to take steps for the identification, freezing, and forfeiture of terrorists' funds.

UN Convention against Transnational Organized Crime. Came into force in 2003. Requires states to adopt laws tackling international criminal syndicates, money laundering, corruption, and obstruction of justice.

UN Convention against Corruption. Signed in 2003, with ratification continuing through 2005. Requires states to adopt laws barring bribery, embezzlement, laundering of public funds, and procurement fraud.

Anti-Bribery Convention of the OECD. Came into force in 1999. Requires signatory countries to make bribery of foreign public officials a criminal offense.

OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. First addressed by the OECD in 1979 and updated in 1984, 1987, 1993, 1995, and 1997. Urges adoption of arms-length pricing between associated companies.

OECD Guidelines for Multinational Enterprises. Revised in 2000. Nonbinding recommendations for corporations to avoid "practices that are deceptive, misleading, fraudulent, or unfair" and to comply with "tax laws and regulations in all countries" and "to act in accordance with both the letter and the spirit of those laws and regulations."

OECD Principles of Corporate Governance. Revised draft text released in 2004. A guide for investors, corporations, and stock exchanges, primarily applicable to publicly traded companies, focusing on shareholder rights, board responsibilities, and financial disclosure.

The Wolfsberg Group. Formed in 2000 and now comprising 12 international private banks pledging to adopt a rather limited code of conduct in dealing with wealthy clients.

The Egmont Group of Financial Intelligence Units. Set up in 1995 and now including nearly 60 members, aimed at coordinating the work of financial intelligence groups, such as the U.S.'s FinCEN, globally.

International Money Laundering Information Network (IMoLIN), part of an anti–money laundering program in the UN's Office of Drugs and Crime in Vienna. IMoLIN probably has the best country-by-country money-laundering database available.

FATF is not an organization established by treaty. It is an intergovernmental body, with 33 members and 20 observers as of this writing and several regional cooperating groups. It cannot impose conditions on members or nonmembers; however, its recommendations are generally accepted as international standards. The United States, with a narrow definition of money laundering as is covered in this chapter, hardly meets FATF expectations.

In addition to FATF's recommendations, many other international efforts are focused on global money laundering and their underlying crimes, briefly summarized in the preceding box. These are just some of the international efforts—organizations, conventions, consultative groups, and more—aimed at attacking and curtailing global money laundering. Dozens of bodies, thousands of people, millions of documents, and billions of dollars concentrated on staffing anti–money laundering programs became a feature of our globalized world by the start of this new century.

THE PATRIOT ACT

Which obviously means that when terrorists struck on September 11, 2001, an enormous apparatus was already in place and primed to trace their dirty money, and the entire world was psychologically attuned to the urgency of this task, because of all the attention given to criminal money laundering over the preceding 30 years. Right? Regrettably, nothing could be further from the truth. Which leads to October 2001, the U.S.A. Patriot Act and the ugliest period ever in the history of anti–money laundering legislative efforts.

With glaring weaknesses in U.S. laws and hundreds of billions of dollars of dirty money streaming into U.S. banks, several senators had been pushing for stronger anti–money laundering legislation for years. Most prominent in this effort were Senators Carl Levin of Michigan, Charles Grassley of Iowa, and John Kerry of Massachusetts. But they faced ideological foes within the Senate Banking Committee, who, by September 2001, had already stopped some 11 bills containing strengthened anti–money laundering provisions from getting to the Senate floor. The latest of these, entitled the "Money Laundering Abatement Act," was introduced by Senator Levin on August 3,

2001, with support from Senators Grassley, Sarbanes, Nelson, Kyl, and DeWine.

Within weeks of the terrorists' attacks it was well understood that the terrorists "left a long paper trail of bank accounts, credit cards and money transfers showing that they used the ordinary banking system with little scrutiny."[19] As the Patriot Act laying out legislation for the fight against terrorism was being formulated, Senator Levin and others insisted that their anti–money laundering provisions must be included.

This deeply concerned, if not angered, the American Bankers Association and particularly its largest New York members, including Citigroup and J.P. Morgan Chase. How could anyone think that money had anything to do with 9/11? Led by Citigroup, a lobbying effort was mounted to abort or dilute the threatening legislation. As the *Washington Post* reported at the time:

> Some of the nation's largest banks—including Citigroup and JP Morgan Chase—are lobbying to change key provisions of proposed money laundering legislation. . . . The legislation is intended to make it easier for federal authorities to detect and dismantle the financial networks of global terrorists, drug dealers and other criminals. . . . Sens. Carl M. Levin (D-Mich.) and Charles E. Grassley (R-Iowa) . . . criticized . . . what they described as efforts by industry to water down the bill. They said any terrorism bill that lacks comprehensive money-laundering provisions would, in Levin's words, "have no teeth" and could subjugate national security interests to those of big business. . . . "They are being unpatriotic in their approach," said Grassley, . . . referring to industry lobbyists.[20]

"Unpatriotic." "Subjugate national security interests to those of big business." These words were more than mere political posturing; they were an indictment of an industry seen to be unpersuaded and unmoved by the events of September 11.

The banks reportedly sought to:

- Uncouple the anti–money laundering proposals from the Patriot Act, so that anti–money laundering could be fought separately and hopefully killed.

- Reduce the strengthened "due diligence" requirements on banks, lessening their obligation to know their customers' sources of money.
- Avoid restrictions on correspondent accounts with overseas banks.
- Continue doing business with foreign shell banks.
- Shift as much discretionary authority as possible to the Secretary of the Treasury, where further lobbying could limit requirements even more.

According to *In These Times*:

> [Shell banks] are used to hide and launder perhaps billions of dollars a year. "Citibank is the only major bank in the United States that admits to having shell banks as clients, and it doesn't want to give them up," says a congressional staffer. . . . "Citibank is the most active bank trying to gut the ban on shell banks, and the American Bankers Association is trotting behind them." Richard Small, director of Citibank's anti–money laundering department, lobbied the House and Senate committees to insert an exception that would allow U.S. banks to work with shell financial service companies. . . . [21]

In late October 2001, the fate of money-laundering abatement provisions hung in the balance. Senator Levin made this issue his personal crusade, joining forces with Senators Grassley, Kerry, Sarbanes, and others to ensure that anti–money laundering measures were included in the Patriot Act. The issue, after years of frustrating delays, carried.

I have referred to October 2001 as the ugliest period in the history of anti–money laundering efforts. How the biggest banks in New York, following the city's most tragic event, a shattering experience for the whole of America, could go to Washington and argue against tougher anti–money laundering provisions directed in good part at terrorists is for me unfathomable. Together, they should have done just the opposite. They should have gone to Washington to say we are here to work with you to take all possible steps to see that our banks and the U.S. financial system are not used by terrorists. Yes, this means increased due diligence and tougher controls on correspondent bank accounts. Yes, this means no more shell

banks and no more secret offshore entities. It's the security and safety of our nation first, and it's our bottom line second. We're here to help in every conceivable way.

In the weeks following 9/11, Citibank, arguing vehemently against key aspects of the Patriot Act, vividly demonstrated its lack of perspective and patriotism. The relatives of the victims and, more broadly, the people of New York deserve an apology from Citigroup's highest executives.

Now, for the Patriot Act itself. Covering such areas as domestic surveillance and security procedures, border protection, coordination of investigations, improving intelligence, and strengthening criminal laws, its longest section is Title III, known as the "International Money Laundering Abatement and Anti-Terrorist Financing Act." Key anti–money laundering provisions of this section are briefly summarized in the box on page 181. Clearly, the Patriot Act is the most comprehensive and important piece of anti–money laundering legislation adopted in years. Belated as it may be, it requires better identification of account holders, extends the range of financial institutions that must set up programs, suggests the need for better customer due diligence, begins to address concentration accounts, criminalizes handling the proceeds of foreign corruption, takes shell banks off the table, forces hawaladars to register, and offers sweeping definitions of terrorist acts and resources. In the minds of some people this caps three decades, since the Bank Secrecy Act was passed in 1970, of great progress on the anti–money laundering front.

I do not agree that great progress is anywhere evident. The distinction that has to be made is between efforts and results. I wrote the following in the November–December 2001 issue of *Foreign Affairs*: "The proper measure of success is not the level of well-intentioned activity but how many billions of fraudulently acquired dollars are prevented from being legalized."[22]

So the question is, what are the results of now 35 years of anti–money laundering efforts? Or, what is not included in the legislation of the United States, European Union countries, and other states that still sustains the level of criminal, corrupt, and commercial dirty money I am writing about? How can a trillion dollars a year—or more—of illicit funds, despite all the laws we have passed and programs we have set up, still move with ease and abandon around the globe?

- Requires all U.S. financial institutions to establish anti–money laundering programs, not only banks but also securities dealers, insurance companies, credit card companies, investment companies and money transmitters. (Sec. 352)
- Requires securities brokers and dealers to submit suspicious activity reports, and authorizes the Treasury Department to extend this provision to other types of financial service businesses. (Sec. 350)
- Requires U.S. financial institutions to establish procedures for "verifying the identity of any person seeking to open an account," but gives the Secretary of the Treasury authority to allow exemptions from this provision. (Sec. 326)
- Requires "enhanced due diligence" when opening and operating accounts for wealthy foreign private bank clients, including "enhanced scrutiny" of accounts for foreign political figures and their families. (Sec. 312)
- Authorizes the Treasury Department to take actions against any foreign country, financial institution, or other entity deemed to be of "primary money laundering concern," including prohibiting U.S. banks from doing business with named offenders. (Sec. 311)
- Allows the U.S. government to seize from a U.S. correspondent bank account an amount equivalent to terrorist or criminal funds deposited in a foreign bank account. (Sec. 319)
- Bars banks and securities firms operating in the United States from providing U.S. correspondent accounts to serve foreign shell banks, that is, a "foreign bank that does not have a physical presence in any country." (Sec. 313)
- Authorizes the Treasury Department to "prohibit financial institutions from allowing clients to direct transactions . . . through . . . concentration accounts," as were used to route Raul Salinas's millions out of Mexico. (Sec. 325)
- Makes "the act of smuggling bulk cash," above $10,000, a criminal offense. (Sec. 371)
- Criminalizes handling the proceeds of foreign "bribery of a public official, or the misappropriation, theft, or embezzlement of public funds" for the benefit of a public official. (Sec. 315)
- Makes it a criminal offense to operate an "unlicensed money transmitting business." At last report, some 18,000 money service businesses and hawaladars have since registered in the United States. (Sec. 373)

(Continued)

- Criminalizes "smuggling or export control violations" of munitions and firearms. (Sec. 315)
- Broadens anti-terrorism statutes to include biological, chemical, nuclear, and cyber attacks against persons or properties, public or private. (Sec. 808) Criminalizes conspiring with, supporting, harboring, and concealing terrorists. (Secs. 803 and 811) Identifies terrorists' assets as "all assets, foreign or domestic . . . acquired or maintained by any person with the intent . . . of supporting, planning, conducting or concealing an act of domestic or international terrorism." (Sec. 806)

DIRTY MONEY IS ON THE RISE

No one I have ever talked to thinks dirty money is declining or that anti–money laundering efforts are stemming the global tide of illicit proceeds. Indicators point in the opposite direction:

- Nonbank private sector deposits outside countries of origin are rising, as said earlier, a portion of which is illegal.
- Offshore assets in tax havens and secrecy jurisdictions are rising, as shown by the Merrill Lynch/Cap Gemini and Celent studies.
- Private banking assets continue to rise, far faster than the rate of growth in global GDP. Again, some of this is legal and some is tax evading, and every private banker on the planet willing to speak honestly knows this statement is correct.
- Global crime has exploded over the past 20 years or so, according to all respected studies. As said earlier, the ease with which dirty money moves across borders is a major driving force.
- The prices of illegal drugs are stable, despite all the anti–money laundering efforts devoted to this particular source of revenue over the past 35 years. If long-term anti–money laundering efforts should work anywhere it should be here, on the supplies and prices of drugs, and there is not any believable evidence that drug prices are up or drug profits are down because money-laundering costs are rising.

- Global corruption probably has not yet turned down, despite a decade of concerted effort.
- Abusive transfer pricing by corporations that break laws of trading-partner countries has become normalized, used by tens of thousands of global businesses.
- The flow of tax-evading money out of the richer countries into tax havens has soared.
- The torrents that have come out of Russia and other countries of the former Soviet Union and China are probably the largest illegal flows ever seen, as discussed in Chapter 3.

We seem to be failing across the board. Are there any bright spots at all? Yes, the pursuit of terrorists' financing is a bright spot. Which indicates what can be accomplished given political will to tackle at least an element of the dirty-money problem in a determined manner.

CHASING TERRORISTS' MONEY

When 9/11 occurred, there was "nothing, absolutely nothing" in place to go after terrorist financing, according to David Aufhauser, at that time general counsel at the U.S. Treasury Department.[23] Two years later, following his leadership as chairman of the National Security Council's "no-name committee" on terrorist financing, he was able to say: "In broad strokes, Al Qaeda is two-thirds less rich than they were when we started. The budget is one-third of what it was when we started."[24]

It wasn't anti–money laundering procedures that accomplished this; it was just the opposite—post–money laundering procedures. U.S. authorities looked for and found the hijackers' financial transactions prior to 9/11 and then traced the transactions to the persons, companies, banks, and charities that had assisted them. This was an after-the-fact exercise, entirely different from the before-the-fact efforts on which anti–money laundering is built. "Following the money trail" means "we will freeze the accounts of people whom we suspect are involved in terrorist financing, if we are lucky enough to know their names."[25]

Three days after 9/11, President Bush activated the Foreign Terrorist

Asset Tracking Center within the Treasury Department, a unit that had been authorized by Congress the preceding year but had never gotten underway. Months later, due to bureaucratic infighting, this activity was shifted to the CIA. Also launched immediately after 9/11 was "Operation Green Quest," headed by the U.S. Customs Service and directed to block and seize Al Qaeda and other terrorist funds.[26] Ten days later the United States froze the assets of Osama bin Laden and 26 other individuals and organizations. Additional names were quickly put on the list: 39 in October, 84 more in November, and the process continued until it now includes nearly 400 entries.

Extending the list comes from old-fashioned investigative work. One transaction leads to another. One bank account leads to another. The same thing is true of credit and debit card purchases, wire transfers, ATM transactions, airlines tickets, hotels, rental cars, and more. The majority of transactions can be traced from place to place simply by sifting through financial documents and computer files.

As Customs grabbed the limelight, FBI officials chafed. Serious contention arose between the two, a battle that had to be settled in a carefully negotiated memorandum signed in May 2003 by the secretaries of Justice and Homeland Security, designating the FBI as the lead agency in investigating terrorist financing. Customs and the FBI shared personnel, and coordination problems finally began to ease.

By 2004 there were more than 25 departments, agencies, and offices of the U.S. government chasing after, blocking, and deterring terrorist financing.[27] What was accomplished by this massive effort? More than 1,400 accounts containing some $136 million accumulated by terrorists for years were frozen worldwide, according to recent U.S. reports.[28] A United Nations Monitoring Group offered a different figure: $75 million frozen by 21 countries.[29] Whatever the correct amount, seizures of such magnitudes put a crimp in the style of Al Qaeda and other terrorists.

The United States and cooperating countries can give themselves a light pat on the back for taking some portion of terrorist funds out of the legitimate financial system. But let us be quite clear about this. The United States has focused an enormous amount of attention on terrorists' money and has spent hundreds of millions, if not billions, of dollars in the hunt. This has been directed at the smallest part of the dirty-money problem. Out of the global total of roughly $1 trillion annually, terrorists' funds at their height

may have been only some $15 million to $50 million annually. Even at the higher number, this is 0.005 percent of the $1 trillion dirty-money total. In other words, with the bulk of our efforts concentrated on the smallest part of the problem, we have had some success. And the dedicated people who have achieved this much, especially David Aufhauser then at Treasury, merit our sincerest thanks.

But the task is nowhere near complete. The UN Monitoring Group's critique underlines the seriousness of the ongoing problem:

> Al-Qaida continues to have access to funds through charities and deep pocket donors, and from business and criminal activities, including the drug trade. Extensive use is being made of alternative remittance systems and cash couriers. Al-Qaida has shifted much of its financial activity to areas in Africa, the Middle East, and South-East Asia where authorities lack the resources or the resolve to closely regulate such activity. There are also indications that a number of entities and persons that have been designated on the list are still able to continue their funding activities, using trusts, front companies and other arrangements to veil their assets and activities. The [UN Monitoring] Group remains concerned that Al-Qaida, the Taliban, and those associated with the network are still able to obtain, solicit, collect, transfer and distribute considerable sums to support their ideological, logistical and operational activities.[30]
>
> The use of shell companies and offshore trusts to hide the identity of individuals or entities engaged in the financing of terrorism . . . make[s] it difficult to locate and deal with terrorist-related financial assets. . . . [S]hell companies, offshore trusts and other beneficial ownership arrangements have allowed [terrorists] to circumvent the full application of the measures set out. . . .[31]

In summary, with a huge expenditure of investigative and legal time and money concentrated like a laser beam on 0.005 percent of the dirty-money problem, which moves through the same mechanisms available to drug dealers, racketeers, despots, and tax evaders, Al Qaeda remains in the dirty-money business.

Why, despite all our efforts? I'll tell you, in the context of why dirty money flows around the globe with such ease.

ILL-INTENTIONED LOOPHOLES

Suppose a U.S. banker or businessperson with a range of financial services to offer goes abroad to call on potential customers. Let's say the first stop is Singapore. Here, a wealthy individual says to the visiting American: "I'm a businessman. I make my money by smuggling aliens—men, women, and children—out of western China and southern Russia and putting them into the sex trade and into low-wage jobs in Thailand, Malaysia, Korea, Taiwan, and Japan. I have a great deal of money on deposit here in Singapore, but I would prefer to have it in the United States, managed by a firm such as yours. Can you take it?"

The American looks over the list of prohibited sources of funds coming into the United States, finds that alien smuggling out of and into foreign countries is not on the list and warmly replies, "Of course, sir; we would be delighted to receive and manage your money."

Going further with this example, suppose that when these aliens are smuggled out of China and Russia, they are required to bring illegal drugs to their destination countries. And suppose that these illegal drugs are supplied by Al Qaeda. Now, our wealthy individual in Singapore is an admitted alien smuggler and an unadmitted drug smuggler and terrorist facilitator, and he's about to do business with the financial services industry in the United States.

How can this be? Very simply because the United States has two different lists of funds prohibited under anti–money laundering legislation, one a very long list of proceeds arising from crimes committed inside the country and the other a very short list of proceeds arising from crimes committed outside the country. The domestic list includes some 200 "specified unlawful activities," meaning that if you knowingly handle the proceeds of these activities, you have committed a money-laundering offense. The foreign list has only a few specified unlawful activities, focused on drugs, corruption, violence, terrorism, and certain treaty violations.

This is the most important point in the dirty-money issue, this difference between what is criminalized if it occurs inside a country's borders and what is criminalized if it occurs outside a country's borders. Table 4.5 summarizes the differences between onshore and offshore specified unlawful activities under U.S. anti–money laundering law. The "criminal activity" indicated usually involves several variations but for purposes of brevity all are included under the general heading. An "X" means that handling such

Table 4.5 Specified Unlawful Activities Under U.S. Anti–Money Laundering Laws

Criminal Activity	*If Committed in US*	*If Committed Outside US*
Aircraft piracy	X	
Alien smuggling	X	
Arms export	X	
Bank fraud	X	X
Bank robbery/burglary, gov. property	X	
Bank Secrecy Act crimes	X	
Bankruptcy fraud	X	
Bribery	X	X
Computer crimes	X	
Congressional/cabinet assassination	X	
Conspiracy to kill, kidnap, maim, injure	X	
Copyright infringement	X	
Counterfeiting and forgery	X	
Customs crimes	X	
Destruction of aircraft	X	
Destruction, explosive/fire, gov. property	X	
Embezzlement and theft	X	X
Emergency Economic Powers Act crimes	X	
Espionage	X	
Export crimes	X	X
Extortion and threats	X	X
Extortionate credit transactions	X	
Firearms	X	
Food stamp crimes	X	NA
Foreign Agents Registration crimes	X	
Foreign corrupt practices	X	X
Fraud and false statements	X	
Gambling	X	
Health care fraud	X	
Kidnapping	X	X
Mail fraud	X	X (thru US)
Mail theft	X	
Malicious mischief	X	
Murder on federal facility	X	
Murder, foreign officials/protected persons	X	X

(Continued)

TABLE 4.5 *(Continued)*

Criminal Activity	*If Committed in US*	*If Committed Outside US*
Murder, U.S. employee	X	X
Narcotics offenses	X	X
National resource conservation	X	
Obscenity	X	
Obstruction of justice	X	
Ocean dumping	X	
Passport/visa crimes	X	
Peonage and slavery	X	
Presidential violence/kidnapping	X	
Prohibited nuclear materials transactions	X	
Racketeering	X	
Securities fraud	X	
Sexual exploitation, children	X	
State felonies	X	NA
Tariff Act crimes	X	
Terrorism	X	X
Threatening/injuring federal official family	X	
Trading with the Enemy crimes	X	
Trafficking contraband cigarettes	X	
Trafficking in counterfeit goods	X	
Trafficking in stolen property	X	
Transportation for illegal sexual activity	X	
Treaty violations requiring extradition	NA	X
Unauthorized sound/video recordings	X	
Union/labor-mgt. embezzlement	X	
Unlawful citizenship	X	
Violence at international airports	X	
Violence, maritimes navigation/platforms	X	
Water pollution	X	
Wire fraud	X	X (thru US)

Source: Information in Table 4.5 is drawn from Alert Global Media, Inc., in Miami, Florida, with their permission, and supplemented with additional legal research. For more than a decade, Alert Global Media, publisher of *Money Laundering Alert*, has done an outstanding job of tracking laws and conducting conferences and training seminars, drawing attention to money-laundering issues. Most prominent in this effort have been Charles Intriago and Saskia Rietbroek-Garces. Through their programs, thousands of anti–money laundering specialists have been trained in the United States, Latin America, and Europe.

funds violates U.S. anti–money laundering laws. A blank space means that handling such funds does not violate U.S. anti–money laundering laws.

As the right-hand column shows, there are a great many more open holes than closed avenues if the money is coming from abroad. Profits from alien smuggling by our Singapore-based businessman are right up there on the legal list. Also not illegal are proceeds arising from crimes such as racketeering, securities fraud, credit fraud, forgery, counterfeiting, trafficking in counterfeit and contraband goods, trafficking in stolen property, loan sharking, protection rackets, advance fee fraud, asset stripping, foreign money laundering, sexual exploitation, prostitution, slave trading, and much more. And tax evasion? Forget that one. The United States is wide open to just about every dollar of foreigners' tax-evading funds that can be found.

Compared to the United States, some other western countries are more open to dirty money and some are less open, and variations in laws are far too extensive to comment upon in depth here. Suffice it to say that no country puts the full range of dirty money on its list of laundered money.[32]

Take just tax-evading money as an example; these proceeds flow illegally out of every developing and transitional economy into every major western economy I have ever researched. The following testimony is revealing: "Private bankers go to foreign countries to recruit capital flight and to meet with the clients who have taken billions of dollars out of the countries. . . . [R]egarding the tax issues and the laws of the foreign country, . . . it is best not to ask those questions of the client because it is not our responsibility . . . if the client is complying with . . . any laws within their country. . . . Basically it is that we don't want to know. . . ."[33] In other words, the easiest thing for criminals to do is make their criminal money look like it is merely tax-evading money, and when they do it passes readily into foreign economies.[34]

The fact is that laundered proceeds of drug trafficking, racketeering, corruption, and terrorism tag along with other forms of dirty money to which the United States and Europe extend a welcoming hand. These are two rails on the same tracks through the international financial system. Holes intentionally left in anti–money laundering laws provide a road map to foreigners, showing them how to relabel their money in order to get it into the western financial system. This is the reason western countries, by their own estimates, have better than a 99 percent failure rate in stopping deposits of laundered money.[35] When we remain legally open to many forms of dirty money we do want, we remove the possibility of successfully curtailing a few forms of laundered

money we don't want. The global anti–money laundering regime has indeed grown, but it remains ineffective because it is narrowly defined, easily circumvented, and poorly enforced.

The linkage, the synergy, the similarity among all forms of dirty money is not widely understood in western business and government circles. It is clearly understood by every drug kingpin, criminal syndicate head, and terrorist mastermind.

The idea at the core of U.S. and European thinking about illicit money is flawed. The idea that we can successfully protect ourselves from a narrow range of dirty money we think hurts us, while at the same time cultivating a much broader range of dirty money we think helps us, is fundamentally unworkable.

The situation is far worse than simply holding open the bank vaults to dirty money in its various forms. We're not passive; we're active in this pursuit. Western banks solicit, transfer, accumulate, and manage dirty money in the trillions of dollars, raking in hundreds of billions every year. The tension between anti–money laundering compliance and bringing in business is no contest. New bank deposits, private accounts, and fee services win nearly every time. When knowledgeable experts on these matters get together, they often talk about how anti–money laundering regimes are designed, first, to offer financial institutions "plausible deniability" when caught with laundered money and only secondarily to avoid actually receiving dirty money.

Western corporations divert profits out of many countries where they are in business, including where they are headquartered. An entire structure has been created, as laid out in the Dirty-Money User Manual, that facilitates—that guarantees!—illicit financial flows. This structure consists of dummy corporations, tax havens, secrecy jurisdictions, shielded trusts, anonymous foundations, flee clauses, falsified pricing arrangements, fake transactions, disguised transfer techniques, and more, which I have been writing about. And this structure and the trillions of dollars it shelters and shifts is without question the biggest loophole in the free-market system. A brief review of its size is appropriate. On this subject, reality resides in grasping the enormity of the problem:

- More than 60 tax havens and secrecy jurisdictions spread across the world.
- More than a million dummy corporations shielding their owners' identities.

- Some $17 trillion lodged in private banks catering to tax evasion.
- Assets of $11 trillion or so parked offshore, outside the reach of regulation.
- In the Cayman Islands itself, foreign deposits of more than $1 trillion.
- Cross-border dirty-money flows estimated at $1 trillion a year, with half—$500 billion a year—coming out of poorer countries.
- Hundreds of billions of dollars in lost tax revenues for rich and poor countries alike.
- Drug dealers, racketeers, thugs, kleptocrats, terrorists, and corporate CEOs using precisely the same structures.
- By some accounts, half the world's money sitting in or passing through systems designed to handle illicit proceeds.

This structure is capitalism's darkest accomplishment. How did we get here? We created this parallel system that operates largely beyond the rule of law. It therefore needs to be better understood. I address two aspects of the structure's origins and supports. First, tax havens and secrecy jurisdictions bringing money into western banks, and second, falsely priced transactions shifting revenues and avoiding taxes for multinational corporations.

HAVEN AND SECRECY STRUCTURE

The Swiss, profiting off hot money in Europe, sanctified bank secrecy:

> Threatened by the depression of 1929 and in particular by the series of bankruptcies in Austria and Germany in the early 1930s, the Swiss financial industry managed to persuade Swiss authorities to adopt the stricter principles of bank secrecy. In an amendment to the Swiss Banking Law of 1934, for "the first time in history the principle of bank secrecy was put under the official protection of the penal law." It became a criminal offense for bank officials to divulge any information regarding a customer's identity, even to the Swiss, and the protection was extended to foreign nationals as well.[36]

The British sanctified the separation of place of incorporation from place of business:

> The precedent for this was the 1929 case of the *Egyptian Delta Land and Investment Co., Ltd. v Todd.* It was demonstrated that although the company was registered in London, "The business of the company was entirely engaged and controlled from Cairo where the directors and secretary permanently resided [and] the seal, minutes, and books of accounts and transfer were kept. . . ." Companies could now incorporate in Britain but avoid paying British tax. The ruling of the British courts proved significant because it laid down the rule not only for the United Kingdom but also for the entire British Empire, a point later exploited by jurisdictions such as Bermuda and the Bahamas and perfected in the 1970s by the Cayman Islands.[37]

Now, combine bank secrecy protected by national law together with incorporation separated from activity, add in silent directors, nominee shareholders, secret trust accounts, veiled foundations, and disguised financial transfers, and you the get the modern dirty-money system that significantly obscures global capitalism today.

Not all uses of tax havens and secrecy jurisdictions are illegal. But this is partly because the law in these places can be bought. Sovereignty, or autonomy, gives you the right to package and market deviations from commercial and financial norms—"the right to write laws."[38] What is legal is commercialized by authorities and sold as a product. Many havens and enclaves are niche players in this business of legalizing subterfuge. Tax lawyers go "treaty shopping" for the most favorable legislation protecting certain types of activities. What they often find is that laws are highly flexible and minimal tax rates are further negotiable. For example, an economic adviser to Jersey, one of the Channel Islands, recalls that a major European bank that had a registered Jersey international business corporation negotiated how much profit it would declare for its registered business (£60 million), and how much tax it would pay (0.5 percent). "Such meetings were not uncommon and were conducted in complete secrecy."[39]

As one economist put it: "The value-added component of a transaction being routed through, for example, the Cayman Islands, does not lie with

any intellectual or other activity performed in Georgetown, Grand Cayman. It lies instead in the tax benefits or in the secrecy space afforded by routing the transaction through the offshore circuits. Without such offshore 'spaces' there is no economic reason to divert a transaction through a tax haven en route to a large capital market."[40] And as another commentator cogently observed: "[T]ax havens as states . . . have learned to use their legislative capacities as 'baits' to attract business into their jurisdictions. Such apparently rational arrangements between states and private operators are . . . deeply disturbing, not least because the two parties to the exchange, one of them a sovereign government, handle highly charged . . . issues . . . in purely utilitarian terms. The willful misuse of ideas and practices that go to the heart of the legitimacy of the modern state . . . is the most disturbing aspect of the tax haven phenomenon."[41]

There are some uses of tax havens and secrecy jurisdictions that have become routine and at the same time risky.

- Much of what is called "offshore banking" is the business of borrowing money from nonresidents and lending money to nonresidents. Major banks participate in this from offshore entities, in order to avoid the bank reserve requirements that would apply onshore. Ultimately, the risk of this activity conducted without reserves is borne by the home institution, its central banker, and the taxpayers of the home country.[42]
- Offshore investment funds are unregulated. They often take gambles that are not fully disclosed and keep books in ways that would not be acceptable onshore. The most threatening element of their operations is the ability to leverage and hedge investments in unsupervised ways. Long-Term Capital Management came close to collapse in 1998, posed a major risk to global financial stability, and was rescued through intervention of the U.S. Federal Reserve Board.
- Concealing liabilities in tax havens has become big business. "Structured finance" often makes use of offshore special purpose entities to shield debt, in deals that draw close to or become criminal frauds. With this technique, Enron produced the biggest corporate failure in history.

- Leasing through tax havens is an area of quasi-legal double dealing. Special purpose entities established in some tax havens can facilitate full depreciation on leased assets for both lessor and lessee.

In short, tax havens and secrecy jurisdictions permit operations outside the rule of law and outside the process of regulation. This benefits the generators and facilitators of criminal, corrupt, and commercial dirty money far more than it benefits the legitimate capitalist system.

Banking communities in the United States and Europe strongly support the dirty-money structure, most especially the operation of tax havens and secrecy jurisdictions.[43] For them, this system serves to feed a good part of the estimated half-trillion illegal dollars a year coming out of nonwestern countries into western coffers. And it provides a cover story for this inflow, that is, much of the dirty money arrives through this semi-legitimizing intermediary beyond western borders, allowing western banks to claim ignorance of its origins. And, as a banker said to me concerning his Cayman Islands unit, it enables his institution to "accommodate corporate clients for staff payments, tax evasion, transfer pricing, etc."[44]

No one should think for a moment that the West is an innocent victim of vile machinations by drug kingpins, crooks, and tax evaders from other countries. No; this system was developed in the West and advanced by the West, and it serves what some people think are purposes beneficial to the West.

FALSIFIED PRICING STRUCTURE

The second major piece of the edifice supporting cross-border dirty money is falsified pricing and the extent to which this practice has become so widespread and out of control. It is a complex subject that engages the attention of thousands of officials, lawyers, and executives. Broadly speaking, individual—particularly western—nations attempt to protect their own revenues while avoiding protection of other nations' revenues. By eschewing the second responsibility, the United States and Europe make it much more difficult to achieve the first responsibility. I boil it down to its essentials.

"No country ever takes notice of the revenue laws of another."[45] So said Lord Mansfield in 1775 in England. This was at a time of growing competition between England and continental Europe and coincided with Adam Smith's completion of *Wealth of Nations*, which appeared the following year.

Ever since, Mansfield's judicial opinion has been known as the "revenue rule," which means that it is not the duty of one nation to enforce the tax regulations of another nation. With this as common law, incentives for tax evasion via falsified pricing and revenue havens steadily grew.[46]

In the United States, the 1928 Revenue Act gave the Secretary of the Treasury the power to allocate income between related parties as necessary to record accurately the tax that should accrue to each party. Section 482 of the Internal Revenue Code reflects this as follows: "In any case of two or more organizations, trades, or businesses . . . owned or controlled directly or indirectly by the same interest, the Secretary may distribute, apportion, or allocate gross income, deductions, credits or allowances between or among [them] if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes . . ."

Regulations adopted in 1934 applied the arms-length rule to transfer pricing decisions, requiring businesses to price transactions between related entities as they would with an unrelated third party. Methods for testing arms-length pricing were laid out in 1968 regulations, which also extended application of transfer-pricing rules to services and intangibles.

For the next 20 years, the U.S. Congress watched as U.S. corporations shifted revenues from imports and exports of both tangibles and intangibles into low-tax jurisdictions. This led to the Tax Reform Act of 1986 and additional temporary and final regulations in the 1990s, which together multiplied the ways in which arms-length transfer pricing could be calculated. These various methods are now referred to as cost plus, resale price, comparable profit, profit split, comparable uncontrolled price, comparable adjustable transaction, matching transaction, and more.

Not only was Congress concerned about U.S. businesses shifting taxable profits out of the United States, it was also angered to find that U.S. subsidiaries of foreign corporations were doing likewise. The GAO completed a study in 1992 that found that, for the year 1986, foreign-controlled corporations in the United States reported sales of $543 billion and losses of $1.5 billion, "possibly because of inappropriate transfer pricing practices."[47] Continuing this line of investigation, a 1999 GAO report covering the period 1989–1995 found that, among some 60,000 foreign-controlled corporations, an average of 70 percent paid no taxes during the period.[48] Yet another GAO report in 2004, covering the period 1996–2000, put the foreign nonpayers at 71 percent.[49]

Of course, U.S. corporations cannot afford to be outdone by their foreign competition. So they, too, curtailed paying taxes. In the 1989–1995 period, 60 percent of U.S. corporations were nonpayers, rising by 2000 to 63 percent, including some of the country's largest multinationals.[50]

Quite simply, using abusive transfer pricing techniques, often combined with tax havens and secrecy jurisdictions, many U.S. and foreign corporations operating in the United States ceased paying taxes. Profits were at all-time highs, but never mind. For some European countries, corporate tax bases have been similarly eroded. In other words, the methods developed in the West, intended at first to pull money out of developing and transitional economies into western coffers, have now come back to bite us—taking money out of western economies into the global netherland and slashing tax revenues in the process.

Now, consider abusive transfer pricing from a different angle: whether it's criminal. This should be a key question for thousands of officers and managers in multinational corporations. I set up a typical situation in the United States. Laws of many other countries are similar.

Suppose your company has an established manufacturing subsidiary in, for example, Malaysia. In connection with new products to be produced there, new materials are to be shipped from the United States. Operating profits are high in the United States, and taxes are low in Malaysia, because you still have a couple of years to run on the tax incentives given to establish your business in Kuala Lumpur. Malaysian customs duties on the imports will be 15 percent. Given these factors, a decision is made to shave profits in the United States by selling the new supplies at a low price to the subsidiary. You and several colleagues meet to discuss the matter and decide on charging 60 percent of the price at which the same items are sold to several other subsidiaries around the world. This price may not even cover all production costs in your U.S. plant. Commercial invoices are prepared, shipping documents drawn, the subsidiary is advised by telephone what the price will be, papers are mailed to Kuala Lumpur, the items arrive, and payment is wire transferred to the parent company. These kinds of conversations, decisions, communications, and financial arrangements are common in thousands of companies every day.

Key elements of this scenario include: agreement to lower U.S. taxes, substantially variant transfer pricing, use of mails and wires, and depriving Malaysia of customs duties.

Does this transaction violate U.S. laws, specifically laws dealing with: schemes to defraud, mail fraud, wire fraud, filing a false customs declaration, or general false statements?

Both statute law and case law need to be considered. Transfer pricing occupies a central position in global tax evasion and money laundering, and a few of the regulations and cases bearing on this need to be touched upon.

Scheme to Defraud

General elements of a common law action for fraud and deceit require a false representation of a material fact, with knowledge of the false representation that someone relies upon as true and acts upon to his or her detriment. The decisive element to determine the existence of a scheme is not the number of participants but whether the scheme had the ability to deceive.[51] The general conspiracy statute (18 U.S.C. §371) makes it an offense "If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose . . ."

Mail Fraud

It is a federal crime (18 U.S.C. §1341) for anyone to use the U.S. mail in carrying out a scheme to defraud. The law states in part, "Whoever, having devised or intending to devise any scheme or artifice to defraud, . . . places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service . . ." in furtherance of that fraud has committed an offense. While use of mails in the conduct of a scheme to defraud appears to be clearly laid out, mail fraud is not commonly applied in cases with extraterritorial jurisdiction.

Wire Fraud

In 1956, Congress amended the wire fraud statute (18 U.S.C. §1343) to include "foreign commerce." The law has been applied to cases that occurred in the United States, wholly outside the United States, and to money-laundering cases where transfers were routed, however fleetingly, through the United States. Application of wire fraud to situations that

deprive a foreign government of revenues is problematic and will be discussed under case law next.

Filing a False Customs Declaration

Imports into and exports out of the United States have to be accompanied by a customs declaration, which states the classification and value of the items. When a company has a normal price of 1X and then trades overseas sometimes at 0.1X and sometimes at 10X, you would think somewhere, someone is filing a false Customs declaration. How can $0.10, $1.00, and $10.00 all be accurately stated prices for the same thing? Well, because the U.S. Customs is not altogether clear on this subject. First, Customs law is focused primarily on imports and the collection of customs duties on imports. Customs officials say that applicable regulations apply equally to exports, but for decades Customs has looked the other way as U.S. exporters build kickbacks into export prices in order to facilitate capital flight coming out of developing countries and into the United States. Second, Customs defines value as "transaction value," meaning "the price actually paid or payable for the merchandise." Customs then goes on to modify this by stating that transaction value is "acceptable" only when "the relationship between the buyer and seller did not influence the price actually paid or payable."[52] This is the arms-length standard discussed earlier. But Customs seldom uses its extensive database to ask questions of corporations that export at 0.1X, 1X, 10X, or other levels of variation. Third, Customs hides behind Part 764.2(g) of its Export Administration Regulations, which states that "No person may make any false or misleading representation, statement, or certification . . ." in connection with export documentation. The potential power of this is undercut when price, no matter what it is or how much it varies, is taken as "transaction value."

General False Statements

The submission of false documents to Customs constitutes a legal violation (18 U.S.C. §1001). Because Title 18 of the United States Code does not contain a specific statute making it a crime to file false Customs declarations for exports, such activity can probably also be successfully prosecuted under

this general false statements statute.[53] Customs has shown little inclination to do so.

As for the example of underpriced exports from the United States to Malaysia, three conclusions are suggested by these five sets of statutes. One, you may very well be committing a felony offense under one of the preceding laws by participating in this or a similar transaction. Two, the U.S. Customs has not exhibited any interest in pursuing you. And three, you have to decide whether you really want to be or risk being a felon, despite the fact that law enforcement is currently weak.[54]

Robert Leo, writing in *International Law Practicum*, does not hedge at all: "U.S. laws on exports require the proper value of the export be declared on the Shipper's Export Declaration (SED) and prohibit the filing of false documents with Customs and the Bureau of Census. . . . In the U.S., a party's intentional misdeclaration of the amount paid for the goods, whether for import or export purposes, is considered civil fraud and may be pursued as a criminal offense, as well."[55]

Law is also evolving on the question of cheating foreign governments out of revenues. This could be the point on which the Malaysian transaction and millions of other falsified pricing arrangements eventually get serious attention from western governments. The centuries-old revenue rule, giving comfort to courts deciding that a foreign nation's revenues are an inadmissible issue, is under attack.

Three U.S. circuit courts in recent years have addressed the revenue rule in cases involving wire fraud and Canada. Additional cases will no doubt continue to arise, as this issue works its way toward resolution. Briefly, the three cases are as follows:

> *United States v Boots*. (1996) Tobacco was smuggled through two Indian reservations in Maine by water into Canada, avoiding Canadian customs. The First Circuit affirmed the revenue rule, deciding that a "wire fraud statute could not be applied to [a] foreign smuggling scheme."[56]
>
> *United States v Trapilo*. (1997) Liquor was smuggled from the St. Regis Mohawk Indian Reservation in New York across the St. Lawrence River into Canada, avoiding Canadian customs. The Second Circuit looked past the revenue rule, asserting that, "At the heart of this indictment is the misuse of the wires in furtherance of a scheme to de-

> fraud the Canadian government of tax revenue, not the validity of a foreign sovereign's revenue laws."[57]
>
> *United States v Pasquantino.* (2003) Liquor was smuggled from Maryland through New York into Canada, avoiding Canadian customs. The Fourth Circuit, overruling an earlier panel, also looked past the old revenue rule in order to vindicate the United States' "substantial interest in preventing our nation's interstate wire communication systems from being used in furtherance of criminal fraudulent enterprises."[58] This decision, upon appeal to the U.S. Supreme Court, was upheld in 2005.

A careful review of these three circuit court rulings concluded as follows: "[C]ourts must conclude that Congress intended fraudulent schemes seeking to evade foreign excise taxes to fall within the broadly established scope of §1341 and §1343 [mail fraud and wire fraud statutes]." "The misuse of U.S. mails and wires in furtherance of an illegal operation transforms schemes to defraud foreign governments of import duties into crimes against the United States."[59]

"Crimes against the United States." Much the same thing can be said about many other countries. Within the framework of mail fraud, wire fraud, filing false customs declarations, and making false statements, enough law exists to curtail substantially the very widespread practice of mispricing in transactions between unrelated parties and abusive transfer pricing in transactions between related parties. A senior Treasury Department lawyer talking with me about available statutes said, "With mail fraud and wire fraud we can do anything we want to do."[60] When I asked him why the United States chooses not to use these instruments to combat false pricing, he hemmed and hawed and backed away from the subject. Because the business of falsified pricing underlies so much of global capitalism and has brought more money into western coffers than it has taken out, western nations are reticent to attack the goose that lays the golden egg. The World Trade Organization and the OECD get into the game with regulations and guidelines, to little avail because the concept of reining in false pricing essentially lacks support from its bigger members.[61]

The whole litany of mechanisms and structures—false pricing, tax havens, secrecy jurisdictions, dummy corporations, anonymous foundations, flee clauses, money laundering techniques, legalized criminal inflows,

concentration accounts, and more—moves trillions of dollars out of poorer countries into western accounts and has begun to move billions out of taxable western profits into distant sink holes.

The only question left to ask is why. And the answer is the simplest one possible.

WE LIKE THE MONEY

"The U.S. has supported this as a matter of policy."[62] A senior Treasury Department official, after explaining the role of his unit in fighting money laundering, was lamenting with me how much more difficult his task is made by the door held open to many forms of illegal proceeds flowing out of other countries into the United States.

"Efforts to curtail flight capital would deprive U.S. banks of deposits. There would be major pressure against it."[63] Another Treasury official was confiding to me his lesson in political reality.

"You should open a branch in the Caribbean to capture your fair share of flight capital."[64] An executive vice president of a major West Coast bank was passing on to me the advice he had received from a Treasury official.

A 2002 article in *World Policy Journal* put it as follows: "Traditionally, the U.S. Treasury has welcomed foreign money from any source to fill the gap in the country's balance of payments. Only in the last years of the Clinton administration did the Treasury begin to draw the line at laundered money, and even then it was tentative, lest it impede global money flows into Wall Street."[65]

At this point, I want to reiterate what I said in the Prologue. I'm all for the free-market system—free trade, free currency convertibility, free movement of capital. Provided it's legal! And that means legal in origin, movement, and use—legal at every point along the way. Legal money stays on the books. Legal money serves legitimate trade and investment. Legal money is properly taxed. Legal money fuels economic growth. Illegal money that is criminally, corruptly, or commercially generated sneaks across borders and hides in secret havens, often disappears from the books, undermines free trade and investment, skips taxation, and reduces growth.

For the United States and Europe, the justification for encouraging and facilitating the inflow of illicit money from abroad has been straightforward.

We have been guided for many years by an implicit cost–benefit analysis suggesting that the receipt of such money is good for the United States, good for Europe. It shows the strength of our economies. People in foreign countries want to bring their money into our systems where they know it will be safe and can grow. Succeeding administrations in the United States and Europe have encouraged this view.

Supporters of dirty money have never subjected this issue to a real cost–benefit analysis. I outline some of what must be included in such an appraisal and then at the end of this chapter lay down a challenge to others who should delve into these same questions.

The Benefits

Dirty money brings hundreds of billions of dollars out of nonwestern countries into western countries. My figure is a half-trillion dollars a year, accumulating to trillions lodged permanently in deposits, properties, and market investments in Europe and the United States. The other half-trillion out of the trillion-dollar annual flow circulates between western countries themselves and cooperating tax havens. Some may feel that this is a benefit to the West, contributing to maximizing private profit and reducing the role of government. This is a dubious argument at best, and I record it only to round out the case that others make for dirty money.

The Costs

If a half-trillion is supposedly a net gain to the West and another half-trillion may serve to discipline overreaching western governments, what is the downside attached to these flows? The costs can be seen in the impact on both domestic and foreign interests of western countries. Domestically it shields and thereby facilitates drug, criminal, and terrorist money passing into the West. This voids anti–money laundering as an effective instrument in the fight against such perils, thereby weakening the ability of western states to counter some of their most serious threats. And internationally it undermines key foreign policy objectives of the United States and Europe in poorer countries in Asia, Latin America, and Africa and in the former Soviet Union and Eastern Europe. Together the damage done to the fabric of western societies resulting from an appetite for dirty money is staggering.

Drugs. Decades into efforts to staunch laundering of drug money hasn't made a dent in the availability or street price of drugs. Money laundering is the reason drug dealers are in business. It's the end point of their game, and it's almost 100 percent successful. The drug problem for the United States, Europe, and now most other major countries absorbs resources, diminishes productivity, foments local gang warfare, expands prison populations, exacerbates racial tensions, contributes to social decay, and threatens generations of urban and rural youth. It costs governments billions trying to counteract drugs, but drug revenues flow easily into western accounts alongside other forms of illicit proceeds.

Global Crime. Taking their cues from drug traffickers, other global criminal syndicates have enjoyed excellent growth rates in recent decades. Crime accepts no borders. Russian mafias, Chinese triads, Japanese yakuza, Nigerian fraudsters, East European thugs, Sicilian mobsters, all have learned that, while crime is occasionally violent and risky, money laundering is the easiest aspect of the criminal enterprise. This accounts for organized crime's cross-border reach, newfound cooperation, and phenomenal expansion.

Terrorism. Part of the responsibility for 9/11, Madrid, Bali, Nairobi, Dar es Salaam, and many other terrorist attacks rests with the global system that shields and facilitates flows of dirty money. Observing how drug dealers launder their profits, the director of the U.S. Drug Enforcement Administration, Karen Tandy, said at a Senate hearing where I also testified, "The American drug consumer is the single largest funder of terrorism . . ."[66] And let me repeat for the third time Osama bin Laden's own words: "These are the very flaws in the western financial system that are becoming a noose for it."

Corruption. Government officials the world over know that if they can steal it, someone will shield it. The ill-gotten gains may have to be loosely disguised as a family business or nominee company, but there are plenty of bankers who will take this or a similar subterfuge as quite sufficient explanation for millions in deposits.

Failed and Nearly Failed States. Dirty money plays a huge role in Iraq, Afghanistan, Pakistan, North Korea, Colombia, Liberia, Sierra Leone, Zimbabwe, and other countries.

Strained States. Hundreds of billions in cumulative outflows undermine stability and progress in Russia, Ukraine, Kazakhstan, Belarus, Egypt, Nigeria, Angola, Argentina, Venezuela, Indonesia, the Philippines, and many more countries and could take a heavy toll on China and other transitional economies.

Severe Poverty. Foreshadowing Part II of this book, dirty money has an enormously damaging impact on the poorer 80 percent of the world, taking resources out of their countries.

Corporate Criminalization. In western countries themselves, thousands of businesspeople participating in falsely priced transactions are placed in a position of being, quite possibly, indictable for felony offenses. What are the costs of criminalizing our own citizenry?

Western bankers and businesspeople anxiously seek to hold on to parts of the dirty-money structure. Many bankers want to keep tax-evading money flowing out of other countries into western deposits. Many corporate executives want to keep false pricing and tax manipulation as central features of global enterprise. Still others want you to believe that these are minor, benign parts of the dirty-money equation. The argument is often made that it is not our responsibility to enforce the tax laws and pricing laws of other countries. While this is an important legal matter, it misses a much more fundamental concern of western nations. Is it in our interest to break the tax laws and pricing laws of other countries, and likely our own laws in the process? When we do, we promote lawlessness in international trade and finance. This adds our hands to the mechanisms that move dirty money around the world. This adds our hands to the techniques that sustain drug dealers, racketeers, human traffickers, illegal arms merchants, despots, and tyrants. This adds our hands to the methods that worsen poverty and deprivation and produce failed states. And, disturbing as it may be, this adds our hands to the instruments that enable terrorists to fly planes into the World Trade Center and the Pentagon and into the ground in Pennsylvania, and to blow up trains in Madrid and embassies in East Africa and nightclubs in Bali and hundreds of other atrocities around the world.

Global capitalism is not to blame for the world's ills. But the way global capitalism is practiced has become a contributing factor to global ills. The hundreds of billions of dollars escaping illegally every year out of weaker

countries, amassing to trillions of dollars lodged in the most advanced nations' repositories, arrive at a punishing cost. What we have sown in the century-long business of moving corrupt and commercial dirty money we now reap in the inflow of drug, criminal, and terrorist money.

CHALLENGE

I have referred to the annual flow of roughly a trillion dollars of dirty money and the mechanisms and structures that facilitate such a flow as the biggest loophole in the free-market system. Yet, it is a loophole that many people, particularly in western private sectors, particularly in countries that receive most of this money, want to maintain. Now it's time for these people to step forward and make their case for dirty money. The first of my three challenges, focusing on the pervasive illegalities that characterize global capitalism, is as follows:

Memorandum
To: Western Business and Banking Communities
From: Capitalism's Achilles Heel
Subject: Challenge: Case for Dirty Money

Assume any reasonably developed estimate of illicit financial flows passing (1) globally and (2) specifically out of developing and transitional countries into western countries. Make the case that the benefits of such flows or any part of such flows outweigh the costs. In appraising such costs, take into consideration the impact that dirty money has on what are generally considered to be major global concerns, including: drugs, racketeering, human trafficking, illegal arms dealing, transnational crime in other forms, terrorism, corruption, tax evasion, poverty and failed states, plus the potential criminalization of corporate personnel. Produce the requested study for western countries in general or for your country in particular.

The challenge calls for works supporting the idea that dirty money or any part of it is good for the West or any country in the West. If the implicit cost–benefit analysis can hold up—that many forms of dirty money are good for western economies—then it is time for adherents to this view to present it as an explicit cost–benefit analysis. Make the case that the costs are worth the benefits.

If the position that the inflow of dirty money to the United States and other western democracies cannot be defended, then our perception of this issue must change, from an assumption of its benefits to a recognition that the price tag attached to these felonious funds is unacceptable. Then a very interesting question arises. Is it possible to attack the global dirty-money problem more aggressively without impeding the legitimate free-market system? Here, it is important to understand that the proper goal is not to set up a process intended to stop all suspect transfers but rather to curtail—very substantially curtail—dirty money and our facilitation of its safe receipt. Stopping dirty money completely would require draconian procedures. Significantly curtailing dirty money can be accomplished without throwing sand in the gears of legal trade and investment and is entirely a matter of political will.

Rampant illegality is the first station along the continuum that threatens global capitalism. With common techniques and use of the same structures, drug dealers, other criminals, terrorists, corrupt government officials, and corporate CEOs and managers are united in abuse of capitalism, to the detriment of the rich in western societies and billions of poor around the world. Global capitalism is operating at a low common denominator. It is underachieving. It is far from spreading maximum or even acceptable levels of prosperity across the globe. And it is capitalists themselves who should have the greatest interest in eliminating the pervasive illegalities that have come to characterize the global capitalist system.

PART II

INEQUALITY: THE GAP MATTERS

Now the big challenge and threat is the gap in wealth and health that separates rich and poor. . . . Here is the greatest single problem and danger facing the world of the Third Millennium.[1]

—David S. Landes, 1998

Well, forget convergence—the overwhelming feature of modern economic history is a massive divergence in per capita incomes between rich and poor countries, a gap which is continuing to grow today.[2]

—Lant Pritchett, 1996

"PLEASE, PLEASE, I beg you. Take my son to America. Let him be part of your family! I beg you! I beg you!"

I've witnessed the effects of dirty money on poverty in all six inhabited continents, but the most poignant incident is this one. The impact on me was so powerful that it led to the writing of this book.

On one of my periodic trips abroad I asked my colleagues in Nigeria to arrange for me to see Mary, the nanny who had taken care of our children when they were infants. We had hired Mary in Lagos in 1972 before Deren was born in New York. She was a cheerful, slight-framed woman in her thirties, with small tribal marks on her cheeks, indicating that she was from the Calabar area in the southeast of the country. Upon returning to Nigeria, she was gentle and loving with our one-month-old son and became attached to him, as he did to her. It took her some time to master the admittedly difficult

task of putting disposable plastic milk containers onto the Playtex baby bottle holder, but other than this little mechanical problem, she was a delight and her performance was flawless.

With Pauline's second pregnancy, we brought Mary back to New York to help take care of Deren, as well as Gayle after her birth. Mary had a natural affinity for little girls and took to our daughter immediately.

Moving to Bethesda, Maryland, in late 1975, we brought Mary to the States a second time. Taking care of the kids during much of the day, she resolved to use her time well and arranged to attend cooking and knitting classes in the evenings. Brimming with self-confidence, she returned to Lagos the next year.

On my trips to Africa every year or two, I made a point to see Mary, as she always wanted to be kept up-to-date on the kids. She held various jobs as a nanny and seemed to be doing quite satisfactorily. On this occasion in the mid-1990s, it had been a couple of years since we last met.

My driver picked up Mary and brought her to the Eko Meridian hotel in Lagos. She telephoned me from the lobby, took the elevator up, and knocked on my door. I opened it, and there in front of me stood a wizened, emaciated, and disheveled old woman, who seemed to have aged 30 years since our last visit. I tried to conceal my shock as I brought her into the room.

Mary greeted me warmly and asked about Deren and Gayle, as I started to reach for their latest pictures. But unable to contain her emotions, she fell to her knees on the floor and begged me—with her hands gripping my ankles, her head touching my feet, and her tears flooding the carpet—begged me repeatedly to take her only child back to America and bring him up as a member of my own family.

This was during the Abacha years. Nigeria's worst dictator had plunged the country into a downward economic spiral, virtually bankrupting the society. Mary was a victim of this process: Abacha's theft, decades of endemic corruption, stolen oil revenues, tax evasion, money laundering, illegal transfers, the whole package of economic ills contributing to impoverishment of a nation. She had fallen through the cracks in Africa's extended family system. She was unemployed, homeless, destitute, and completely despondent. Yet she was not asking for money but instead pleading to give up the only thing in the world she still had, the only person who might provide for her in her old age. She was on her knees in front of me because tens of billions of dollars had been embezzled from her country and spirited into accommo-

dating foreign coffers, producing disaster for her and her child, as it had also for millions of others.

This was a shattering experience for me. And before you begin to think this is a tale told by a bleeding heart, let me ask you to imagine that you were in that hotel room. Further, let me ask you to keep this image of Mary, weeping, on her knees, in mind for the rest of Part II. Then you will more easily grasp the linkage between dirty money and global poverty and inequality, which is the second part of capitalism's threatening continuum.

The unchecked diversion of trillions of dollars out of other countries into western accounts not only constitutes the biggest loophole in the free-market system, as Part I concluded. It's also the most damaging economic condition impoverishing the poor in developing and transitional economies, as Part II reveals. It drains hard-currency reserves, heightens inflation, reduces tax collection, worsens income gaps, cancels investment, hurts competition, and undermines trade. It leads to shortened lives for millions of people and deprived existences for billions more. Within the economic realm, as distinguishable from political affairs or environmental constraints, nothing approaches the harmful effects caused by massive outflows of illegal money from poor nations into rich nations.

"So what?" as I've heard many times. Or, as a senior Federal Reserve Board official in Washington asked, "If the foreign government isn't concerned about it, why should we be concerned about it?"[3]

"So what?" "Why should we care?" Government officials, academics, and businesspeople have expressed these sentiments repeatedly. And it always leaves me completely incredulous. The cause and effect relationship between dirty money and global inequality is not some vague, abstract notion. It is an overarching reality in today's world. It devastates or impairs the lives of Mary and her son and billions like them. Their poverty flows in part from our complicity. And, given the complicity of affluent nations in encouraging, accommodating, and holding illegal wealth from abroad, the extent of disparity across the planet needs to be understood and appreciated.

Why should you care? Because of all the features of global capitalism, good and bad, the one reality that has the potential to bring the structure down is inequality. On this rock the system could founder.

CHAPTER 5

THE GLOBAL DIVIDE

WRITING MORE than 2,300 years ago, Plato spoke about the dangers of inequality: "If a state is to avoid the greatest plague of all—I mean civil war, though civil disintegration would be a better term—extreme poverty and wealth must not be allowed to arise in any section of the citizen-body, because both lead to both these disasters."[1]

The broad subject of poverty in the midst of wealth has been around for a long time. However, over the past 30 years or so, the study of poverty and wealth has been extended much more aggressively than at any earlier time. Global income and consumption data covering almost the entire world's population are now available. The good news is that a great deal of attention is being focused on the measurement and analysis of global poverty and inequality. The bad news is twofold: (1) the emerging picture shows a global gap much wider than we had earlier imagined it to be, and (2) there is, despite all the scholarship, great confusion and uncertainty about whether the gap is expanding or contracting.

Capitalism does indeed have a huge problem with inequality, and it is important to grasp just how big this problem is.

THE QUINTILE CANYON

The easiest way to talk about global income disparities is to divide the world into equally populated segments, ranging from poor to rich. The most widely available data for this purpose use 20-percent groupings, or quintiles, to array everyone in a country by income levels into an appropriate ranking. Then these five quintiles within countries can be further

arranged into global quintiles to offer a picture of all the world's six-billion-plus inhabitants.

The work of several economists has produced a fascinating picture of global income disparities beginning in 1820 and extending to 1980. Figure 5.1 illustrates the stark two-centuries-long rise in inequality. From a gap of 12 to 1 between top and bottom quintiles in 1820, the gap rose to 35 to 1 by 1980. As one of these writers, Angus Maddison, reported, total output of the advanced capitalist countries increased 70-fold, population increased 5-fold, per capita output increased 14-fold, average hours worked dropped by half, and life expectancy doubled. In other words, rich countries soared while poor countries lagged.[2]

In 1994, a United Nations ranking showed that the ratio between the top and bottom income quintiles of the world's population was 60 to 1, a figure that was repeated often in the press. Unfortunately, the tally was far from accurate. It was made by ranking countries from richest to poorest based on their average income, then dividing the countries into five roughly equal population groups, or quintiles. This meant that all citizens of a country were put into a single global quintile regardless of their actual income, which may have been much lower or higher than the average. Coming up with an average income for a whole society is virtually meaningless. Thus, in

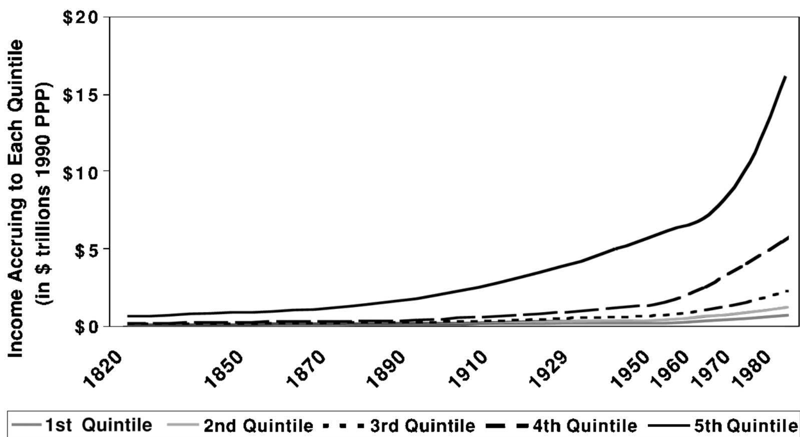

FIGURE 5.1 WORLD INEQUALITY 1820–1980
Source: Bourguignon and Morrison, 2002.

the 1994 UN ranking, Brazil, which has an extravagant upper class, was put into the richest quintile—all of its 150-million-plus people—despite the fact that Brazil has some of the poorest people on Earth living in *favalas*, shanty towns. And China, which has an average income just a bit higher than the lowest fifth on Earth, had none of its billion-plus population in the bottom quintile, despite the fact that the country has hundreds of millions of people whose low incomes qualify them for admission into the ranks of the poorest. Trying to make world income comparisons by using averages for entire nations is completely misleading.

In recent years, income breakdowns into 20-percent groupings within countries that comprise 96 percent of the world's people have become available. The World Bank's annual statistics provide data for almost all nations, including GDP and quintile shares of GDP. This enables global quintiles to be compiled regardless of where income groups reside. Economists often take shares of GDP as an acceptable measure of personal income and use the terms interchangeably. Unless otherwise indicated, the following pages treat income as shares of GDP.[3]

Using World Bank statistics, we can find the poorest group of people in the world. This happens to be the bottom quintile in Sierra Leone, with an annual per capita income of $8 per year! Then we can find the next group a bit better off, and the next, until we finally reach the richest group of people, which happens to be the top quintile in Luxembourg with a per capita income of $92,000 per year.

The five income quintiles of the world are summarized from World Bank statistics[4] in Table 5.1. There is a major assumption in these data. Income levels are based on converting the currencies of foreign countries to U.S. dollars at prevailing exchange rates. If one U.S. dollar can be converted to six South African rand, then a South African income of R6,000 could be swapped for a U.S. income of $1,000.

This is not a particularly accurate way to compare incomes. The fact is R6,000 will get you more food, clothing, and housing in South Africa than $1,000 will get you food, clothing, and housing in the United States. The financial exchange rate between the two currencies doesn't satisfactorily reflect the difference in what can be purchased with the two equivalent incomes. A better way to compare the two incomes is to equate what they will buy locally, rather than what they can be exchanged for at a bank or bureau de change.

TABLE 5.1 RANGE OF ANNUAL PER CAPITA INCOMES IN EACH GLOBAL QUINTILE, AT EXCHANGE RATES

	1st Quintile	*2nd Quintile*	*3rd Quintile*	*4th Quintile*	*5th Quintile*
Income at bottom of quintile	$ 8	$285	$ 516	$1,042	$ 3,964
Income at top of quintile	$282	$516	$1,036	$3,963	$92,104

Source: Calculations based on World Bank data from *World Development Indicators 2004*.

This has led to development of purchasing power parity (PPP) figures. If, in fact, the food, clothing, and housing that you can buy in South Africa with R4,000 is the same or the equivalent of the food, clothing, and housing you can get in the United States for $1,000, then it's fair to say that R4,000 equals $1,000 in purchasing power, rather than the R6,000 figure at exchange rates.

Purchasing power parity calculations have been made for most countries. Again, the beginning and ending points of the global quintiles, drawn from World Bank statistics and based on PPP data,[5] are shown in Table 5.2.

Figure 5.2 presents bar charts showing global income disparities as of 2002. Both sets of numbers are depicted: currency exchange rates and purchasing power parity. The bar based on currency exchange rates shows a level of inequality between the richest 20 percent and the poorest 20 percent of 121 to 1. The bar based on PPP shows the level of disparity at 31 to 1. These

TABLE 5.2 RANGE OF ANNUAL PER CAPITA INCOMES IN EACH GLOBAL QUINTILE, AT PPP

	1st Quintile	*2nd Quintile*	*3rd Quintile*	*4th Quintile*	*5th Quintile*
Income at bottom of quintile	$ 29	$1,217	$2,138	$ 4,759	$ 11,443
Income at top of quintile	$1,213	$2,136	$4,731	$11,443	$119,024

Source: Calculations based on World Bank data from *World Development Indicators 2004*.

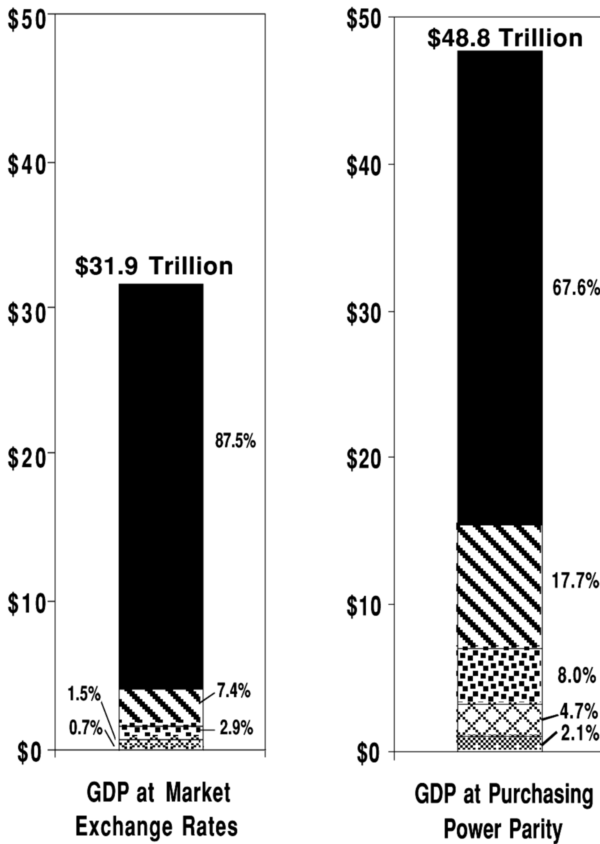

FIGURE 5.2 GLOBAL GDP AND GLOBAL QUINTILE INCOME DISPARITY, 2002
Source: Calculations based on World Bank data from *World Development Indicators 2004.* Data from *World Development Indicators 2005* show no significant differences.

two ratios of global income disparity are obviously very different and are discussed later.

But there is something else in the bar charts that is not so different—the percentage of global income accruing to the top 20 percent. In the exchange rate figures it's 87 percent. In the PPP figures it's 68 percent. And therein lies the danger. Whether the more accurate figure is 87 percent or 68 percent hardly matters. Both figures demonstrate a world in which there has arisen an enormous concentration of income in the top 20 percent, leaving 80 percent to meagerly share all the rest. This is the second part of capitalism's

Achilles heel, this enormous disparity that, no matter how you measure it, demonstrates a level of income concentration that is foreboding. And, worse than this, even these percentages are too low, because the amount of illegal, unmeasured, and unrecorded money flowing out of poor countries into rich countries serves to understate the income accruing to the top 20 percent, unavailable to the bottom 80 percent.

Before moving ahead, further explanation of purchasing power parity is needed. This is the basis for nearly all commentary about the comparative state of the economic world.

Almost everyone who has ever traveled outside his or her country knows that familiar items may cost more or less in another country. The *Economist* annually publishes its "Big Mac" price comparison, based on how much it costs to buy McDonald's favorite hamburger in some 32 countries. A recent survey showed local prices converted into U.S. dollars ranging from $1.23 in the Philippines to $2.90 in the United States to $4.90 in Switzerland.[6] The *Economist* has also experimented with a Starbucks tall-latte index. These are interesting little numbers but hardly sufficient for sophisticated international economic comparisons.

The idea behind PPPs focuses on identifying the costs in different countries of purchasing the same basket of commodities. For example, we can come up with a representative basket of goods for an American and then take that same basket to a foreign country and price it in local currency. Perhaps for the American we could choose appropriate amounts of sugar, coffee, bread, cheese, pasteurized milk, ground beef, jeans, and underwear and add some electricity, gasoline, telephone charges, rent, and credit card interest. Sounds like a reasonable range of items on which many Americans regularly spend money. So we can take this basket of commodities abroad and see how others spend money on the same basket. The trouble is, when we get to Burkina Faso, we find that most consumers have never bought any of these items in the American basket, and there's no reasonable way to make any such price comparisons. So maybe we can make the process work in the opposite way: Take a basket of their typical commodities and compare those prices in the United States. The Burkina Faso basket has cassava, millet, warm milk straight out of the cow's udder, bush meat, spear points to drive away marauding lions, straw for thatching the roofs of mud huts, and an imputed amortization cost for the price of a bride. None of this can be converted for comparative purposes back to the United States. In other words,

it's very difficult to come up with a basket of commodities that forms a reliable picture of prices between countries.

Enter the United Nations. In the 1950s and 1960s, the UN participated in developing a System of National Accounts (SNA) forming a common basis by which nations could compile data on their economies. The well-known scholar Simon Kuznets was instrumental in this work, receiving an early Nobel Prize in economics. The SNA format for national accounting is now used by most UN members. While standardizing pictures of national economies at a point in time, SNA does not by itself readily facilitate cross-country comparisons. To accomplish this, more detailed purchasing and pricing correlations between states are needed.

In 1968 the UN and the University of Pennsylvania, with funding from the Ford Foundation and the World Bank, set up the International Comparison Program (ICP) to facilitate purchasing power measurements. Benchmark price data have since been collected in 10 countries in 1970, 34 countries in 1975, 60 countries in 1980, 65 countries in 1985, and 117 countries in 1993/1996. A survey begun in 2004 will cover even more countries. Indices based on assembled price information are then applied to each country's standardized SNA accounts, in order to come up with valid estimates of GNP and GDP and details on the composition of national income. Reams of data emerging from these studies have been extremely useful in analyzing income, growth, poverty, and inequality within individual countries, regionally, and globally.

The data are also controversial and subject to widely varying interpretations. A basic criticism is that the ICP's collection of price data is primarily designed to fit into the SNA. This serves the purpose of measuring GDP in terms of purchasing power parity. It does not serve particularly well to measure poverty and inequality within a country or globally. To accomplish this effectively would require a different survey with a different set of questions, not to mention additional funding.

As recently as 1995, an IMF working paper concluded the following: "[B]ecause of unresolved data and methodological issues, the use of PPP-adjusted estimates would seem inappropriate for the Fund's operational purposes at this time. Although it is generally agreed that PPP rates are appropriate conversion factors from a conceptual viewpoint, their practical implementation has been hampered by the uneven quality of the PPP indices currently available."[7] While improvements in coverage of countries

have continued over the past decade, serious questions remain as to the accuracy of PPP estimates.

Nevertheless, taking the World Bank's PPP data as the best numbers available, these compilations can be further laid out to exhibit recent trends. We can begin with 1993, when the Bank expanded its quintile income database to encompass a large number of countries. Figure 5.3 shows how global GDP and the planet's richest and poorest quintiles have progressed over 10 years. It also shows total GDP and richest and poorest quintiles for the world's three biggest economies—the United States, China, and Japan. Figure 5.4 provides similar information for 12 selected countries. Notice how every chart depicts growth in GDP and a growing dollar gap between rich and poor quintiles. This is the threat to capitalism, the growing accumulation of income dollars accruing to the rich, unavailable as purchasing power to the poor. And this leads directly into the following section on how to gauge poverty and inequality.

MEASURE FOR MEASURE

In William Shakespeare's play *Measure for Measure*, Duke Vincentio wants someone else to clean up his town while he observes the proceedings disguised as a monk. In Act 3, Scene 2, he speaks the following line: "There is scarce truth enough alive to make societies secure." The Duke would feel right at home today.

How many poor people are there in the world? How poor are they? What makes them poor? A half century into the business of development you might think we should have answers to such basic questions. Not a chance. If anything, scholars are more divided than ever. For every ideological bias, evidence is available, confirming what anyone already wants to believe. The "truth," if it exists, is elusive.

There is an old saying among corporate executives, "What gets done is what gets measured." In other words, if a CEO or division head or department manager wants to focus attention on accomplishing some goal, then he or she should devise a measure of progress toward that goal and review it together with others continuously. With this in mind, I suppose it's useful to have so many measures of poverty and inequality and so much argument about what each means, in the hope that some consensus may emerge eventually.

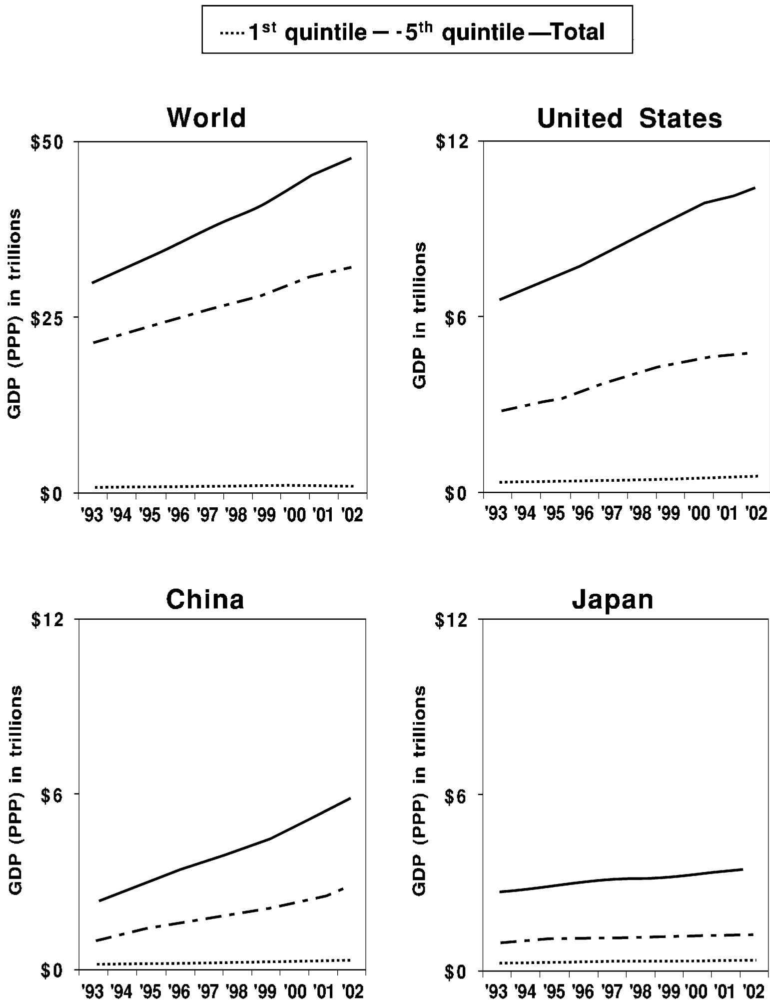

FIGURE 5.3 TOTAL GDP AND SHARES OF RICHEST AND POOREST, 1993–2002
Source: Calculations based on World Bank data from *World Development Indicators* for 1995 through 2004.

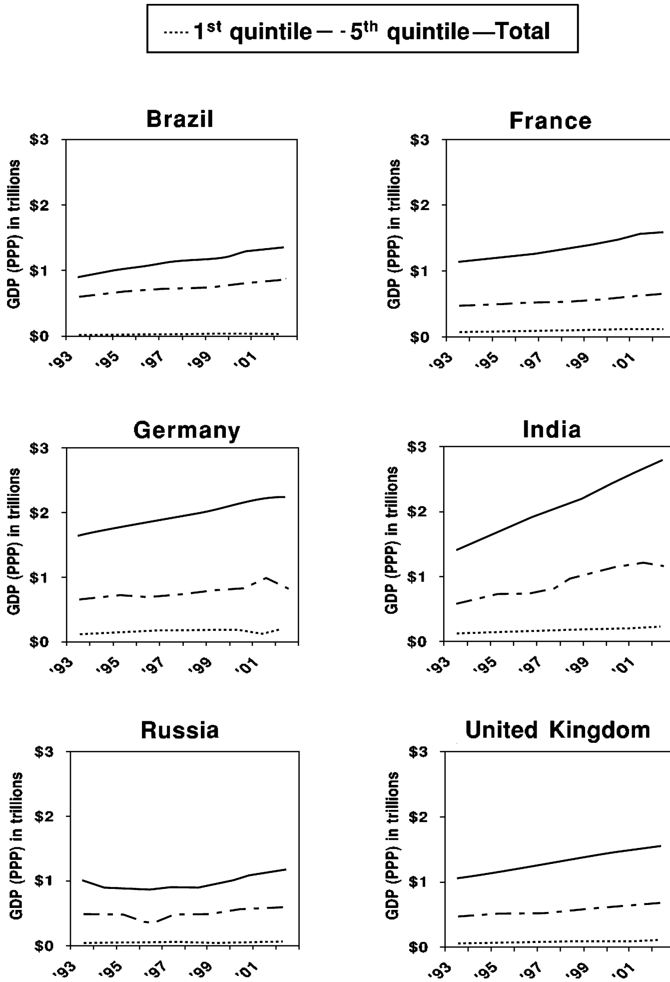

FIGURE 5.4 TOTAL GDP AND SHARES OF RICHEST AND POOREST, 1993–2002
Source: Calculations based on World Bank data from *World Development Indicators* for 1995 through 2004.

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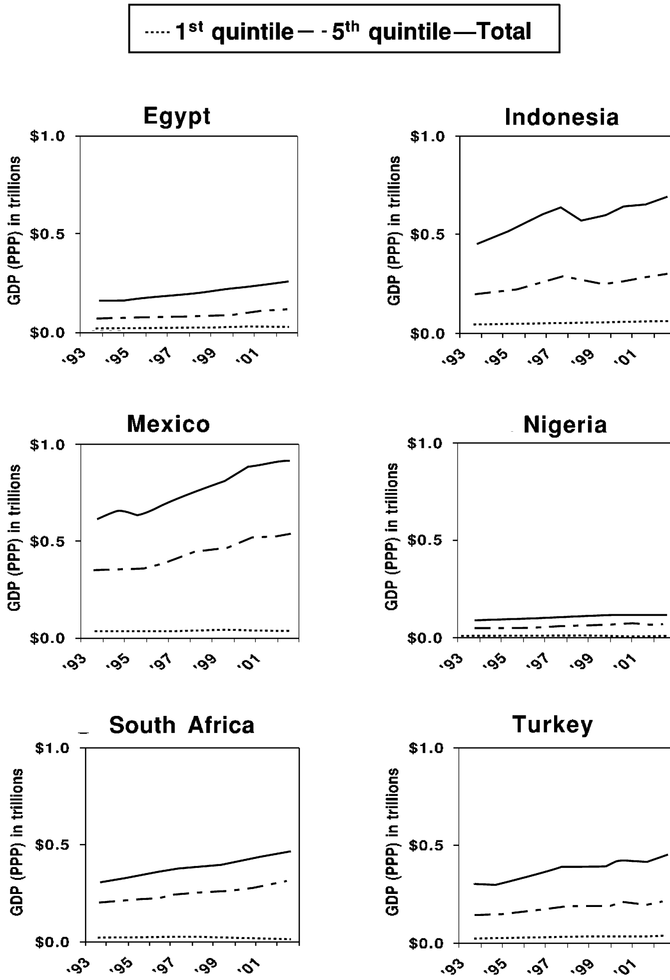

Figure 5.4 *(Continued)*

In the 1950s the development community was focused on growth in GDP as the all-revealing measure of progress. By the 1960s experts realized that this wasn't satisfactory; it had to be per capita growth in GDP, to assure that rising populations enjoyed rising personal incomes. Then in the 1970s this focus was supplemented with the idea of basic human needs, the notion that everyone deserves to have at least the minimum components of food, clothing, and shelter. What these minimums should be was never fully agreed. The 1980s produced another shift, adding to per capita GDP such nonmonetary factors as life expectancy and literacy in measuring well-being. Starting in the 1990s, this trend among some scholars toward broadening the meaning of poverty continued, now including deprivation of capabilities and social opportunities.

Through it all, there has been no accepted definition of poverty. Part of the reason is because poverty is both a moving target and a relative term. Furthermore, what is considered as poverty in the United States has no comparison to the far more severe levels of deprivation I have seen in Africa, Latin America, and Asia. Despite the complexities of the matter, however, a basic grounding in some of the common measures of poverty and inequality is useful in appreciating the scope of these issues.

First, the poverty line. In monetary terms, the World Bank most often uses $1 a day and $2 a day. Other levels, such as $3 a day and $5 a day also appear in the literature. And the poverty line is adjusted for inflation, so that $1 a day may actually mean $1.08 or $1.34 or some other figure.

Poverty head counts are important. With a poverty line set at $1 a day, how many people around the world are living at or below this level? Depending on their calculations, various researchers have produced figures of 300 million, 766 million, 1.2 billion, and more than 1.8 billion.[8] In other words, with estimates varying by as much as a factor of six, there is no consensus on the count of the global poor.

Poverty gaps can be measured, providing a sense of the depth of poverty. For those living below $1 a day, what is their average distance below this poverty line? Are they just below it or far below it? Take Sierra Leone as an example. The three poorest quintiles have average annual PPP incomes of $29, $52, and $256, respectively. This averages $112 per year across the three quintiles, which is far below a poverty line set at $1 a day. In other words, in Sierra Leone the poverty gap is huge and the depth of poverty is extreme.

Relative poverty is becoming more widely used. Instead of basing a poverty line on $1 or $2 or any other fixed amount, poverty can be measured against the average income of a society. The World Bank occasionally provides analyses of poverty levels at one-third, one-half, and two-thirds of average incomes. In the United Kingdom, the low-income line is set at 60 percent of median income, or about £10,000 per year based on a national median income of some £16,800 per year.[9] This is not done to meet any technical requirements but rather is a political decision.

Just as poverty is gauged by many forms of measurement, inequality lends itself to even more. Figure 5.2 presents the easiest way to visualize inequality, as percentages of income accruing to each quintile of society. Economists generally prefer more sophisticated equations.

The most commonly used technique is the Gini coefficient, named after Corrado Gini, an Italian statistician writing in the early twentieth century. Suppose a society has perfect income equality, that is, everyone has the same income: 20 percent of the population receives 20 percent of the income, 40 percent receives 40 percent of the income, and so on. This is depicted as a 45° line in Figure 5.5.

In the real world, this never happens. Obviously, rich people have more income than poor people. In order to depict this skewed distribution, the Lorenz curve was introduced early in the past century, conceptualized by Max Lorenz, an American economist. A society's real income distribution

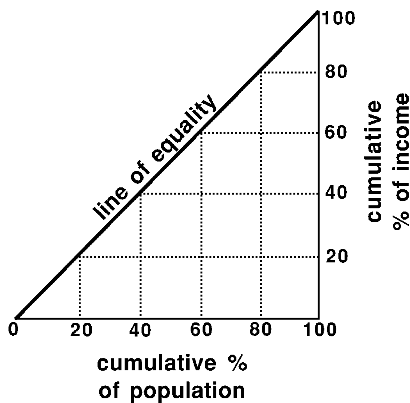

FIGURE 5.5 PERFECTLY EQUAL SOCIETY

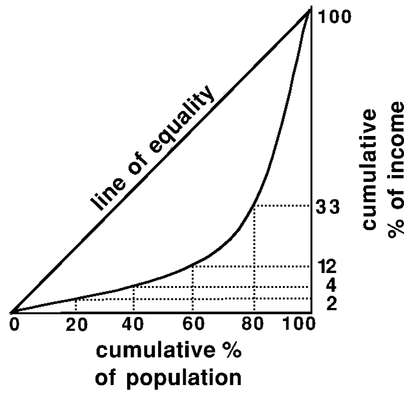

FIGURE 5.6 LORENZ CURVE

might look like Figure 5.6, with 20 percent of the population receiving 2 percent of the income, 60 percent receiving 12 percent of the income, and so on.

Inequality in the society is measured by how much the real income distribution falls below the 45° equal income distribution line, as shown in Figure 5.7. In this illustration, the shaded area amounts to 65 percent of the whole area below the line of equality. This is the Gini coefficient for this society, expressed as

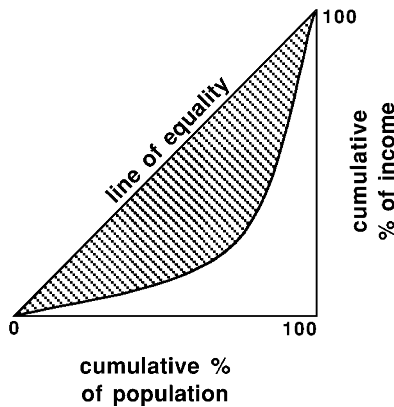

FIGURE 5.7 WORLD LORENZ CURVE (Gini ≈ 0.65)

65 or 0.65, and this picture corresponds approximately to today's Gini coefficient for the whole world.

Gini coefficients are useful but imperfect. Not every society has a nice, smooth income distribution curve. Some have lumpy curves, corresponding to concentrations of income at various levels. Thus, two societies with the same Gini coefficient can show quite dissimilar curves, depending on where their incomes may be clustered. In fact, to be even clearer, there are an infinite number of curves that can produce the same Gini.

While Gini coefficients are commonly referred to in the popular press, there are a great many other inequality measures that are used by specialists. By way of mention only, these include the Dalton measure, the Theil index, the Atkinson index, variance of logarithmic income, squared coefficient of variation, and mean logarithmic deviation, as well as some with whimsical names such as the Parade of Dwarfs and the Robin Hood index. Suffice it to say that an enormous amount of scholarly attention is focused on measurement issues and will likely pay off in future years with greater public attention devoted to global inequality and poverty concerns.

IT'S AN UNCERTAIN WORLD

As poverty and inequality are studied more deeply, the fog of statistics confirms the enormous uncertainties surrounding fundamental questions still facing our shared planet. Some of these shape the way we think about philosophical, geopolitical, and security issues. I address six of these big questions in this section.

First, are monetary measures the right bases for evaluating poverty and inequality? A number of researchers are pushing definitions of poverty well beyond per capita GDP and its various PPP conversions. The direct calorie intake measure sets a basic nutritional requirement at 2,112 calories per person per day and considers poverty to be any shortfall below this level. The food energy intake method prices the 2,112 calorie intake and sets that expenditure as the poverty line. A variation on these themes defines extreme poverty as households that spend 80 percent or more of their total income on food and yet still receive 80 percent or less of their daily calorie require-

ments. At least these techniques focus on the most crucial aspect of poverty: simply having enough to eat.

The United Nations Development Programme annually publishes a composite index of monetary and nonmonetary indicators, called the Human Development Index (HDI). This was an early 1990s brainchild of Mahbub Ul Haq, a distinguished Pakistani economist at the UN. HDI contains three elements: life expectancy at birth, a composite of school enrollment and adult literacy, and GDP per capita. At first rejected by other economists, Haq successfully argued that a broader measure than GDP alone was needed, one that focused attention on health and education as well. Ranking development standards from 0 to 1, the 2004 HDI put Norway at the top with an index of 0.956, and clustered 31 African countries at the bottom with indices all below 0.5.[10] The HDI has also spawned the UNDP's Human Poverty Index, which measures population below the poverty line, availability of improved water sources, proportion of underweight children under the age of 5, and probability of death before the age of 40. Together, these two indices have helped meet Haq's goal of shifting social development "from the periphery to the core"[11] of poverty debates.

Amartya Sen, distinguished economist and philosopher and 1998 Nobel Prize winner, added to the intellectual ferment surrounding these issues with his concept of development as the expansion of human capabilities. Sen refers to Aristotle's views in *The Nicomachean Ethics*: "First ascertain the function of man" and then proceed to analyze "life in the sense of activity."[12] For Sen, "capability" is "a kind of freedom: the substantive freedom to achieve"[13] a set of functions, as Aristotle spoke of, in order to live a fulfilling life. "In this perspective, poverty must be seen as the deprivation of basic capabilities rather than merely as lowness of incomes."[14] In other words, Sen sought to refocus assessments of poverty from means to ends, for example, from the means—the money—available to buy food to the ends of being adequately nourished.

To Sen's ideas about capabilities, others have added the concept of "social exclusion," that is, exclusion from normal activities in a society such as employment, housing, minimal income, citizenship, democratic rights, and communal contacts. In fact, the European Union has made the concept of social exclusion a central tenet of its policy, focusing on any "process whereby certain individuals are pushed to the edge of society."[15]

Nonmonetary measures of poverty and inequality—social exclusion, Sen's capabilities, the UNDP's Human Development Index, caloric requirements, and more—are difficult to quantify and operationalize. Nevertheless, they are steadily working their way into the framework of economic policy, first in western countries and perhaps eventually in developing and transitional economies. I am not yet persuaded that these broader measures are necessarily more accurate or revealing than monetary measures. This leaves me somewhat conflicted over their use. On the positive side, they have the benefit of bringing more disciplines—sociology, psychology, even philosophy—into the business of global development. This is especially important, as I address again in Chapter 12. On the negative side, they contribute to removing western business and banking sectors from development concerns, convinced that these issues are the province of specialists and peripheral to commercial pursuits. As it is, many informed people believe that development is primarily a function of foreign aid dispensed by economists, statisticians, and do-gooders, and this view is reinforced by measurements that are, rightfully or wrongfully, seen as soft, esoteric, and subjective.

What is the preferable approach to evaluating poverty? People living on $1 a day and percentage growth in GDP—these are the kinds of numbers that can hold the attention of corporate and financial executives. Capabilities and social exclusions—these can expand the community of global development experts. Both monetary and nonmonetary measures will no doubt be used for the foreseeable future. It's uncertain which is likely to contribute more to the alleviation of poverty.

Second question: Is global poverty rising or falling? I say earlier that you can find evidence to support any ideological position you want to take. With this in mind, the few quotes on the facing page may be mildly amusing.

Wide press commentary followed the April 2002 release of a study by the economist Xavier Sala-i-Martin, demonstrating that global poverty had plummeted between 1976 and 1998. In his analysis, the number earning $2 a day or less declined by 450 million and those earning $1 a day or less fell by 234 million.[16] Free-market fundamentalists cheered the result, proof that capitalism's "invisible hand" spread the benefits of prosperity all across the globe.

Global Poverty Is Down!	*Global Poverty Is Up!*
Poverty not only declined from 1985 to 2000, but did so at a faster pace than at any time in world history.[17]	A growing divide between the haves and the have-nots has left increasing numbers in the Third World in dire poverty.[18]
The one-dollar-a-day poverty rate fell from 20 percent in 1970 to 5 percent in 1998. The two-dollar rate fell from 44 percent to 8 percent.[19]	Statements that global poverty is decreasing have no evidential justification . . .[20]
We find that there was a net decrease in the overall incidence of consumption poverty over 1987–98.[21]	It is estimated that the actual number of income-poor people increased by almost 100 million during that period [1987–93] from 1.2 billion to 1.3 billion, and the number appeared to be growing in every region except Southeast Asia and the Pacific.[22]
World poverty has fallen dramatically in the past 30 years.[23]	Poverty is everywhere.[24]

The study was based on income-share data for 125 countries, encompassing about 90 percent of the world's population. Multiyear data were available for 68 countries. Only a single year's data were available across the 28 years of the study for another 29 countries. And no income-share data were available for 28 countries, more than half of them in Africa, which were nevertheless included by assuming that everyone had the same income. Furthermore, neither Russia nor any of the other former Soviet Union countries were included in the 125-nation sample.

Considering limitations inherent in the sample and rather serious uncertainties in the income-distribution measures, the conclusions of Sala-i-Martin's study extrapolated across the globe—a huge drop in poverty—would appear to be overdrawn. Insights into what is happening within various regions are more convincing. Asia shows a major decline in poverty. Latin America experienced

large reductions in poverty head counts in the 1970s but rising counts in the 1980s and 1990s. Sub-Saharan Africa simply fell through the floor, quadrupling the number living on $1 a day across the period of the study.

On the other side of the question, Thomas Pogge, a philosopher we will meet again in Chapter 12, and Sanjay Reddy, an economist colleague at Columbia University, have teamed up to offer a serious challenge to the World Bank's poverty calculations. Taking the Bank's 1998 number of 1.2 billion people living on $1 a day, they attack the methodology used to arrive at this figure on several fronts. First, the purchasing power parity measure is based on an unpublished general consumption PPP. Second, the Bank plays fast and loose with assumptions about countries not reporting or not recently reporting survey data. And third, the Bank adjusts the $1.00 a day PPP base measure set in 1985 to $1.08 in 1993, without adequate justification.[25]

Pogge and Reddy argue that the $1.00/$1.08 international poverty line is badly measured, wrongly calculated, far too low, and unreliable in determining trends. A better derived and barely more adequate line at $2.15 a day focused on food alone would raise the global poverty head count to 2.5 billion. Translating the $2.15 a day back to the United States on purchasing power parity terms would mean that an American family of four would have less than $70 a week for all expenditures. At such a level, this American family will be homeless, cold, hungry, weak, and ill.

Estimates of global poverty rising or falling are largely dependent on where lines are set, on what prices of products and services are tallied, on how you divide the world into comparison groups, on the choice of purchasing power parity conversion formulas, and on much more. In my judgment, the jury deciding which way poverty is moving is still out. Angus Deaton at Princeton University concluded that, "The plethora of new data has not resolved the controversy because the new sources are mutually contradictory."[26]

Third question: Okay, if the trend in poverty is unclear, what about inequality; is it widening or narrowing? Well, once again, let's sample the experts (see box, page 229). You can find support for whatever bias you choose.

Surjit Bhalla, ex-World Banker and think-tank denizen, constructed an analysis of inequality that he refers to as a simple accounting system, utilizing data made available in 1996 by Klaus Deininger and Lyn Squire at the World Bank. His procedure "corrects" for a slight upward bias in

Inequality Is Narrowing!	*Inequality Is Widening!*
The overall picture is clear: inequality has reduced substantially during the last 20 years.[27]	The evidence strongly suggests that global income inequality has risen in the last 20 years. The standards of measuring this change, and the reasons for it, are contested—but the trend is clear.[28]
The weight of recent evidence points to relative stability in world inequality over the last half-century, and probably a modest decline in the last two decades.[29]	The gaps between rich and poor countries, and rich and poor people within countries, have grown.[30]
Far from world inequality worsening, it actually improved with globalization. The peak of world inequality occurred in 1973; today, it is at its lowest in the past 50 years.[31]	In a world of disturbing contrasts, the gap between rich and poor countries, and between rich and poor people, continues to widen.[32]
The current wave of globalization, which started around 1980, has actually promoted economic equality.[33]	Gaps between the poorest and the richest people and countries have continued to widen.[34]

quintile inequality measures and leads Bhalla to conclude that "world individual inequality has improved significantly since the 1960s," a conclusion that he says "is different from all other studies."[35] Nevertheless, his estimate showing that more than 70 percent of global income accrues to the top 20 percent of the world is within the range of figures depicted in Figure 5.2 of this book.

Bhalla makes a point which is often stressed. Almost all of any lessening of global inequality, if it exists, stems from the rising income of China. This vast country, comprising a fifth of the world's population, has reported annual growth rates of six percent to nine percent or more for some years. China itself, as seen in Figure 5.4, has sharply rising internal inequality, but

the country's improving average income levels are enough to shift global measures of inequality. India has also had good growth rates in recent years, likewise aiding the global picture.

Now, there are problems with past conclusions about China and India. First, neither was included, as mentioned earlier, in the 1993 International Comparison Program price surveys, so data about these two countries extrapolated from earlier surveys are suspect. Second, China's official growth rate is dependent on reports received by Beijing from provincial governors, who have every incentive to exaggerate improvements in their regions. Frankly, no one believes China's self-alleged growth rates, and the question among scholars is by how much—1, 2, 3 percent?—should China's annual GDP be corrected and over how many years should such corrections be applied. Bhalla's assertion that global income inequality is suddenly reversing, an analysis largely dependent on China, is therefore problematic.

Branko Milanovic, also a World Bank economist, surprised researchers studying global inequality with an analysis first offered in 1999 using actual income and expenditure figures derived from household surveys (rather than share of GDP) covering about 90 percent of the world's population.[36] Focusing his attention on two years, 1988 and 1993, Milanovic found that the world Gini coefficient moved from 62.5 in 1988 to 66.0 in 1993, showing that global inequality had swelled. As he says, "This is a very fast increase, faster than the increase experienced by the US and the UK in the decade of the 1980s."[37] He then goes on to make a rather forthright judgment: "World income inequality is very high. . . . One can conjecture that such a high inequality is sustainable precisely because the world is not unified, and rich people do not mingle, meet or even know about the existence of the poor (other than in a most abstract way)."[38]

To recap the first three big questions addressed in this section: (1) I remain agnostic as to whether monetary or nonmonetary information provides the better measure of poverty, (2) the jury has not rendered a verdict on whether global poverty is up or down, and (3) the data are equally inconclusive on whether global inequality is widening or narrowing. And I have another ringer to throw into these debates in the pages to come.

Fourth question: Is economic growth good for the poor of the world? There are at least three ways this question can be approached. I dispense with the first two and focus on the third.

To begin with, little empirical evidence exists showing that economic growth takes income out of the hands of the poor. This can, however, happen in particular situations. Earlier I wrote about rural dwellers in Indonesia being forced off their land to make way for huge palm oil plantations owned by Suharto and his cronies. Assuming that these plantations are more efficient than the subsistence farming that they replace, exports go up, growth is enhanced, and the farmers are out of luck. Same thing happens in Brazil when rain forests are cleared, tropical woods are exported, and Amazonian tribes are displaced. In other words, some poor can be made worse off by activities that contribute to growth. But generally speaking, the economic condition of growth cannot often be said to cause widening poverty.

Again, if the poor are not worse off, are they somewhat better off, with a little more income available? In more countries than not, the answer to this is yes. Growth creates more wage earners, an economic multiplier effect, more money circulating among the poor. I have no quarrel with a conclusion that growth is better for the poor than no growth.

Finally, and this is the question that has engaged many development specialists in recent years, does growth carry the poor along at the same pace as the rest of their society? Fifty years ago, Simon Kuznets said no. His studies drew upon a long time series of data available for the United Kingdom, Germany, and the United States and led to formulation of his famous Kuznets hypothesis. He found that as these three countries moved from agrarian to industrialized societies, inequality worsened. Manufacturing was more productive, factory wages were higher than farm wages, fortunes were made more quickly, income disparities widened. Then, as more and more people moved from agrarian to industrial and service activities, the diffusion of high wages through the economy tended to level out the disparities earlier created, making those disparities decline as good incomes became more extensively distributed. Thus, according to his theory, industrialization widened income gaps at first and corrected these gaps later. Good theory, but most cognoscenti now think it's wrong.

While the Kuznets hypothesis earlier sustained many scholars believing that global growth created global separation, David Dollar and Aart Kraay, World Bank economists, later argued a different view, that "growth is good for the poor."[39] Building on the work of others, they compiled a sample of almost a thousand observations spread across 137 countries covering some 50 years. Their basic conclusion: "Average incomes of the poorest fifth of

society rise proportionately with average incomes."[40] They further reported that "in our large sample of countries and years, there is no apparent tendency for growth to be biased against low-income households at early stages of development."[41]

As with all other studies of inequality, the conclusions of Dollar and Kraay are primarily dependent on the accuracy of data on income shares. In household surveys, the poor have little reason to overstate their income or consumption, while the rich, fearing social pressure or the tax man, have ample reason to understate their income or consumption. Several studies have suggested that underreporting of consumption by the rich may be large, and nonreporting of income earned on assets, as opposed to salaries, may be huge. This would be consistent with my observations globally and with much of what is covered in Part I of this book. More on this in the next few pages.

Economic growth certainly has the capacity to benefit the poor proportionately. Whether or not it does in fact is not yet a settled issue.

Fifth question: Is globalization, in this case meaning free trade and free capital movement, good for the poor? The whole of Part I, Illegality, talks about how trade and capital movements are very badly abused. So the answer to this question must also be qualified. Openness to trade and capital movements can be beneficial to the poor. But often such openness leads to cross-border flows of corrupt, criminal, and commercial dirty money, which take resources straight out of the poor's hands, driving the lower rungs of societies, people like Mary, to their knees.

In the 1960s and 1970s trade liberalization in East Asian countries appears to have bolstered the poor and reduced inequality, lending credulity to the idea that free trade is unambiguously good. The data from more recent studies are not quite so clear. In many liberalizing East Asian, Latin American, and African countries, inequality has now turned upward. This has led to a reexamination of the issue, breaking the components of trade down into separate parts.

Resource exports and manufacturing exports produce two different pictures. Petro-states such as Algeria, Angola, and Venezuela have demonstrated worsening inequality in recent years, as corruption and instability favor governing elites. Anarchy, such as in the Congo, a major mineral exporter, has made some very evil people very rich. William Easterly, author of *The Elusive Quest for Growth*, speculates that "trade at low levels of openness in-

volves natural resources associated with inequality, so more trade in these goods raises inequality."[42] An earlier study in 2001 supports this view, finding that "The type of exports appears to matter, as primary export countries, of which most are developing ones, are associated with an increase in inequality . . ."[43]

The picture seems to be different with manufactured goods. Easterly suggests that "at higher levels of openness, trade may involve more labor-intensive manufactures and traded goods, so at higher levels, trade lowers inequality."[44] Garment manufacturing is an example of this, providing employment to low and moderately skilled wage earners (leaving aside the question of whether wages and employment conditions are fair). An interesting globalization index is offered by A.T. Kearney and *Foreign Policy* magazine, measuring economic integration, personal exchanges, technology, and global political integration. The 2003 index found that "technology transfers reduce inequality."[45] Thus, the early stages of manufacturing and export may, according to these works, be a moderating influence on income disparities.

International financial deregulation has a more problematic impact. It can bring money in and take money out with amazing speed, both what belongs to citizens and to foreigners. When the money goes out of a country in a banking crisis, such as has been experienced in Mexico, Thailand, Russia, Argentina, and elsewhere, it usually leaves the poor holding the bag, worsening income distribution, as even the World Bank admits.

The potentially beneficial forces of globalization and its corollaries, free trade and financial liberalization, work well in the presence of the rule of law, political integration, institutional stability, and domestic accord. Absent these, the process can instead have a negative impact on growth and cohesion. What globalization must not be is a license to plunder, disrupt, and further weaken already fragile states.

Sixth and last question: Is there a linkage between poverty and terrorism? The answer is yes, not because there is a direct link, but because there is an intervening link that connects the two: global crime. Terrorists resort to crime—drug smuggling, counterfeiting, arms trading, piracy, fraud, and more—to finance their activities. These activities bring them into close working relationships with criminal groups all over the world: in Pakistan, Indonesia, Russia, Eastern Europe, Iraq, Gaza, Liberia, Congo, Colombia, and elsewhere. Crime flourishes in weak states, those that have millions in

poverty, often accompanied with vast inequality. Poverty fosters crime, and crime is in business with terrorism. Terrorism feeds off crime and poverty. It is the middle link in this chain—crime—that unites poverty and terrorism, a linkage that needs to be well understood.

THE MONKEY WRENCH

Before beginning to write this Part II on inequality, I handed over a knee-high stack of studies and reports I had been accumulating for years to my associate, Jennifer Nordin, and asked her to absorb them fully and further analyze some particular aspects of the measurement of global poverty and inequality. Jennifer is exceptionally bright, well informed, holds a master's degree in foreign service from Georgetown University, has an undergraduate degree in mathematics and, before and after graduate school, packed 10 years of work experience in finance and consulting into her career. She added more studies and papers to the pile, digging into the assignment. Producing a lengthy memo, she concluded with the following paragraph, which I offer with her permission and in her words:

> These researchers are attacking just the first step in the problem of global poverty: getting a firm grasp on its scale and trend. A problem that can be identified and measured is a step closer to being solved. These authors do not present themselves as anything other than economists measuring an economic problem. They do not venture further (in most cases) into the realm of policy prescription. Having said that, the measurements do matter, because they are used to formulate government policy and allocate resources. That there is no agreement among the experts on the scope and trend of global poverty is disheartening, because all of that brainpower fails to help those who need it most.

What is to be made of all the conflicting opinions about global poverty and inequality? In a survey of surveys published between 1997 and 2002, covering various time periods from 1960 to 1999, Giovanni Cornia at the University of Florence totaled up the results of various studies and found that 31 studies showed inequality up, 4 showed it stable, and 8 showed it down.[46] Thus, the preponderance of survey opinion is that inequality within

countries, between countries, and globally is up. But the issue remains hotly contested and uncertain.

Where does this leave us? As of this writing, and I suspect for many years to come, the following questions have not been answered:

- How many poor people are there in the world?
- How should we measure their poverty?
- How big is the gap between rich and poor?
- How should we measure the gap?
- Is the gap, however measured, widening or narrowing?

Now for the truly complicating factor, which I've been saving to this point. Permit me a moment of reminiscence. Back in my youth when I worked in the oil fields of northern Louisiana and southern Arkansas, one of the larger tools I used was a four-foot-long monkey wrench. That's about the size of what I'm now throwing into the middle of the raging controversies about poverty and inequality. Warring statisticians should be prepared to duck.

All the data on inequality and most of the data on poverty are incomplete and wrong. None of the data take into account the hidden transfer of money out of poorer countries into richer countries. None of the data reflect abusive transfer pricing in related-party transactions and mispricing in unrelated-party transactions. Money laundering escapes most of the data. Smuggling proceeds escape most of the data. And, if Part I on illegality conveys anything, it is that these are very large and very damaging sums of money, hundreds of billions of dollars a year, accumulating to trillions of dollars shifted out of developing and transitional economies, unseen and unrecorded.

To be specific, the following national accounts are wrong: imports, exports, capital outflows, capital inflows, and GDP. And because they are wrong, the inequality and poverty measures drawing upon these accounts are wrong. Let's take them one at a time.

Imports

When imports are falsely priced for the purpose of shifting capital out of a country, nothing in national accounts picks up the fact that the trade figure

is wrong and capital is disappearing. The common pattern is that imports are overpriced, as explained earlier, and the result is that a deposit has been created abroad and there is no record of it locally. That Venezuelan I wrote about earlier paid $1.2 million for his machine. Venezuela's import statistics show he paid $1.2 million for the machine, but $200,000 went into his private bank account overseas. That $200,000 went out of his company account, he got richer, and there is $200,000 less wealth in the country and $200,000 less to pay his workers. He's the only person in Venezuela who knows all this. His accumulation of wealth is unseen in any Venezuelan national accounts.

Exports

Same story. When Russians sell oil for $10 a metric ton, as I wrote about earlier, their country's national accounts show $10 a metric ton. They do not show what should be the price—$120 a metric ton. As far as the accounts reveal, the price was $10 a ton. The fact that the exporters put $110 a ton into their European bank accounts is not reflected in any Russian statistics. The country is out $110 times the thousands of tons exported, the company is out the fair value for its production, the workers don't get fair wages, and the government doesn't get its fair taxes.

Capital Outflows

What appears to be trade, that is, the overpriced costs of imports or the underpriced revenues from exports, is instead, in part, capital flows. Nowhere do national accounts pick up the fact that capital has flowed abroad, out of the country, unavailable within the country for deposit or investment. (Don't forget, as I pointed out earlier, this same result can be accomplished in some cases by underpricing imports and overpricing exports.)

Capital Inflows

Let's switch to the other side of the fake trade transaction, the country into which the money is coming. Its national accounts are wrong. What appears to be an export or import and is recorded as such in trade accounts instead has a component of capital that should properly be recorded as an incoming

capital transfer. Hundreds of billions of dollars come into the United States, European, and other recipient countries in the guise of trade but are actually illegal capital transfers out of other countries. For these recipient countries, their national accounts are wrong.

GDP

Now you might ask, which is the proper measure of gross domestic product? Should it be the value of what is produced or should it be what the production actually earned? GDP measures the money, not what the money should have been. As far as Venezuelan or Russian national accounts are concerned, that overpriced machine or underpriced oil cheats GDP, invisibly shifting the real production value offshore. When diamonds and minerals are smuggled out of the Congo, the value of those smuggled goods doesn't appear in GDP. When drugs are smuggled out of Colombia and paid for abroad, a small part of their production costs may get reflected in GDP, but not the whole value of the secret transaction. Mispricing, falsified transfer pricing, smuggling, corruption, and most forms of money laundering shift money out of developing and transitional economies, contributing hugely to poverty within these economies.

These holes in national accounts affect measurements of inequality in two ways. First, the hundreds of billions in disguised funds going abroad annually into the accounts of the rich are unrecorded and rarely picked up in local economic data. Second, the earnings on the trillions of dollars that have accumulated abroad, out of poorer countries, are unrecorded and again not picked up in local economic data. The rich get richer and no one knows it. That is the principal motivation behind dirty money as I explained earlier, and it works very nicely to the supposed advantage of the rich and the real disadvantage of the poor.

I have estimated that about $1 trillion of dirty money crosses borders annually, of which $500 billion of illegal, disguised proceeds comes out of developing and transitional economies. Not every dollar of this escapes being recorded in national accounts. For example, proceeds stolen locally that are taken to a local bank and wire transferred into an offshore tax haven are picked up in GDP. The question arises, how much of the $500 billion escapes being recorded locally and therefore remains outside GDP? By far the

majority. I estimate it at a minimum of 80 percent, or about $400 billion. That's the first part of the hidden proceeds accruing to the rich.

The second part is earnings on assets already taken abroad over a period of years and unrecorded in a country's national accounts. Earlier I estimated this external accumulation at perhaps $5 trillion. Assuming a modest rate of return of four percent on these assets, that's another $200 billion earned off-shore annually and unseen locally. The sum of the two is an estimated $600 billion annually received by the richest in the poorest countries, lodged far away, out of sight of GDP in the home countries. Taking conservatively estimated hidden income into account, the global GDP accruing to the top quintile, illustrated in Figure 5.2 at 67.6 percent and 87.5 percent depending on the measurement, grows to rounded figures of 70 to 90 percent.

The comparison of the illegal money of the poor countries' rich to the total money of the poor is staggering. The bottom quintile of the world has total earnings at exchange rates of about $230 billion per year. (Exchange rates are the preferable base of comparison in this instance.) Thus, the rich people in poor countries receive out of their countries nearly three times the total money that the poor receive inside their countries. Think of that! The illegal money alone that flows annually out of poorer countries is a multiple of the total money available to the world's bottom fifth. And it doesn't really matter if better calculations in the future put rich people's dirty money taken abroad at only double the money available to the bottom fifth, or even merely equal to the money available to the bottom fifth. A capitalist system with as much or more dirty money moving offshore illegally to the rich as the total amount of money available domestically to the poor is in deep trouble.

The rich in developing and transitional economies are far richer than they appear to be from available data. They are concealing wealth from their own countries' national accounts by illicitly transferring major portions into tax havens, secrecy jurisdictions, and western deposits. Researchers who assert that inequality is declining because the poor are prospering have missed what's happening at the other end of the scale. Starting in the 1960s and accelerating in the 1970s, 1980s and 1990s, the rich have steadily taken advantage of the package of mechanisms available for shielding wealth and hiding income. What seems in some studies to be declining inequality may simply be poor accounting. The gap appears to be narrowing because, in part, the full income of the rich is understated. Until estimates of the unrecorded income of the rich are included in inequality studies, the notion

that inequality is narrowing is unconvincing, and the notion that the poor grow at the same pace as the rich is likewise unconvincing. It may be true but not because of the analyses thus far presented. Hopefully, future inequality studies will strongly qualify any conclusions drawn from recognizably incomplete data.

Capitalism's Achilles heel, in this second part of the three-part continuum, is best understood as, not the one or two percent of global income received by the bottom 20 percent, but the 70 to 90 percent of global income received by the top 20 percent. This is the situation that must change decisively and in a time period shorter than centuries.

Amartya Sen is most articulate on these issues. He speaks of ". . . the general process of globalization, from which there is no escape and no great reason to seek escape." "What is needed is a fairer distribution of the fruits of globalization. The central issue is inequality. The principal challenge relates to inequality—between as well as within nations. The basic concerns relate to the massive levels of inequality and poverty—not whether they are also increasing at the margin."[47]

CHAPTER 6

"I DON'T UNDERSTAND" AND "DON'T TELL ANYONE"

A FEW YEARS ago I made an appointment to see the head of the Africa division of the World Bank, who at the last minute was unable to attend the meeting and sent his deputy and two assistants. I talked for about 15 minutes on the disappearance from Africa of hundreds of billions of dollars in illegal flight capital, through both commercial transactions and government corruption. I spoke a bit about the private work I've done coming to grips with the nature and scope of such financial flows. I also related at length how, across 24 African countries and several decades of work and travel, I'd watched living standards decline for hundreds of millions of people on the continent. I called the drainage of dirty money, as I do in this book, the most damaging economic condition hurting the poor.

When I finished my remarks, the deputy division head said: "I don't understand the linkage between flight capital and poverty."

I didn't twitch a muscle. I patiently explained it again: When money illegally vanishes from poor countries, it hurts the poor in those countries. He still didn't get it, leaving me completely dumbfounded. At the time I thought, no, it's not possible; no professional can fail to comprehend that billions in illicit transfers out of a country harm the poorer people in those countries. Not possible that he doesn't grasp the point. And yet, since then, I've heard the same thing perhaps a half dozen times.

I ask for your patience and indulgence for a moment, so I can get something off my chest. I have no comprehension how any official with years of

development experience can fail to recognize immediately, even if never having thought of it earlier, the linkage between dirty money and global poverty. Perhaps it's because our accumulated experiences are different. I've read a thousand or more income statements and balance sheets in my career—total money in, total money out, what's left over. To put it simply, revenues minus expenses equals net gain or loss. It seems that many people, particularly in the World Bank, are focused on money entering poorer countries, primarily loans and grants, and are naïve about money exiting poorer countries, at least the illegal component. They are oblivious to the net effect of the two on the bottom line—poverty alleviation and economic growth in developing and transitional economies. When it comes to the linkage between foreign aid inflows and dirty money outflows and residual net effects, I'm baffled as to how so many professionals don't get it.

MYTHS

The World Bank collects leading minds from around the globe to focus on poverty and development. Yet, for years I have watched World Bank and other advisors make alarming mistakes based on fundamental misunderstandings. A number of myths have become conventional wisdom. For poorer countries, the consequences of such delusions are enormous.

Myth 1

One of the most common mistakes has to do with "errors and omissions," which is a catchall, residual figure in national accounts, used as a balancing entry when numbers don't add up. Most experts I've talked to about this believe that illegal flight capital passing out of a country shows up within errors and omissions. And because these figures are usually fairly small in most nations' accounts, flight capital must be small and therefore unimportant.

Not long ago I had a lengthy and quite testy argument with a Harvard-educated Ph.D. who was vice president and on his way to the presidency of the Brazilian central bank, in the capital Brasilia, one of my favorite architectural environs on the planet. I talked about the impact of falsified trade pricing. He maintained that when trade is mispriced, that mispriced amount

shows up in Brazil's errors and omissions account. Because these numbers are always minor, Brazil has no problem with over- and underinvoicing.

Now, this was about the hundredth time I'd had this conversation somewhere in the world. "Here's the commercial invoice for this imported machine—$1,200,000. It's the only piece of paper seen by your ports officials, customs authorities, clearing agents, banks, and government statisticians and by the local company accountants. Look at this piece of paper and tell me how much of the $1,200,000 is the real cost of the machine and how much is the overloaded capital transfer that's going to be secretly deposited abroad."

Rousing himself, he confidently mocks, "Well, you see, there's an offsetting, balancing, adjusting, reconciling, correcting, it shows up . . ."

"No, sorry, there's no offsetting, balancing, adjusting, reconciling, correcting, it doesn't show up . . ."

We go at it hard for 10 minutes until the light finally dawns; the intentional mispricing doesn't appear anywhere, and there's no way to determine how much it is short of costly investigations that reach back to the trading partner in the other country. The fact is, in every mispriced transaction, trade flows and capital flows are mixed. And whether it's one falsified commercial invoice or the accumulated mispricing on a million falsified invoices, the same thing is true. This mixture of trade costs and capital transfers makes all those national accounts I wrote about in the last chapter wrong. The United States and Europe may think that the error isn't terribly important to them. For poorer countries, the error is hugely important. In large measure it explains how trillions of dollars have disappeared abroad with hardly anyone taking notice. Over the years, the practice of mispricing in arms-length transactions and exaggerated transfer pricing in related-party transactions has moved more money out of weaker nations—unseen—than any other mechanism. The errors and omissions account doesn't show it.[1]

Myth 2

Another piece of conventional wisdom almost universally accepted by World Bankers is that illegal overseas deposits, however they are done, are merely rational reactions on the part of well-heeled citizens who fear that their hard-earned savings will be taxed, blocked, or confiscated. Not correct. But to grasp what is correct, we must delve into motivations. This dirty-

money business is a subject area in which underlying intent is much more important than apparent intent. My research in some 30 countries has led to a different understanding of the matter.

The primary motivation for cross-border dirty-money flows is getting rich secretly. Another principal motivation is avoiding pressures for distributions locally. Both are much more important than concerns about taxes or loss of control or value.

Most developing and transitional economies have poor mechanisms for collecting taxes anyway, and those mechanisms that do exist are diverted fairly easily with well-placed bribes to tax collectors. In other words, avoiding taxes within the country is not very difficult, so avoiding taxes by taking money out of the country doesn't fully explain the phenomenon.

Furthermore, if tax evasion is all that a person wants to accomplish, money can come straight into the United States and Europe and elsewhere, which for the most part remain wide open to the inflow of tax-evading funds. The structure of dummy corporations, shell banks, flee clauses, foundations, secrecy jurisdictions, and more would not be necessary if mere tax evasion was the object of the endeavor.

The most telling evidence that tax evasion is not the first aim of the dirty-money exercise is that illicit proceeds continue to stream abroad even after a country has regularized and moderated its tax regime and opened its capital account. Take Argentina as an example, discussed earlier in the Dirty-Money User Manual. Argentina dollarized its economy in 1991, making it legal for anyone to take pesos to a local bank and convert them to dollars, no taxes on the exchange, no questions asked. Many experts were certain this would benefit the economy, including eliminating illicit capital flight. It certainly should eradicate trade mispricing, right? Why would anyone do something illegally (falsify trade in order to convert pesos to dollars) when they can do the same thing legally (take those pesos to the bank to get dollars)? Well, in fact, for a very good reason. Because doing it illicitly through falsifying trade transactions means that the money can be accumulated abroad without anyone in Argentina knowing about it. Hence, even after Argentina dollarized its economy, illicit proceeds continued to flow abroad, unrecorded. As I've been made aware many times in my research, getting rich secretly is the first motivation of the dirty-money business, and this motivation remains even after the incentives for tax evasion cease to be an issue.

This is a key point. The overriding intent for illegally moving money out of poorer countries is the hidden accumulation of wealth. And the West has welcomed and serviced this intent for a century.

Myth 3

Related to this is another myth, the idea that it doesn't make any difference whether rich people hoard their money abroad or in-country; it still isn't available to the poor. This is most certainly not correct. Trying to hold on to large sums of ill-gotten gains inside one's country fails the secrecy test, which requires disguising how those funds were accumulated in the first place. Furthermore, large sums become known and pressures mount from shareholders, managers, employees, unions, wives, mistresses, children, brothers, sisters, nephews, nieces, aunts, uncles, cousins, in-laws, churches, synagogues, mosques, charities, and complete strangers to distribute the wealth to those less successful at the art of rapacity. And, most importantly, it makes a huge difference to the local economy whether money is kept in-country or out-of-country. Abroad and unrecorded domestically, it has little value to the local economy. At home and recorded domestically, it's likely to be in a bank deposit that can provide funds for loans, or it's in stocks or bonds or in real estate, or it's simply spent, producing a multiplier effect through the economy as the money circulates among businesses and individuals. More on this later.

Talking about these issues with me, Galal Amin, the distinguished economist at American University in Cairo, said, "Consumption in poor countries often has a cap, and above that cap rich people take their consumption abroad."[2] He's right; large savings, and especially those illegally accumulated, want to exit from developing or transitional economies. And western businesses and banks are indeed most generous and accommodating in providing the means for their departure.

Myth 4

The legal and illegal components of transfers abroad cannot be distinguished. On the contrary, the two types of flight capital have a very clear difference. The legal component stays on the records of the corporation or proprietorship or individual making the transfer. If a business chooses to

buy U.S. Treasury notes or make a real estate investment in Europe or set up a factory on another continent and does so with a transfer through the banking system and properly documents that transfer in local journal entries and receives statements and reports on that investment, that's legal and open and recognized and shows up properly in national accounts. Illegal transfers are structured to disappear and remain unrecorded in local accounts, and return statements or reports are usually not allowed, except perhaps occasionally by telephone or e-mail. In short, the legal component stays on the local books, and the illegal component disappears from the local books. And there are plenty of ways to maintain the legal flows while substantially curtailing the illegal flows, as will be covered in Chapter 12.

Myth 5

When a struggling state gets its affairs right, ill-gotten gains that have been spirited furtively away will return. Not so. By far the greater portion, probably upward of 80 to 90 percent, is outplaced "permanently, permanently!" in the words of a banker in Africa. Small amounts occasionally come back, for example, to Poland because it's the darling of ex-communist states, to Russia because it takes a little working capital coming in to keep flight capital going out, to Egypt to settle local debts, to Kenya in years past to buy government bonds paying high interest rates, and periodically to Nigeria to buy votes in free and fair elections.

Illegal money taken abroad that does turn around and come back into a country almost always returns as foreign direct investment (FDI). In other words, the money sent abroad acquires a foreign nationality as a company or partnership or investment fund. If it comes back, it does so identified with that nationality as a foreign investment, intending to go abroad again in future years as interest or principal on loans or as dividends on share capital. I have asked central bank governors in many countries if they regard this sort of FDI as the return of citizens' flight capital. The answer is always no; it's FDI just like any other FDI. Citizens almost never want to admit that they earlier took that money abroad illegally. They don't bring it back in their own names. The little that comes back does so as foreign investment, often with the source disguised in a tax haven or secrecy jurisdiction.

Mexico is sometimes an exception to the general rule. A small percentage of illicitly transferred proceeds comes back as investment funds belonging to

Mexican citizens in their own names. Mexico is also the only developing country that has a border with a major industrialized democratic state, and it's not surprising that the porosity of this long border lends itself to back and forth movements of people and money. China has a good bit of illicit wealth transferred abroad returning as FDI, perhaps as much as a third or a half of its annual investment inflows.

A Swiss banker was honest when he said to me that there has been "no evident leveling off" of his private bank holdings for citizens in poorer countries.[3] A central banker in Turkey confirmed that her country's citizens "are not liquidating their foreign principal and bringing it home."[4] Of the trillions of dollars transferred illegally from developing and transitional economies into foreign coffers, by far the greater part of this is permanently shifted into western economies, never to return to the countries of origin.

"DON'T TELL ANYONE"

Western countries prefer to deal with poverty in other lands through the instrument of foreign aid. Unfortunately, over the years, ideas about what constitutes effective assistance to developing and transitional economies have had a very checkered history. Guiding principles have a shelf life of only a decade or so and then are replaced.

In the late 1940s and through much of the 1950s, most developing countries were viewed as materials exporters, either agricultural produce or rubber or coffee or oil or other primary products. In the late 1950s and through the 1960s, as more than 50 nations gained their independence, import substitution was thought to be the first order of industrialization, producing locally what had previously been imported. In Nigeria alone I saw hundreds of plants set up to manufacture pots and pans, textiles, garments, bicycles, motorcycles, plastics, soft drinks, beer, mattresses, nails, pipes, tires, you name it. These infant industries were protected behind tariff barriers on competing imported products, and often such barriers allowed local pricing to be high, facilitating over-invoiced raw materials and component parts coming in and illicit transfers going out. At the same time, the World Bank focused on infrastructure projects—roads, dams, irrigation systems—as its major contribution toward helping countries achieve "takeoff," consistent with the five stages of economic development offered by W.W. Rostow in 1960.[5]

Robert McNamara, during his presidency of the World Bank from 1968 to 1981, expanded the institution into program lending, emphasizing a basic human needs strategy stressing education, health, and agriculture. Under his tenure, bank lending expanded from $1 billion to $12 billion a year, and the staff grew to more than 5,000. Still, economic takeoff in Latin America, Africa, much of the Middle East, and parts of Asia remained elusive.

The Third World debt crisis of the 1980s brought about another change in policy. As prices for primary products dropped and interest rates on foreign borrowings soared, poor countries could no longer pay their debts. The World Bank and the IMF responded with "structural adjustment programs," demands for austerity to justify new lending to service old debts. The mantra for strapped governments was cut budgets, cut subsidies, cut inflation, devalue currencies, raise interest rates, retrench until you recover. These tight-fisted policies contributed to a decade of no growth in Latin America and severe economic decline in Africa.

Structural adjustment segued into the Washington Consensus, which emphasized additional themes of deregulation, privatization, free trade, financial liberalization, tax reform, and more fiscal prudence. The name itself implied a dictated message to poorer countries, and its institutional sponsors eventually adopted Poverty Reduction Strategy Papers as the new title for the same set of prescriptions.

While not actually dropping the Washington Consensus formula, the more recent thrust of the World Bank is toward institution building, ownership, and participation by the leaders of borrowing countries. This means property rights, contract law, effective judicial systems, good governance practices, and anticorruption programs.

The point of this very brief tour of development theory and practice is that many countries have now been brought full circle. Africa is, in terms of growth prescriptions, right back where it started in the 1950s and 1960s, seen as an exporter of minerals, resources, and produce and an importer of light manufactured goods, which were in earlier years produced locally. I asked a senior World Bank official recently what, given current Washington policies, can ever move Africa beyond the stage of serving as a supplier of primary goods. He had no answer. Apparently, the World Bank lacks an end game for the poorest countries that will lift them any time soon out of their dilemma: selling the yields of their lands cheap and buying the products of our factories dear. Many Latin American and Middle Eastern countries are

similarly affected. Even Russia and the newly independent "stans" along the southern border have reverted to dependence on oil and mineral exports. In other words, a trillion dollars of foreign aid and four decades of shifting hypotheses have produced precious little for poorer countries, many of which are today no better off than they were many years ago.

Why? Some people consider foreign aid an abject failure, others see it as an underachieving effort, and a few point to South Korea or Taiwan or Chile as examples of success. But, by comparison, if the Marshall Plan merits an A+, 50 years of development assistance merits a D or lower. Why indeed?

Economic aid from western countries usually runs about $50 billion annually and has been rising a bit in recent years.[6] I spent Part I talking about dirty money and its damaging effects, and I estimated amounts emerging from poorer countries at $500 billion a year. Think of the comparison: $50 billion aid in, $500 billion dirty money out. For every $1 of foreign aid generously handed across the top of the table, we take back some $10 in dirty money under the table. It is impossible to produce success with this equation.

Criminal, corrupt, and commercial dirty money transferred out of developing and transitional economies is the biggest loophole in the global free-market system and the most damaging economic condition hurting the poor. It is also the most important factor militating against success in western aid efforts. There is no way to make the formula of $1 of official money in and $10 of dirty money out work for anyone—the rich or the poor countries.

The only other candidate for the world title of Most Damaging Economic Condition Hurting the Poor is hyperinflation that runs several hundred or even several thousand percent a year and obliterates purchasing power and the meager savings of the poor. But hyperinflation is usually a short-term occurrence, perhaps a few years or in the case of some countries such as Brazil a bit longer. The phenomenon of hyperinflation does not do nearly the long-term damage of massive illegal transfers, which, recall, have been going on decade after decade and are most frequently one-way shifts of wealth abroad. No; nothing approaches the harm done to poor countries by trillions of dollars transferred out to rich countries.[7]

When I discuss this issue with friends or acquaintances in the development community, they usually probe into my numbers. We ratchet through alternatives. They ask: Suppose the amount of dirty money illicitly pouring from poorer countries is only $400 billion a year. Okay, that's still the most damaging economic condition hurting the poor, and it's still a multiple of

foreign aid, and it's still not on your agenda. Suppose it's $300 billion a year. It's still the most damaging economic condition hurting the poor and still a multiple of foreign aid and still not on your agenda. How about $250 billion a year, the lowest figure that can reasonably be compiled? Sorry, still the most damaging economic condition hurting the poor and still a multiple of foreign aid and still not on your agenda. Five hundred billion dollars a year, as compiled earlier in Part I, is the best estimate I can produce. I think any more accurate number that includes everything moving illicitly—cross-border money-laundering, mispricing, abusive transfer pricing, the proceeds of drugs, human trafficking, racketeering in all its forms, counterfeiting, contraband, illegal arms trading, corruption, tax evasion, the whole gamut—is more likely to be above $500 billion than below. We usually end such conversations when I say to my friends, "Look, the ball is not in my court to prove my numbers. The ball is in your court to explain why you can't deal with the issue. It's not my estimate; it's your dereliction that's on the table."

Talking with the chief economist of one of the principal aid organizations in Washington, D.C., I put forward my assessment that there is much more money coming illegally out of poorer countries into western deposits than foreign aid going into these countries. I asked him if he agreed. His answer: "Yes, but don't tell anyone."

CORRUPTION—AT LONG LAST!

In the late 1980s and early 1990s, Peter Eigen was the World Bank's senior representative in East Africa, based in Nairobi. His wife, a medical doctor who often worked in hospitals and clinics, regularly berated him about the widespread corruption in government, which translated into inadequate health facilities for the poor. Eigen concluded that "the World Bank was deluding itself." While imposing various forms of conditionality on loans, it refused to adopt an anticorruption policy. As he related to me, he asked Barber Conable, former U.S. Congressman and then World Bank president, to put corruption on the Bank's agenda. No luck. He then asked Conable if he could work on the problem on his own time. Conable said no again and backed it up with a memo from the Bank's legal department saying that corruption was a political issue, and the institution's charter prevented it from delving into such matters.

Conable was succeeded by Louis Preston, who had many years of experience with J.P. Morgan, the New York bank. His appointment seemed to please everyone but me, because I feared, correctly, that he would keep the world safe for dirty money as long as he was president.

Eigen put his anticorruption proposals to Preston and got nowhere. The Bank's general counsel Ibrahim Shihata was the strongest opponent to placing any additional strictures on loans to borrowing countries. Frustrated, Eigen left the Bank and formed Transparency International in 1993, headquartered in Berlin.

According to Eigen, in 1994, six senior Bank officials, all vice presidents and department heads, initiated a dialogue with Preston aimed at getting an anticorruption program in place. After various exchanges, Preston, supported again by his legal department arguing that anything approaching this subject put the Bank at "legal risk," wrote a memo to the six rebelling officers that was "stunningly offensive" and "most deeply insulting," suggesting that the Bank was in bad shape because of just such nonsense being proposed. Several of the officers soon resigned in disgust, after long careers.

Preston passed away in 1995 and was succeeded by James Wolfensohn. Eigen organized a one-day seminar by Transparency International for Wolfensohn, presenting the case for an anticorruption program and specific steps the Bank could take: competitive bidding procedures, procurement guidelines, blacklisting bribe payers, and more. Wolfensohn agreed, while the legal department continued to disagree and to criticize TI at every opportunity. Ultimately, Wolfensohn had to cram an anticorruption effort onto the agenda of his extremely reluctant institution. The legal department's many objections slowly and embarrassingly melted away. However, even today, with a revolving door between the World Bank and leading commercial and investment banks, fighting corruption is shunned by many professionals who prefer to keep open the career option of private sector employment.

Transparency International is active in more than 90 countries and has influenced the OECD, the EU, and the U.S. Congress to take up the global struggle against corruption. Eigen receives no salary and gives any speaking honoraria back to his organization. His commitment to and impact on this issue have been outstanding.

The World Bank's anticorruption efforts got off on the wrong foot. At first, the Bank offered assistance to any interested countries, but the line of

volunteers proved to be amazingly short. Then the view emerged from the Bank that "you don't fight corruption by fighting corruption," meaning that you fight it by strengthening the economies of poor countries so that incentives for corruption dissipate. This served to bring Bank officials back into their comfort zone—economic development.

There are two things wrong with this position. First, a country's level of corruption is not correlated with poverty. Julius Nyerere's Tanzania in the 1960s and 1970s was dirt poor, but it was not correspondingly corrupt. There was some bribery and intimidation at the rural levels, but he ran a clean central government. Admired by Robert McNamara and hordes of Scandinavian aid officials, Nyerere's socialist economic policies were a disaster but not because he and his ministers were robbing the treasury. Poverty and corruption were not in league during his presidency.

Contrast this with Saudi Arabia, garishly rich and without doubt one of the most corrupt countries in the world. It's a kingdom, and the only time corruption is frowned upon is when the level is so egregious as to offend the king. Other than this, most anything goes. A banker friend of mine catering to the overseas interests of Saudi civil servants told me that, on average, high-level bureaucratic officials have between $10 million and $30 million in external assets, accumulated primarily through kickbacks and payoffs from foreigners. Of course, no self-respecting minister at the very highest appointed level would think of having anything less than $50 or $100 million for starters.

Corruption is not an inevitable product of poverty. It is rooted in the weak rule of law. Good legislation and effective judiciaries in poor countries curtail corruption. Bad legislation and ineffective judiciaries in rich countries promote corruption.

The second flaw in the World Bank's understanding of this issue is the notion often heard that corruption has to be fought from the bottom up. Pay the military and police more, and they won't subject citizens to shakedowns. Raise civil service pay, and demands for bribes will decline. Not correct. As long as top government officials are thought to be corrupt, nothing done at lower levels will effectively curtail corruption. The more nuanced view is that the fight against this scourge has to be balanced, addressing all levels of society simultaneously. This sounds quite reasonable and is again incorrect. As long as the top is corrupt or seen to be corrupt, the so-called balanced approach won't work either.

Fighting corruption is a top-down exercise and must be if it is to succeed. Heads of state and government and senior officials have to be clean and held accountable before anticorruption efforts can take hold at lower levels.

For the World Bank, fighting corruption starts at home, in its own projects. A senior Bank auditor said to me several years ago that most loan officers thought that about 15 percent of their disbursements were lost to corruption. His own estimate, combining what is stolen and what is wasted, was 50 percent. Only half the Bank's money in his experience does what it's supposed to do.[8]

Matters have improved since 2000. Some 100 countries have lined up for corruption assessments and suggestions on fighting the problem. Perhaps only a few are serious about the effort. For its part, the Bank has published an "ineligible list" of some 300 companies and individuals, most based in developing countries, removed from bidding on construction and supplies, resulting from violation of World Bank guidelines.[9] Western country representatives at the Bank reportedly work feverishly to keep their companies off the list.

The World Bank, to its credit, is finally attacking the problem. But by now official corruption globally has a head start of several decades and will be just that much more difficult to curtail.

The Bank's slow, guarded approach to corruption hardly augers well for attacking the much more damaging issue I am addressing: the flow of hundreds of billions of dollars of dirty money permanently out of poorer countries. This is the problem the Bank cannot bring itself to acknowledge.

FILLING WESTERN COFFERS: MUM'S THE WORD

For the World Bank and also the IMF, discussion of illicit cross-border transfers is addressed almost exclusively to developing and transitional countries and occasionally offshore financial centers but virtually never to western banks and corporations. The United States and Europe, principal owners and controllers of the Bank and the Fund, get a bye on any responsibility for dirty money.

The IMF's official chronology, for the first time since its founding in 1944, mentioned the words "money laundering" in 2002. A year earlier, in an extraordinarily cautious policy paper jointly prepared by Bank and Fund

staffs, it was noted that the two institutions could "increase their participation in the global fight against financial abuse and money laundering" by "recognizing" FATF standards, "publicizing" the need for strengthened measures, and "working" with others taking the lead on these issues.[10] "Principal contributions" stem from the promotion of "stronger financial, economic and legal systems in general."[11] Even a year after 9/11, some IMF economists continued to eschew any meaningful leadership on anti–money laundering and terrorist financing efforts: "[W]hile the main responsibility for these activities rests with governments, financial institutions, and citizens of individual countries, the IMF could play a facilitating role—focusing on the integrity and stability of the international financial system and working closely with the FATF, other standard setters, and the World Bank."[12]

In 2002 the Bank and Fund launched an "assessment" process, whereby they set up a collaborative framework to evaluate how countries were performing in efforts aimed at anti–money laundering and combating the financing of terrorism, called the AML/CFT program. Between the Bank, the Fund, and FATF and its affiliates, some 50 pilot studies were conducted in 2003, using measures of compliance with FATF's 40 + 8 recommendations, discussed in Chapter 4. Of course, the United States refused to be assessed.

The World Bank and the IMF, the two premiere global financial institutions, have declined to take a leading role on the cross-border dirty-money issue. A secondary role, yes, but out in front, no. Despite the damage done by international flows of dirty money—worsening poverty, advancing crime, facilitating terrorism, curtailing trade, limiting investment, generating massive tax evasion, upsetting banking systems, causing financial instability, promoting failing states, spawning conflict—these institutions will not point a finger at western complicity in the process. To do so would place their appointed directors and employed staffs at odds with western country governments and private sectors. As a former top World Bank (nonwestern) official said to me about illicit flows and flight capital: "The World Bank and IMF cannot touch such issues. They are the extension of national bureaucrats. They favor the status quo. They are not there to experiment. Anyone trying to do so will be stamped down. The Bank and the Fund are primarily concerned with their owners, that is, the wealthy countries."[13] He is an unusually committed and articulate individual, and I've heard the same disappointment expressed in many similar conversations over the past several years.

The World Bank in particular faces a problem—global dirty money—which negates its mission to succeed in the struggle against poverty. Whether it will find the courage to address the issue in the future is an open question.

DEBTOR'S PRISON

Dirty money going abroad has contributed to severe indebtedness for billions of people left behind. The total external debt owed by developing and transitional countries is $2.3 trillion! And this debt continues to mount.

The World Bank separates poor countries into four categories, as shown in Table 6.1. Severely indebted countries, 39 in number, encompass most of the population of Sub-Saharan Africa and some of Latin America, as well as two of the Central Asian "stans" and a few other states. These are countries where debt at present values is greater than 220 percent of exports and 80 percent of gross national income. Moderately indebted countries are supposedly much better off. For them, debt falls between 220 percent and 132 percent of earnings on exports. The debt of severely indebted and so-called moderately indebted countries combined is more than $1.5 trillion.

Hundreds of books and papers have been written about this debt. It's an enormously complex subject. However, in the next two sentences you will grasp 99 percent of what you need to know about this debt. First, 98 percent of what's important to understand is that it will never be repaid in full. Sec-

TABLE 6.1 DEBTS OF POOR COUNTRIES, 2002

Classification	*External Indebtedness (in US$ billions)*
Severely indebted	$ 898
Moderately indebted	$ 630
Less indebted	$ 732
Indebted but unclassified	$ 40
Total	$2,299

Source: World Development Indicators 2004.

ond, 1 percent of what's important to understand is that it will never even be serviced adequately with renegotiated principal and interest payments. The remaining 1 percent of what you need to know has to do with the woefully inadequate official efforts directed toward debt rollover and relief.

Debt rollover gathered steam in 1957 when a group of creditor countries met to renegotiate Argentina's bilateral obligations, that is, debt owed to the governments of the lending nations. This joint approach worked quite well, and the creditors dubbed themselves the Paris Club. Fast-forward a half century and you now find 373 rollover agreements with 78 countries, all very civilly discussed in the Paris Club's Secretariat General operating within the French Treasury.

Not to be outdone, private creditors, originally comprised mostly of western banks loaning money to governments or government-guaranteed borrowers, met and dubbed themselves the London Club. Starting with the Philippines in 1970, they, too, have corkscrewed their way through countless "agreements in principle," sometimes involving hundreds of creditors.

Debt rescheduling in its many forms has become a continuing aspect of economic management for both creditor and debtor countries. The plethora of plans and proposals in recent years include the following: Special Program of Assistance; Structural Adjustment Facility; Enhanced Structural Adjustment Facility; Rights Accumulation Program; Systemic Transformation Facility; swaps of debt for equity, commodities, nature, and environment; suggested programs bearing the names of Bailey, Bradley, Garcia, Kenen, Robinson, Rohatyn, and Schirano; as well as efforts encompassed in the Baker Plan and the Brady Plan, the promising Toronto Terms and Trinidad Terms, and some 10 or so less well-known schemes. The administrative effort involved on both sides in negotiating reschedulings and meeting and monitoring conditionalities is daunting. Developing country debt has become an arcane industry, and the poorest nations are this industry's most constant customers.

The World Bank and the IMF got into the act in the 1990s with the HIPC Initiative, offering debt relief to "heavily indebted poor countries." There are now 23 multilateral creditors involved in the program, including regional development banks and others. The HIPC negotiating process begins with a Debt Sustainability Analysis to determine if a country can hopefully continue contributing to its rolled-over debts forever or if it truly is a basket case and needs forgiveness. With adoption of enough reforms

dictated by the World Bank and IMF, a country can then reach a "decision point" at which a process of interim debt relief begins, leading to a "completion point" at which further relief is proffered. This convoluted process thus far has brought 27 countries to or past the decision point, qualifying them eventually to receive a combined total of about $50 billion in debt forgiveness. In other words, of the $1.5 trillion external debt presently owed by severely and moderately indebted countries, the proudest accomplishment of creditors under the HIPC Initiative extends to impoverished countries the eventual prospect of cancellation of barely three percent of their external obligations.

Over the past years, at the same time that western governments and banks were lending money to poorer countries, western bankers and businesspeople were helping corrupt government officials and private tax evaders take money out of these countries. A U.S. banker related to me an incident when his New York institution had two teams in a very heavily indebted Latin American country at the same time, one comprising private bankers seeking flight capital deposits and the other comprising debt collectors from the international department seeking repayments.

Let me drive this point home, in terms that will be especially appreciated by my friends in the World Presidents' Organization and the Young Presidents' Organization, two groups of CEOs from all over the globe.[14] You own or manage a good-sized company. You borrow a lot of money from a bank. Soon the bank's officers come quietly calling on your executives and managers offering personal financial management services. This includes advice on how to get money illegally out of the company and introductions to suppliers or customers who can facilitate these subterfuges, with the bank even offering to handle the paperwork between compromised employees and their co-conspirators. Cash begins to disappear from your company. This goes on for years, as your colleagues, their counterparts, and solicitous bankers cover their tracks. The bank is pressing you to pay your debts, but you can't because the money is gone. Then you discover why. The bank itself has been abetting theft from your company. Much of your firm's cash is now in private accounts belonging to your employees, deposited at the bank from which your company borrowed heavily in the first place.

Do I need to carry this analogy to its logical conclusion? Not for my tough-minded friends in WPO and YPO. It'll be a cold day in hell when those bankers ever try to collect their debt from you. They pulled the rug

out from under your ability to repay, and in so doing they lost the claim to their money, and you're going to make certain they understand this in very clear terms.

This analogy parallels what has happened in well over a hundred countries across the globe over the past 40 years. With one minor variation. As often as not, the head of the country was involved in the ripoff as well. Bankers and businesspeople can argue that they would never do this kind of thing in their own countries. But the rules stop at the border, and tens of thousands of them have done it in other lands. They may squirm uncomfortably with the bluntness of this comparison, but unfortunately it hits home because it's true.

Many bankers find it acceptable to subvert poor countries, while insisting that poor countries have to pay off or sustain their debts in order to be creditworthy in the future. The arrogance of this position is breathtaking. And with this, the issue of debt relief is at an impasse. Hanging like a Damocles sword over the negotiators is instant demise to anyone on either side who ventures into the minefield of past transgressions, money that has been intentionally moved out of poor countries into western banks. The fact is, the borrowers stole the money and the lenders helped them steal it and neither side can say so. In my judgment this is the ugliest chapter in international commerce since slavery.

Countries home to most of the world's population are in, quite literally, a debtor's prison. The World Bank, IMF, and the Paris and London clubs say dance to our tune and we'll relieve three, maybe four or five percent of your debt. The impoverished countries watch their citizens live and die in desperate straits, as they attempt to do Washington's bidding. This is no way to open the twenty-first century. Chapter 12 offers suggestions on how to break the deadlock.

WHAT IF?

Of the $500 billion a year in illicit proceeds that I estimate pass annually from developing and transitional economies into western accounts, suppose that reasonable steps can keep a good part of these funds in these poorer economies. What if the money stayed home legally rather than going abroad illegally? What could it do? What could it buy?

Consider, for example, an initial amount of $100 billion a year remaining in the poorer countries. It could stay in private hands or public hands or a combination of the two. If it remained in private hands it could:

- Be spent on consumption, contributing a multiplier effect through the economy as the same money gets respent.
- Be invested in shops, properties, and factories, employing millions and again producing a return on investment for these economies.
- Be deposited in banks, enabling a comparable amount of loans to be made.
- Be used to capitalize banks, where the money could be leveraged to approximately $1.25 trillion in loan funds under normal capital adequacy ratios.[15]

In a combination of private and public hands, what could be done with $100 billion annually? How about what is shown in Table 6.2 drawn from UN, World Bank, and other sources?

Some of these items are not necessarily a straight multiplication when scaled up to $200, $300, $400, or $500 billion or more annually, but the thrust of the point is clear. Leaving money in poorer countries does more good in these economies than any other step that can be taken, strengthening health, education, consumption, investment, growth, and in all likelihood democracy and stability.

Indeed, what if?

INTELLECTUAL GAP OR CHARACTER GAP?

Within days after arriving in Africa for the first time in 1961, I became aware that financial chicanery and abject poverty are somehow related. Fast-forward several decades. One World Bank official says to me, "I don't understand the linkage." Another aid official, well aware of the relationship, implores, "Don't tell anyone."

What is happening here? Is it a failure of analysis or a failure of courage? Or, worst of all worlds, is it a failure of both?

After announcing his resignation as chief economist at the World Bank,

TABLE 6.2 HOW TO SPEND $100 BILLION

Item	*Annual Expenditure (in US$ billions)*
Vaccinations and additional health services for 100 million children	$ 2.5
Training and retraining, basic medical supplies, support, and salaries for 1.5 million health care workers, per year	15.8
200,000 new hospital beds	9.0
Triple-drug therapy and testing for 10 million AIDS patients, per year	4.0
Universal family planning services, per year for 10 years	10.5
One million new classrooms	6.9
Training and annual salaries for one million new teachers	3.3
Sustainable agricultural programs for 800 million malnourished people, per year for 10 years	17.0
Clean water systems for 1.75 billion people, per year for 10 years	10.0
Self-help housing for one billion people, per year for 10 years	21.0
Total	**$100 billion**

Source: The annual expenditure estimates are drawn from several sources: the World Health Organization (hospital beds), UNICEF (childhood vaccinations and teacher training), the World Bank (classrooms and teacher salaries), the Clinton Foundation (negotiated rates for antiretroviral triple-drug therapy and AIDS tests in certain developing countries), and UNESCO (for all other items listed).

Joseph Stiglitz said that there is an "intellectual gap between what we know and what is still practiced."[16] The *New York Times* commented, "His premature departure . . . removes from Washington the most outspoken critic of the practices that the big industrial nations favor in their relations with the developing world."[17]

The World Bank of recent years is long on scholarship and short on results. And there are blinders on the scholarship. For many of its researchers, if it can't be seen, it doesn't exist. If dirty money does not show up in GDP or in international financial statistics, then it literally has little or no reality. Some work has been done on underground economic activity in a few countries, estimated at

times to amount to 35 to 80 percent of total economic activity. Yet the World Bank ignores the obvious conclusion that a significant part of this activity is spirited out of these economies and into foreign accounts. And you can forget about extending the study of dirty money into the vaults of financial institutions in New York, London, Paris, Frankfurt, and Geneva, where a good part of this money ends up.

What the World Bank has failed to see has badly damaged—some would say defeated—its efforts at poverty alleviation and economic development. Countervailing illegal financial flows dwarf and swamp aid flows. The World Bank, with the finest collection of growth analysts on the planet, has just plain missed it.

How is it possible for so many people passing through the World Bank for 50 years to pay attention to only a part of the development equation, the money that goes into needy countries, while ignoring a far larger part of the development equation, the money that illegally gushes out of these same countries? A focus only on the disbursing side of the development equation—foreign aid, finance, and credits—that is blind to reverse flows of illicit capital of far greater magnitude is distressingly deficient in meeting the enormous challenges of poverty and development.

The World Bank and other aid agencies have been casting about in the past few years for reasons why poverty alleviation efforts are not yielding anticipated results. The answer is in the stark reality of pervasive illegalities in which the West is both instigator and participant, and an inability on the part of Bank professionals to grasp this marks one of the larger intellectual failings of the post–World War II period.

Or is it a failure of courage? It seems that the World Bank can speak for the poor only so long as it avoids criticizing the rich. Dirty money exiting poor countries means deposits entering rich countries. While the World Bank tries to curtail poverty, western banking and business interests are often promoting poverty. Is silence on this issue the price for selling Bank debt instruments to the private sector? The Grand Bargain seems to be, we won't mention your solicitation and management of illicit money if you will continue to purchase our World Bank bonds and notes.

World Bank professionals are very often dealing with life and death issues for huge numbers of people. And most bring a fine sense of dedication to their tasks. But with such responsibilities and burdens, nothing should be left off the agenda. Yet illicit transfers take trillions of dollars from poorer

countries, shorten and damage the lives of billions of people, and can hardly be mentioned in research studies or policy pronouncements. What has foreign aid become, a cover story for western rapacity, a sop to our collective conscience?

For all its good intentions, the World Bank as an institution and its thousands of professionals need to understand something. Good intentions in the absence of courage are pointless.

What the World Bank has failed to see, what it cannot ask, and what it does not want to know largely accounts for its underachievement. And "underachievement" is a very charitable word. For the West, the net effect of pumping out foreign aid and sucking in dirty money has been harmful to the global poor. It may be very comforting to think that poverty and inequality are the fault or misfortune of the poor, and salvation for them comes from the advice and benevolence of the rich. It is certainly discomforting to think that part of their poverty, their misfortune, stems directly from us—our actions and our silence. The global poor deserve better.

In its present thinking, the World Bank appears to have reached an analytical cul-de-sac. In the next chapter I fling down the gauntlet that the Bank has to pick up if it is to contribute to moving the issues of poverty and inequality—and itself as an institution—forward.

CHAPTER 7

IT'S THE 70 TO 90 PERCENT THAT MATTERS

THROUGHOUT THIS Part II on inequality, I have been drawing attention to the concentration of global income—70 to 90 percent—in the hands of the top 20 percent of the world's population. As we open the twenty-first century, no feature so threatens capitalism as this one. Billions of people in poor countries have little or no stake in the system we think is right for the world. Millions of people in rich countries are breaking or skirting laws of their own or other nations, unconcerned about who and what may be harmed in the process. Market fundamentalists want the rich to get richer and the poor to figure out the system, as they struggle to reach and pass incomes of $1 and $2 a day. This formula whereby the rich shoot far ahead and the poor ploddingly learn the tricks has the potential to be disastrous. Capitalism, both in the way it is practiced and in the outcomes it produces, faces its biggest challenge.

IT CAN'T LAST

We got through the twentieth century with immense and growing income imbalances. Can't we get through the twenty-first century in the same way? No, for four good reasons.

1. The global chasm between rich and poor quintiles of 31 to 1 as shown in the purchasing power parity chart of Figure 5.2 far exceeds

the disparities currently prevailing in all the major developed countries. By comparison, disparities within richer nations are shown in Table 7.1.

No rich nation is anywhere close to a 31 to 1 gap. The reasons for much lower disparity ratios are economic, social, and political and beyond the scope of this book. But at a gut level, a 31 to 1 ratio in a rich country would be insufferable, and should the gap ever rise toward such numbers the hue and cry would be deafening. Taxes would be raised on the upper class, and increased education, medical coverage, support payments, and tax relief would—hopefully—be directed to the disadvantaged.

Table 7.1 Gap between Top and Bottom Quintiles

Japan	3.4
Finland	3.8
Norway	3.9
Sweden	4.0
Denmark	4.3
Germany	4.3
Belgium	4.5
Spain	5.4
Netherlands	5.5
France	5.6
Canada	5.8
Switzerland	5.8
Italy	6.5
United Kingdom	7.2
Portugal	7.9
United States	8.5

Source: Calculated from income share data from *World Development Indicators 2004*.

Now translate the unacceptability of massive disparities in rich nations onto our shrinking sphere. Successful globalization is dependent on narrowing global divisions. Thomas Friedman, the outstanding *New York Times* columnist, often asks the question, "What happens when everyone knows how everyone else lives?" Driven by satellites, television sets, and cell phones, that awakening is rapidly approaching. As the world grows inescapably closer and more interdependent, what today is intolerable in any one rich country will tomorrow be intolerable in a closely linked planet. The existing global gap and the future globalized world are incompatible. Several billion living in squalor juxtaposed with one billion living in splendor is simply unsustainable. The 31 to 1 disparity has to diminish, and the pace of diminution needs to exceed the pace of globalization, and there is little indication that this is happening at the present time.

2. Richer people have a vested interest in increasing the purchasing power of poorer people, so that modern goods and services devised in industrialized nations can find broader markets. The best analogy is Henry Ford in the United States. Ford understood more than a hundred years ago that if he was going to sell more cars, workers had to be able to buy them. He soon doubled the wages he paid to $5 a day, stabilized his work force, and maximized their efficiency with assembly lines. His success and influence encouraged rising pay across the United States, hastened the enlargement of the middle class, and thus helped propel western progress, especially in the second half of the twentieth century.

Another Henry Ford or several Henry Fords are needed to propagate similar goals and encourage rising incomes across the globe in the twenty-first century. This is certainly not the situation that currently prevails. Instead, western firms chase the lowest wage employees around the world, to Mexico until they get too pricey, then to China until they get too pricey, and then finally corporations farm out production processes to subcontractors who can get away with low wages and poor working conditions, for which western firms buying the subcontractors' production take little or no responsibility. Capitalists need to figure how to be long range in their global thinking. Instead of paying $2 for that toy or garment, how about paying

$5 and stabilizing the work force, just like Henry Ford did? Then those workers can afford to buy a cell phone and soon a computer and some day even a car.

3. With a near quadrupling of our global population in a single century, western countries have slowly begun to appreciate that the health of the planet and its people is intertwined across regions and ethnicities. The environment has become one of the most talked about issues of recent times, rising from little awareness four decades ago to widespread concern today. While greenhouse gasses, global warming, and nuclear disposal are still vigorously debated in the West, many poorer countries barely have such problems on their agendas. Four-fifths of the world's population lives inside the borders of developing and transitional economies, and they increasingly dump waste and pollutants on land, into the sea, and into the air and have few resources to do otherwise. Why worry about deforestation tomorrow when you need firewood today? Rich and poor countries together have stakes in the global environment, and poverty and inequality among the poorer 80 percent thwart dealing effectively with the problem.

The HIV/AIDS crisis has been a devastating lesson. It arose in the poorest continent, Africa, and from there spread everywhere. As of this writing, we are up to an estimated 20 million dead and 40 million infected. The biggest concentrations of the disease are in poorer areas—Africa, China, and India. With lower levels of poverty and inequality, by how much could the infection and death rates have been reduced?

Then there is a looming issue that can further separate rich from poor. Actually, it's here already: the ability of the rich to manipulate genetic inheritance, at costs that are at this time unaffordable by the poor.

Already some 1,200 genetic diseases can be detected in eight-cell zygotes, in a procedure called preimplantation genetic diagnosis. One cell is removed, and normally only a single test is conducted. A family with a history of a particular disorder can assure that the disorder is not passed on to the next generation. Commonly tested conditions are spina bifida, cystic fibrosis, hemophilia A, sickle cell

anemia, anencephaly, Down syndrome, Duchenne's muscular dystrophy, polycystic kidney disease, and many more. Genetic tests also can be conducted post-implantation.

Richer countries currently examine most newborns for genetic disorders that are likely to require immediate treatment. Thereafter, infants, children, and adults can all be genetically tested to predict a disposition for a particular disease, to confirm a diagnosis, to make a prognosis of how a patient is likely to respond to a treatment regimen, and to detect a disease indicator in a "carrier" before that person has a child. This is not some future fantasy; this is available now, if you can afford it.

The poor cannot afford it. The World Health Organization takes a lofty position on the issue: "Genetic services should be available to all without regard to ability to pay and should be provided first to those whose needs are the greatest."[1] Well, you can forget that; genetic services will be provided to those who can pay the bills.

Long ago we became comfortable with the fact that most rich countries have healthier populations and longer life expectancies than most poor countries. But heritability differs from health by an order of magnitude. The prospect that rich people will be able to afford the best genes that money can buy and poor people will be left to carry the continuing burden of genetic disorder is deeply disturbing. An income underclass that becomes a genetic underclass rips the fabric of global society.

A tangential issue far removed from capitalism? On the contrary, genetics could pose a key test: Can the capitalist system contribute to equal genetic opportunity for all, regardless of what happens thereafter? In the short run gene testing, intervention, and correction are likely to be available only to the rich. Optimistically, these procedures may become available in the long run, like inoculations, to the poor across the globe. The transition period when genetic disparity is likely to be linked to income disparity is extremely troubling.

4. Severe inequality and poverty have a tendency to coalesce in a sense of humiliation and alienation. Since 9/11 there is a growing perception that such detachment lies close to the heart of a propensity for terrorism. Poverty is linked to crime, and crime is linked to terror-

> ism. Inequality is linked to alienation, and alienation is linked to terrorism. A capitalist system that inadequately addresses poverty and inequality is at risk. Poverty concerns are not just for aid workers. Inequality concerns are not just for economists. Security concerns are not just for soldiers. Capitalism must learn to lessen the gap between rich and poor out of informed self-interest, recognizing that the safety and progress of the most fortunate nations are intimately tied to the engagement and well-being of the rest of the world.

Seventy to 90 percent of global income accruing to the richest 20 percent; a 31 to 1 ratio between top and bottom global quintiles; these realities cannot last through the twenty-first century. The resulting strains—economic, social, political, security, even genetic—would be unbearable. In my view, the only question on the table is, do the rich sit passively and let moderation hopefully evolve, or do we take more proactive steps to ameliorate poverty and narrow disparity?

CONVERGENCE?

We can choose to do little or nothing more than we are doing now. We can disburse a bit of additional foreign aid and push more free trade and then rely on convergence as has occurred between North America and Europe to bring up the rest of the world's poor and ease global unevenness. For capitalists, the idea of natural convergence is seductive, suggesting that economic forces are immutable, and we can relax and watch Adam Smith's magic at work. But if we are going to depend on this, the idea and its potential for success need to be clearly understood.

The convergence hypothesis is that, over time, income variations across regions will by natural events decline or possibly disappear. The past 50 years have produced competing schools of growth proponents who model the world with regression analyses inputting capital, labor, education, trade, savings, technology, quality of government, rule of law, and more. The most bullish envision absolute convergence, where developing countries raise per capita GDP faster than mature manufacturing nations and move toward income equivalence. Others foresee conditional convergence where nations with favorable social and political conditions can eventually close economic

gaps. Still others predict club convergence into two or more clusters, as a few well-endowed countries make the transition to a higher station and a great many more countries settle into long-term secondary positions.

Before getting into convergence, a word about growth theory will be useful. John Maynard Keynes and Roy Harrod, both British, and Evsey Domar in the United States made important early contributions to growth studies before mid-twentieth century. Robert Solow, a U.S. economist at the Massachusetts Institute of Technology, presented in 1956 an analysis of how growth is affected by different levels of physical capital and labor. Solow went on to show that increases in capital and labor were not sufficient to explain economic growth and that the unexplained portion—the "Solow residual" as it came to be called—had to be technological progress and innovation. Solow received a Nobel Prize for this work in 1987.

The question then arose: What brings about technological progress and innovation? This led to New Growth Theory in the 1980s, spurred by Paul Romer and Robert Lucas, the latter receiving a Nobel in 1995. Romer identified education and workplace training as key contributors to raising the level of productivity. Others have added national policies such as subsidies for research and development to the equation. Still others have gone on to focus on quality of government, corruption, and rule of law. Lucas has insisted for years that growth theory must be able to model the "main features of the world economy [including] very wide diversity in income levels across countries," if it is to be coherent.[2]

New Growth Theory (NGT) is applied primarily to the economic leaders and to newly industrializing countries moving up the technology ladder, such as the Asian tigers. It's much more difficult to figure out how to apply NGT to the poorest countries, especially those that are essentially resource exporters. Given continuing uncertainties, even Solow wrote in 2000, ". . . it is hard to see where growth theory is going."[3] Nevertheless, the great contribution of New Growth Theory is that it has expanded into many elements—economic, institutional, social, and cultural—in trying to figure out how nations prosper.

Now back to convergence theory, which makes use of growth models to predict whether and how countries will balance out their differences. In essence, convergence suggests that poorer countries will grow faster than richer countries, because returns to physical capital will diminish in richer

countries and increase in poorer countries. For example, returns to the textile and garment industries will diminish in the United States, returns to these industries will increase in China, production will shift from the United States to China, and China will grow faster than the United States—all of which is, in fact, happening. In a Brookings Institution paper, Jeffrey Sachs, Andrew Warner, and others put it as follows: "The power of trade to promote economic convergence is perhaps the most venerable tenet of classical and neoclassical economics, dating back to Adam Smith. As Smith's followers have stressed for generations, trade promotes growth through myriad channels: increased specialization, efficient resource allocation according to comparative advantage, diffusion of international knowledge through trade, and heightened domestic competition as a result of international competition."[4]

The proof that convergence works is seen in a tendency to balance incomes in various parts of the United States, in Japanese prefectures, in the regions of Spain, across the European Union, and in the North Atlantic area broadly. Given open economies and reasonably similar social values, productivity levels and thus income levels draw closer together. A World Bank paper concludes that ". . . [for] rich western economies that are well integrated, in a cultural sense, so that technological transfers (via books, private exchange of information, personal and business travel, etc.) do take place, . . . [then] convergence may be simply a reflection of that deeper integration. Transmission of information is what may drive modernization of the techniques of production, total factor productivity growth and ultimately income convergence."[5]

Sachs et al extend their argument for possible convergence to the whole world: "We suggest that the most parsimonious reading of the evidence is that convergence can be achieved by *all* countries, even those with low initial levels of skills, as long as they are open and integrated in the world economy."[6]

For other scholars, the proof that absolute convergence does not work is seen across much of the rest of the globe. Divergence characterized the second half of the twentieth century, with many countries slipping further behind the global leaders. From the old expression, "You can't make a silk purse out of a sow's ear," the term "sow's ear effect" has been introduced into the economic lexicon, pithily summarizing how some countries just cannot get their act together.

Divergence, past and future, seems to be grounded in a number of factors:

- Many countries failed to benefit much from the Industrial Revolution. Whether the digital revolution can be grafted onto such societies is uncertain, possibly leaving the poorest countries steadily losing ground.
- Income inequality in many countries is extreme and discourages investment.
- Social institutions and cultural conditions in some countries are not particularly conducive to rapid productivity gains.
- Biotechnology and genetic engineering, progressing in richer countries, may have a very difficult time moving into other regions of the world.
- Population growth in this century will be concentrated almost entirely in poorer countries.
- The forces of globalization and the imposition of structural adjustment have already, as noted earlier, deindustrialized many countries, and how they can renew industrialization is uncertain.
- External debt worsens income divergence, and the $2.3 trillion overhang for developing and transitional economies retards growth.
- The HIV/AIDS crisis hits poorer countries hardest, debilitating and killing millions, shattering family units, and absorbing health care resources.

In short, I find it very difficult to argue with the conclusion reached by Lant Pritchett at Harvard: "Well, forget convergence—the overwhelming feature of modern economic history is a massive divergence in per capita incomes between rich and poor countries, a gap which is continuing to grow today. Moreover, unless the future is different in important ways from the recent past, we can expect this gap to grow ever wider."[7]

Absolute convergence is not in the cards for the foreseeable future. Divergence is the pattern for many countries in relatively stagnant positions or falling further behind. Given these realities, researchers have offered two main variations on the convergence theme—"conditional" and "club."

Conditional convergence means, in essence, that convergence between countries can occur if a whole host of conditions are similar, as measured by indices of, for example, democracy, rule of law, government spending, life expectancy, fertility rate, and school attendance.[8] In other words, for two countries with widely separated income levels but broadly similar social and political conditions, economic convergence can be an outcome.

Club convergence looks at countries that have substantially different per capita incomes, investment, productivity, and social conditions. A three-tier set of convergence clubs offers an example of this hypothesis. David Mayer-Foulkes, a mathematician and professor of economics in Mexico City, analyzes countries according to income levels and life expectancies, the latter serving as a proxy for broader gauges of human development. A "semi-stagnant" group exhibits both low incomes and low life expectancies. Much of Sub-Saharan Africa falls in this category. A "semi-developed" group has low incomes but rising life expectancies, suggesting that income improvements have a social base on which to build. A "developed" group has crossed both frontiers of high income and high life expectancy. Much of the North Atlantic area, Japan, and the other more successful Asian economies are in this group.

Club convergence suggests that, across any reasonable time span encompassing the next several generations, (1) already rich nations will draw closer in income and development, (2) relatively low-income countries improving their social and political institutions may achieve accelerated growth rates, and (3) the poorest countries, already saddled with weak institutions, massive debts, and populations living at $1 and $2 a day, will have a long, tough time cracking into the ranks of the prosperous. These three clubs might correspond roughly to the richest postindustrial societies, middle-income manufacturers, and poor primary producers.

To put it simply, hoped-for convergence is a siren call to inaction that should be resisted. With 200 years of extreme divergence under our belts, only the most optimistic or naïve can think that, ah, now we have the right economic policies available to everyone across the planet, and soon those other countries will pull themselves up to our exalted levels.

This presents capitalism with what may be the most difficult prospect of all—long-term disparity. Or, to be more correct, global instability arising from severe separation. Lagging groups that cannot reach leading nations are unlikely to accept permanent subordination. How second- or third-class status

for billions of people plays out over generations to come may determine the fate of the system we confidently believe holds all the answers.

My final point on convergence is this: None of the analyses take into account illicit proceeds that today pass so easily out of poor countries into rich countries. How do you achieve convergence, how do you even realistically imagine that convergence is a possibility, when a significant percentage of the resources of developing and transitional economies are leaving those economies, impoverishing people in those economies, arriving into western economies, and enriching people in those economies? How does capitalism encourage convergence with this as a key component of its modus operandi?

Convergence scholars are doing some of the most interesting macroeconomic work today. Let me close this section with a note to them: Leave $500 billion a year in the poorer countries, compound the effect for decades, and show us the results of your calculations. This is where convergence theory has a shot at becoming reality.

THE GAP MATTERS

"Poverty matters." "The gap doesn't matter." I've heard these comments repeatedly from businesspeople, scholars, World Bankers, and aid officials. And I disagree. It's a shallow argument. The sheer enormity of global income concentrated in the hands of the rich matters a great deal. It is threatening to capitalism, and it is an issue that is virtually off the table. Yes, the rich are concerned about severe poverty and provide aid to the most indigent and offer advice to their governments. But, no, the concentration of income—70 to 90 percent accruing to the top 20 percent—for most people has nothing to do with anything.

When it is said that the gap between rich and poor doesn't matter, the tacit message is that how the gap is generated and sustained doesn't matter. If the gap doesn't matter, then the rich can wash their hands of responsibility for inequality. What's the point of feeling obligated for something that doesn't matter anyway? Now, holding the idea that the gap doesn't matter, walk with me into my world. We find that the financial games played with a wink and a smile among the global elite are simply business as usual. If we send and receive illicit proceeds out of poorer countries—"So what?" We're

not wasting the money. We're not throwing it away. We're making it safe and secure and earning a decent return. Only wealth accumulation and preservation matter. If the gap doesn't matter, what worsens the gap doesn't matter either. That's simply not the business of capitalism. Other people have to deal with those kinds of issues. Helping global corporations and rich people shift their money by illegal means doesn't matter. They've already made it. Where they keep it is for them to know.

What I'm implying here is that part of the reason the gap does matter is because so many people think it doesn't matter and then take actions based on that notion. I've stood in front of business and banking groups talking about the movement of illicit proceeds out of developing and transitional economies. You'd be surprised how many people think that there are no economic consequences whatsoever to such actions. If the gap doesn't matter, then income and wealth derived at the expense of the poor doesn't matter. There's only one minor question: Is it legal? Or, more bluntly, can it be accomplished without getting caught? But consequences to others? That's not of concern.

It's not only the business and banking communities. Many people in the aid community believe that poverty can be conquered without addressing inequality. Again, I disagree. Focusing only on global poverty prejudices the way we deal with global poverty. With eyes locked on the bottom of Figure 5.2, Global GPD and Global Quintile Income Disparity, you miss what's at the top—70 to 90 percent of global income. And you miss how a lot of that money got to the top. Your concern is not the rich; it's the poor. You send aid to the poor, but what the rich do is largely off your radar screen. And what the rich in poor countries do in league with the rich in rich countries is completely off your radar screen. You're dependent on rich people in rich countries giving you money to distribute to what you hope are poor people in poor countries. You're not about to bite the hand that feeds you. Shenanigans between the rich over there and the rich here are not noticed. You've got your eyes on the poor, on aid going into poor countries. Millions of dollars in administrative costs are spent in order to send billions of dollars of loans and grants to the poor. You don't notice the hundreds of billions of dollars that come the other way, out of those poor countries. Those flows worsen inequality in poor countries, but you're not into inequality, you're into poverty.

Let me repeat: The World Bank has never put the whole of the development equation or the whole of the poverty alleviation equation on the table for analysis and discussion and eventual incorporation into its programs. To do so, it must get into the question of severe inequality and what generates and maintains severe inequality. Dirty money is a large part of this question, and the World Bank has a hard time looking rich countries in the eye and saying, This has to stop. Better to have a weak program of poverty relief than an honest program that speaks for the poor in the full range of their needs.

Nancy Birdsall, a development economist across the street from me in Washington, wrote a fine piece on "Why Inequality Matters."[9] What is distressing is that when it was published in a small journal in 2001, it made arguments that many people had never considered. Inequality can inhibit growth and prolong poverty reduction. It can undermine the political process, as wealthy groups hold the levers of power. And in culturally divided societies it can lead to a self-justifying tolerance for economic imbalance.

Poverty is treated by looking only at the poor. Inequality requires us to look at both rich and poor, in other words, to take a comprehensive view of the whole of our global society and the relations among all its parts.

I do not believe that global poverty can be sharply curtailed while at the same time ignoring global inequality. Or, to put it differently, by downgrading inequality, we delay poverty reduction by generations.

The fact that the gap does matter is part of the reason why all rich countries have much lower income disparities than the global average of 31 to 1. Reducing poverty means reducing inequality to levels that do not threaten social cohesion. These levels may differ from country to country, but for the rich they seem to be in a band roughly between 4 to 1 and 10 to 1. Certainly not 31 to 1.

When the aid community says the gap doesn't matter, as I've heard many times, it forestalls the alleviation of poverty. When the business and banking communities say the gap doesn't matter, it justifies illegalities. Both groups have become accustomed to thinking that the gap doesn't matter, and that's a major reason why it does matter—because thinking that it doesn't matter produces behaviors and consequences in rich and poor countries that work against global progress and stability.

Looking at the 70 to 90 percent concentration of income among the

top 20 percent should lead those of us in rich countries to two conclusions. First, we should alter our own laws and practices that have an adverse impact on the poor, facing up to those we choose to ignore that deprive wherewithal to the lowest reaches of humankind. And second, we should take forthright steps to lessen the gap for our own long-term advantage, recognizing that our well-being is intimately tied to the well-being of the whole of this sphere and its people. Reframing the issue reshapes the agenda. These points are brought home to the reader in Chapters 12 and 13.

CHALLENGE

Dirty money kills people. How many? Since the 1950s and 1960s when development assistance became an important issue on the global agenda, how many people have died as a result of our failure to deal with dirty money flowing out of developing and transitional economies and into western coffers? Or, to put the question differently, how many lives could have been saved if we had put the issue on the table 40, 30, 20, or even 10 years ago? How many lives will be saved in the next 10, 20, 30, or 40 years by curtailing the flow of dirty money out of poorer countries? What measure of responsibility for unnecessary deprivation and death rests with those unwilling to ask the hard questions?

Many professionals at the World Bank sense that something serious is going on in this business of illicit cross-border transfers, even without detailed Bank studies exploring the issue. Many researchers feel that something is missing in their analyses. And it is a failure to ask the right questions that marks the World Bank's most glaring shortcoming as an institution.

It's not only the Bank's dereliction; it's a weakness among the western countries to which dirty money flows. Within the cause-and-effect relationship between dirty money and global poverty and inequality lurks potentially acute embarrassment for the United States and Europe. We in the West are not willing to ask the questions because we are apathetic on the one hand and afraid of the answers on the other hand.

Apathy and fear are inadequate reasons for failing to address a hugely important issue that damages the lives of billions of people. I am flinging down the gauntlet to the World Bank.

Memorandum
To: The World Bank
From: Capitalism's Achilles Heel
Subject: Challenge: Illicit Outflows from Developing and Transitional Economies

Drawing upon your own extensive resources and those available from the International Monetary Fund, United Nations, World Trade Organization, Organisation of Economic Cooperation and Development, Bank for International Settlements, and European Union, and the central banks and finance ministries of the OECD countries, undertake a thorough research study to answer the following questions:

- What is the estimated total amount of criminal, corrupt, and commercial dirty money, in all its various forms, including tax-evading money, coming illicitly out of developing and transitional economies?
- How is it generated, and how does it flow?
- Where does it go?
- What effect do these estimated illicit outflows have on developing and transitional economies?
- What effect do these estimated illicit outflows have on foreign aid programs of donor nations?

The challenge calls for thoroughly developed estimates; I know better than anyone else that definitive numbers are impossible to find. I have no problem with the Bank coming up with a different figure from my own of $500 billion a year. I do have a problem with the Bank coming up with no figure, or an inadequately researched figure, or a figure limited narrowly to drug and terrorist money. I forewarn that, if honestly compiled, the Bank's number is likely to be above my estimate.

On this issue of illicit outflows from poorer countries, silence is a killer, and from the World Bank the silence is deafening. Frankly, the Bank is letting the poor down. Addressing this subject requires the Bank to place the alleviation of poverty and inequality above its predisposition to avoid self-criticism and to avoid confronting its rich patrons. The World Bank has a responsibility to the billions living severely deprived existences, like Mary on

her knees, to raise the profile of this issue to the highest level and to press it upon the global agenda. It has a responsibility to exert leadership with the richer nations on this reality that undermines its success.

The World Bank has the potential to be the most important institution to human development in the twenty-first century. It is a potential that can be realized only when the Bank deals with the whole of the financial equation affecting human development.

Capitalists themselves have a crucial role to play. Capitalism's future depends on alleviating poverty and curtailing inequality. I said at the beginning of Part II that the staggering imbalance in income distribution is the one reality that can collapse the system. Accordingly, everything that logically contributes to curtailing such disparity must be on the table. And getting the issue of global inequality, what causes and worsens inequality, and how to lessen inequality squarely on the global agenda is a capitalist investment that can pay very rich dividends.

PART III

DISUTILITY: BENTHAM KOs SMITH

[M]ake sacrifice of a portion of the happiness of a few to the greater happiness of the rest.[1]

—Jeremy Bentham, 1789

The economic theory of public policy is relentlessly utilitarian.[2]

—Frank Hahn, 1982

"WE'RE GOING to build our nation on the backs of one or two generations of farmers."

This is the minister of industries speaking in an African country, which in this instance will remain unnamed. The time frame is the 1970s, and she and I are in a raging argument.

"We're going to buy their produce at cheap prices and sell it abroad at big profits. Then we'll take that money and invest it in our cities, our industries, and in infrastructure to propel our economic growth. The farmers will get little. We refuse to remain just a poor agricultural society. We're going to become a modern nation!"

"No," I insist heatedly, "you're sowing the seeds of unrest. You can't make part of the population into a lagging sector, exploited for the benefit of the urban class. There has to be balanced growth, with all segments of the society progressing together."

She had been educated in the United Kingdom, was well traveled in

Europe and the United States, and was drawing upon her observations of the western world. For her, to "make sacrifice of a portion of the happiness of a few to the greater happiness of the rest," as prescribed by Jeremy Bentham, was sensible and consistent with policies advocated in other capitals.

I pressed on. "The idea of deliberately mandating that some people will be kept behind while others are pushed forward is poor planning and fraught with risk. You build development, build community, build nationhood out of shared commitment, not disproportionate sacrifice."

To no avail. She and her like-minded ministers and then successive governments pursued their biased and flawed programs for growth and prosperity. And today their country is one of the poorest, most corrupt, severely divided, continuously violent, and politically shakiest on Earth, one of the many countries that have adopted unproductive formulas and gone backwards over the past quarter century.

Enormous inequalities blithely accepted, even promoted, cannot exist in an intellectual vacuum. Rampant illegalities regularly perpetrated by businesspeople and bankers cannot exist in an intellectual vacuum. Both must be dependent on justifications that have settled into the substructure of capitalism itself. I do not think it is possible to have millions of people around the globe indulging in fraudulent transactions, oblivious to economic consequences, without some process of validation affording comfort to these activities and their outcomes. Something is saying to practitioners in the free-market system all over the world, in rich and poor countries alike, that this is okay, this is reality, this is the way the process works, this widely condoned interplay of illegality and inequality.

How did our prevailing norms and values get to this point? Quite simply, by badly perverting Adam Smith and conveniently embracing Jeremy Bentham, which will illustrate the third position on the path imperiling capitalism.

Reaching into the philosophical underpinnings of the free-market system is a vital part of the story presented in this book. It is key—perhaps the most important key—to understanding capitalism's corrupting continuum. Recall, this is a book about linkages among fundamentals. The linkages between illegality and inequality do not present the whole picture. To try to get to the larger picture, we have to ask why. Why do we find tolerable a world in which 70 to 90 percent of global income accrues to 20 percent of the population? Why are we largely indifferent to legal structures that sus-

tain unlawful dealings and worsen inequalities? How do we narrow the yawning gap in consciousness that has opened between the wealthy western world and the billions around the globe living on the edge of degradation? These are the kinds of questions I contemplated while sitting on the patio of my home peering across Five Cowrie Creek at those two embassies, American and Soviet, trying to make sense out of competing systems, neither of which was working at acceptable levels of advantage for most of humankind. And to move toward answering such questions we have to delve into what Adam Smith originally had in mind for political economy and how central components of his vision got set aside by Jeremy Bentham in favor of rationalizations that are soul-satisfying to the elite.

"Disutility," in the title of Part III, is a proper though little-used word in the English language. It means "the quality of causing inconvenience or harm or distress." And as I hope will become clear, it is the correct word to use in talking about the way we have perverted capitalism's basic philosophical tenets.

CHAPTER 8

THE ANGUISH OF ADAM SMITH

WE ARE lucky to have Adam Smith with us at all. He was born on an uncertain date in 1723 in the town of Kirkcaldy on the Firth of Forth in Scotland, his father having died six months earlier. Smith's first biographer, Dugald Stewart, recounts the following incident:

> An accident which happened to him when he was about three years old, is of too interesting a nature to be omitted in the account of so valuable a life. He had been carried by his mother to Strathenry, on a visit to his uncle Mr. Douglas, and was one day amusing himself alone at the door of the house, when he was stolen by a party of that set of vagrants who are known in Scotland by the name of tinkers. Luckily he was soon missed by his uncle, who hearing that some vagrants had passed, pursued them, with what assistance he could find, till he overtook them in Leslie wood; and was the happy instrument of preserving to the world a genius.[1]

Following his early education he went to the University of Glasgow in 1737 and then in 1740 to the already 500-year-old Balliol college at Oxford. Philosophy, history, mathematics, literature, and languages all "opened a boundless field to his curiosity and ambition; and while it afforded scope to all the various powers of his versatile and comprehensive genius, gratified his ruling passion, of contributing to the happiness and the improvement of society."[2]

After seven years at Oxford, Smith returned to Scotland to a life of

study and lecture, taking up in 1751 the Chair of Logic at the University of Glasgow at age 28 and the next year the Chair of Moral Philosophy. In 1759 he published his remarkable book, *The Theory of Moral Sentiments* and solidified his position as an enormously popular teacher and respected philosopher. Lecture notes taken by his students continued to turn up for years, as late as 1958.

In 1763 Smith resigned his professorship in order to accept a lucrative assignment accompanying Henry Scott, the young Duke of Buccleuch, on a two-and-a-half-year tour of Europe, a position that paid him £500 annually during these years and the same amount as a pension thereafter. Returning in 1766, he devoted 10 years to completing his outstanding treatise entitled *An Inquiry into the Nature and Causes of the Wealth of Nations*, published in 1776, fortuitously coincident with the American Declaration of Independence, making this a pivotal date in world history.

THEORY OF MORAL SENTIMENTS

At age 36 Adam Smith offered his contribution to the fervent explorations of many philosophers of the Enlightenment period who were seeking a basis for morality in analysis of alternative ethical systems rather than in religion. Upon what do our concepts of right and wrong, approval and disapproval, rest? Theology was seen as an unsatisfactory source. This left human judgment as the remaining locus, and two broad schools of thought were actively pursued. One school sought structures for morality in notions of general or personal well-being and gravitated toward identification with Utilitarianism, as is addressed in the next chapter. The other school sought structures that were intuitively appropriate regardless of time and place, and they became grouped around a Moral Sense doctrine of ethics. Smith was influenced by his teacher Francis Hutcheson at the University of Glasgow, a leading figure in the Moral Sense school who believed that morality can be inwardly divined. But Smith found this not altogether satisfying, and he instead fixed the essence of his theory to the interactions that take place continuously between people. Thus he constructed his program mainly around the principal of personal sympathy operating within its larger social fabric.

The foundation of Smith's philosophy rests on his view that man is "fitted by nature" to subsist "only in society," that is, in the company of others.[3] All members of humanity's ranks "stand in need of each other's assistance."[4] Through interlocking obligations afforded out of love, gratitude, friendship, and esteem, "society flourishes and is happy."[5]

Smith lays out plainly his view of the core characteristic of sympathy in human affairs in the first sentence of *Moral Sentiments*: "How selfish soever man may be supposed, there are evidently some principles in his nature which interest him in the fortune of others and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it."[6]

With the word "selfish," Smith acknowledges the self-centered school of thought but immediately separates his ethical system from the offerings of Thomas Hobbes, Bernard Mandeville, and others. With "principles in his nature," he suggests that, just as an appreciation of harmony in music and beauty in earth, sea, and sky is innate, so, too, is sympathy inherent in human capacities. With his emphasis on "others," Smith sets his theory in a context of social engagements. And with "their happiness" and the observer's "pleasure of seeing it," he points to the interplay, the exchange, of emotions that stands at the center of his project.

"Sympathy" in Smith's use of the word means "fellow-feeling," including compassion and sharing in suffering and anger, as well as elation and humor in good fortune and friendship. Sympathy draws on powers of imagination. Given the ability to empathize with another person's condition, we can judge the appropriateness of our response only by imagining that we are in a similar state and by reacting accordingly. In his words: "As we have no immediate experience of what other men feel, we can form no idea of the manner in which they are affected but by conceiving what we ourselves should feel in the like situation."[7]

Smith then goes on to ask how we should judge our own emotional responses. He introduces the concept of an "impartial spectator": "When I endeavour to examine my own conduct, when I endeavour to pass sentence upon it and either to approve or condemn it, it is evident that, in all such cases, I divide myself, as it were, into two persons, and that I, the examiner and judge, represent a different character from that other I, the person whose conduct is examined into and judged of."[8]

We are to surmise how this well-informed and unbiased person would react to us—with sympathy at the same level we are feeling or with concord

of greater or lesser intensity or perhaps with discord and contention. The degree of sympathy afforded by an impartial spectator serves to guide us in understanding the propriety, suitability, or correctness of our own actions.[9]

Smith went further than any of the other British moralists[10] in placing his psychology of ethics wholly within the feedback loop of society. From an inborn capacity for sympathy, this human characteristic grows through childhood and matures in adult relationships, with the joys and sorrows of family members, friends, acquaintances, strangers, and people unseen in distant regions.

The philosopher David Hume, one of Smith's close friends, believed that moral judgments could be reached within the individual contemplating his or her personal opinions or options.[11] Smith held otherwise and rejected the opinion that morality could be reduced to any single motive or perceived from a solitary vantage point.

In Smith's analysis, when considering another person's conduct, we approve or disapprove based on the exercise of placing ourselves in that position and judging the propriety of the person's action. When pondering our own conduct, we create an impartial spectator who is detached from us and approves or disapproves of the propriety of our own actions. It is neither received theology, weighing of advantages, nor internal reasoning that undergirds Smith's approach.[12] It is the functioning of man in society, in communication with his fellow man, evolving through "habit and experience" an ever-widening archive of moral sensitivities and convictions that constitutes the driving force in his ethical system.

Adam Smith is a beautiful writer, exhibiting in his thirties when he composed *Moral Sentiments* a richness of language and style that captivated his readers. Illustrating his example of the impartial spectator, he speaks of

> the inhabitant of the breast, the man within, the great judge and arbiter of our conduct. It is he who, whenever we are about to act so as to affect the happiness of others, calls to us, with a voice capable of astonishing the most presumptuous of our passions, that we are but one of the multitude, in no respect better than any other in it, and that when we prefer ourselves so shamefully and so blindly to others we become the proper objects of resentment, abhorrence, and execration. It is he who shows us the propriety of generosity and the deformity of injustice.[13]

Believing that a capacity for moral behavior is inherent, Smith says: "Nature has implanted in the human breast that consciousness of ill desert, those terrors of merited punishment, as the great safeguards of the association of mankind, to protect the weak, to curb the violent and to chastise the guilty."[14]

On wealth and corruption, Smith says: "This disposition to admire and almost to worship the rich and the powerful, and to despise, or at least to neglect, persons of poor and mean condition, is the great and most universal cause of the corruption of our moral sentiments. That wealth and greatness are often regarded with the respect and admiration which are due only to wisdom and virtue, and that contempt is often most unjustly bestowed upon poverty and weakness, has been the complaint of moralists in all ages."[15]

On justice and harmony, Smith writes: "Society may subsist, though not in the most comfortable state, without beneficence, but the prevalence of injustice must utterly destroy it. . . . [16] Hence it is, that to feel much for others and little for ourselves, that to restrain our selfish and to indulge our benevolent affections, constitutes the perfection of human nature and can alone produce among mankind that harmony of sentiments and passions in which consists their whole grace and propriety."[17]

Moral Sentiments is filled page after page with Smith's view of the "amiable virtues" befitting men of character: "perfection," "modesty," "moderation," "tranquility," "veracity," "duty," "order," "harmony," "grace," "taste," "judgment," "prudence," "probity," "delicacy," "gratitude," "kindness," and "generosity." This is the perspective—upright, principled, conscientious, and trustworthy—that he brought to all his teachings and writings. These are the people, people of sincerity and sympathy, that he envisioned would operate the free-market system he laid out in *Wealth of Nations*, the second of his great contributions to Enlightenment thought and to the centuries that followed.

WEALTH OF NATIONS

Adam Smith is credited with creating the field of political economy and providing free enterprise, later called "capitalism," with its most persuasive argument. In its original insights and its consolidation of earlier analyses, the book adds the everyday business of commerce to the liberalizing

Prevailing Practices and Common Views	***Contrary Offerings by Adam Smith in* Wealth of Nations**
The wealth of a nation is seen in its accumulation of national treasure, in particular, gold and silver.	**The wealth of a nation is in its consumption of goods and services.** "Wealth does not consist in money or in gold and silver but in what money purchases and is valuable only for purchasing."[18]
Land and agriculture are the true sources of wealth.	**The process of exchange between agriculture and manufactured goods is the proper source of wealth.** "The country supplies the town with the means of subsistence and the materials to manufacture. The town repays this supply by sending back part of the manufactured produce to the inhabitants of the country. The gains of both are mutual and reciprocal, and the division of labour is in this, as in all other cases, advantageous to all the different persons employed in the various occupations into which it is subdivided."[19]
The value of land is the principal source of the value of commodities.	**The value of commodities results from the relationship of land, labor and profit, of which labor is the key component.** "The real value of all the different component parts of price is measured by the quantity of labour which they can, each of them, purchase or command. Labour measures the value not only of that part of price which resolves itself into labour, but of that which resolves itself into rent and of that which resolves itself into profit."[20]

(Continued)

Prevailing Practices and Common Views	***Contrary Offerings by Adam Smith in* Wealth of Nations**
National economic policy should focus on mercantilism, restraining imports, and subsidizing exports.	**Free and open trade with nations pursuing their individual competitive advantages is the path to wealth. (This is Adam Smith's most fundamental point in *Wealth of Nations*.)** "A nation that would enrich itself by foreign trade is certainly most likely to do so when its neighbors are all rich, industrious and commercial nations."[21] "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage."[22]
Trade monopolies assure needed protections to artisans and craftsmen.	**Monopolies in any form act to raise prices.** "The price of monopoly is upon every occasion the highest which can be got. The natural price, or the price of free competition, is the lowest which can be taken."[23]
The system of apprenticeships and masterships restrains excessive competition and passes down skills to succeeding generations.	**Workmen must be free to pursue their chosen skills to the limits of their abilities.** "The patrimony of a poor man lies in the strength and dexterity of his hands, and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour is a plain violation of this most sacred property."[24]

Prevailing Practices and Common Views	***Contrary Offerings by Adam Smith in* Wealth of Nations**
Both legislative acts and employer practices serve to limit workmen's wages.	**Wages should be free to rise together with national wealth.** "Is improvement in the circumstances of the lower ranks of the people to be regarded as an advantage or as an inconvenience to the society? The answer seems at first sight abundantly plain. Servants, labourers and workmen of different kinds make up the far greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an inconvenience to the whole. No society can surely be flourishing and happy of which the far greater part of the members are poor and miserable. It is but equity besides that they who feed, clothe and lodge the whole body of the people should have such a share of the produce of their own labour as to be themselves tolerably well fed, clothed and lodged."[25]
Taxation is often arbitrary and unpredictable.	**Taxation should be fixed and known in advance.** "The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person. Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay."[26]

agenda of the Enlightenment period. Observing Scotland's practice of slavery in its colliers, England's mercantilist relations with its colonies and France's restraints on domestic commerce backed by hordes of revenue officers, he confronted customary norms and offered alternative solutions aimed at releasing the fullest potential within every person.

The intellectual climate of the Enlightenment encouraged fresh thinking, but even within this welcoming atmosphere the range of Smith's challenges to the established order was astonishing. In economic affairs, virtually nothing among conventional practices and accepted wisdoms was sacrosanct after being exposed to his penetrating examination, flowing from his support of the common man. Several examples shown in the preceding box serve to make the point.

Adam Smith's free-market thinking laid out in *Wealth of Nations* seems rather obvious today. But at the time, it marked a major deviation from much of the tradition of the age, characterized by monarchies, churches, colonies, class oppression, slavery, and restrictions on many aspects of liberty and opportunity. The book was an immediate success, not so much because many leaped to agree with his program, but because the well-known author of *Theory of Moral Sentiments* had spread the Enlightenment's preoccupation with liberalism unexpectedly into the everyday realm of economics. By presenting the case for the free flow of labor and capital, Smith greatly strengthened the case for political freedom and thus contributed to the spread of democracy. Across the ocean, his book influenced Thomas Jefferson, John Adams, James Madison, Alexander Hamilton, and, as discovered recently, George Washington.

INVISIBLE HAND

Alas, what many people remember of Adam Smith is limited to just two words—"invisible hand." This refers to the altogether soothing notion that no matter how rich a part of society becomes, mysterious forces will spread the benefits of wealth to all the rest of society. In modern parlance, we need not overly concern ourselves with the state of the poor; trickle-down economics will be their salvation if we but give the process enough centuries to work its magic.

Smith uses the term "invisible hand" once in the 500 pages of *Moral Sentiments*, as follows:

> The rich . . . consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own convenience, though the sole end which they propose from the labours of all the thousands whom they employ be the gratification of their own vain and insatiable desires, they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessities of life which would have been made had the earth been divided into equal portions among all its inhabitants.[27]

He repeated the term, again just once, in the nearly 600 pages of *Wealth of Nations*: "By preferring the support of domestic to that of foreign industry, he intends only his own security, and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention."[28]

What are we to make of Smith's fleeting references to the benign influence of an invisible hand? Scholars have debated the question for years. The eminent Emma Rothschild in her book, *Economic Sentiments: Adam Smith, Condorcet, and the Enlightenment*, finds Smith's use of the words to be ironic and quite out of sorts with the rest of his work. She writes: "[T]he conception of the invisible hand, if it were intended seriously, would have been in conflict with several of Smith's most profound convictions. . . . The conclusion is that the invisible hand was an unimportant constituent of Smith's thought. The idea of the invisible hand, like the words in which it is described, is un-Smithian, and unimportant to his theory."[29]

Joseph Stiglitz subjects the construct of the invisible hand to withering review. In *The Roaring Nineties: A New History of the World's Most Prosperous Decade*, he presents the model of a candid book written by a professional, taking to task the Clinton administration and the World Bank, his peers, and himself for creating conditions that resulted in economic decline and corporate scandal. Citing his earlier research and that of other economists, he summarizes the unrealistic conditions under which the invisible

hand could conceivably work: Available information is perfect or unimportant, information is equally known to all, competition is perfect, and insurance can be bought against any risks. These are not conditions that have ever existed and most assuredly were not present in the 1990s. The "principal agents" who were supposed to be stewards of our welfare—the Ken Lays, Bernie Ebberses, Arthur Andersen auditors, Citi and Chase bankers, and maybe a few million others—were not acting as our agents and were functioning without heed to good principles of ethics and management. Stiglitz skewers both the hypothesis and its consequence: "[O]ne of the reasons that the invisible hand may be invisible is that it is simply not there. . . . [The] theory was a great relief to CEOs, for it told them that by doing well (for themselves) they were doing good (for society). Not only should they feel no guilt in greed; they should feel pride."[30] Stiglitz laments that in the course of the 1990s, "essential pieces of the social contract were torn to pieces."[31] Would that many more could be so forthright.

I offer an alternative explanation of Smith's use of these two words. In the passage of *Wealth of Nations* where Smith speaks of the invisible hand, he is talking specifically about "domestic industry." In *Moral Sentiments* he is comparing the rich to the "thousands whom they employ." Both settings are local, rather closely relational. In such limited environments it is possible—not automatic, but possible—for a bounteous spirit to spread the benefits of shared good fortune among all participants, not equally, but so that none is left in comparative poverty. In Smith's view local opprobrium arising from field hands, factory workers, or villagers can have a restraining influence on overbearing ostentation by the rich and can moderate the excesses of the wealthy lording it over the poor. In other words, Smith may have meant what he said about the invisible hand, but, if he did, he meant it as a potential force in a small community. He did not envision the Industrial Revolution, world wars, population explosion, and global corporations, and most of all he did not envision the staggering levels of widespread fraud and dishonesty that would come to pervade the affairs of supposedly gentle men and women. Nor did he envision that out of his two thoughtful books, so many people would fasten upon just two words in summation of his meticulously drawn analyses of moral philosophy and political economy.

If Smith were writing today, rest assured you would read nothing about some disembodied, munificent hand flitting between rich and poor spread-

ing the joys of wealth to all. In the global economy of the current century, it is time to put the noble but outdated image completely to rest.

DAS ADAM SMITH PROBLEM

After its first publication in 1759, Adam Smith added to and revised his *Theory of Moral Sentiments* five times, the sixth edition appearing in the year of his death, 1790. *Wealth of Nations* went through four altered printings after 1776, with revised texts appearing in 1778, 1784, 1786, and 1789. None of these editions ever mentioned one book in the other.

Moral Sentiments is grounded in Smith's view of sympathy as the great regulator of human behavior, producing in people of character demonstrations of propriety, merit, benevolence, and prudence. But in *Wealth of Nations* he identifies a different motivating drive for economic man—self-interest. He explains that out of language and reason peculiar only to humans arises "the propensity to truck, barter and exchange one thing for another,"[32] and out of this aspect of human nature arises the drive for advantage. As Smith says so eloquently near the beginning of *Wealth of Nations*: "It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity, but to their self-love . . ."[33] Repeating the same point through his book, he summarizes again near the end: "The natural effort of every individual to better his own condition . . . is so powerful a principle that it is alone and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations."[34]

Now we have a problem, or so it seems. *Moral Sentiments* is built on sympathy and *Wealth of Nations* is built on self-interest. Several German scholars leaped onto this apparent discrepancy in the 1800s, and it became known as Das Adam Smith Problem. Since then, thousands of pages have been written attempting to resolve the dilemma presented by a moral philosopher and a political economist—one and the same—offering two different versions of what motivates moral man and economic man in no doubt diverging pursuits. Is Smith a certifiable schizophrenic, a liar, or just plain wrong in one or the other of his books?

Reduced to its fundamentals, the argument is that sympathy and self-interest are incompatible at best, if not wholly irreconcilable. Economic man pursuing his profits cannot also be sympathetic man acting with benevolence. Yes, we see the dichotomy in many people. But the appropriate question is, is this a necessary condition, an inevitable tension, arising from conflicting forces impinging on each of us?

Adam Smith himself lived very comfortably, receiving a pension from the Duke of Buccleuch, a salary as a commissioner of customs in Scotland, and royalties on his highly successful books. At the same time, for many years he secretly gave away his money to the needy, which became public knowledge only after his death. He was certainly not naïve to the potential for avarice and malevolence among others, but in his own life he embodied the qualities that he advocated in his writings. His very clear bearings no doubt mediated between his two books, perhaps dampening any personal perception that the dual characters he was positing might be seen by others to be in opposition.

I have had the great good fortune to know someone who held both of Adam Smith's laudable characteristics within the same being. A few paragraphs will, I hope, make the point that what Smith had in mind was not a mutually opposed set of values, perpetually in disharmony, but instead a coherent system able to function in the day-to-day world. The individual was my father, the most honest person I have ever known.

James Wimberly Baker was born in the first month of 1898. In the small town of Mt. Lebanon, Louisiana, his father, J. Egan Baker, owned a good-sized general store that catered to surrounding rural communities, selling commodities, canned goods, hardware, textiles, and more. As a young boy, Wim, as he was called then, hung around the store and helped out receiving shipments, stocking shelves, and watching customers arrive by horse and wagon from 60 miles around to make their purchases. Some of these wagons were made by Studebaker and assembled by the youngster, around the time that company shifted into manufacture of the emerging modern phenomenon, automobiles.

In addition to the general store, my grandparents owned a 280-acre farm a few miles out of town. Residing there was a sharecropper, Tom Crawley, his wife, and 10 children. As was commonly the pattern, the split of corn produced on the farm was 50-50, and cotton was similar, depending on who

paid for seed and fertilizer. Tom and his wife raised a strong family, as five of their children graduated from college, unheard of for black sharecroppers in those days. I asked my dad once, "Who checked to see that the distribution from the farm was equal?" He tilted his head slightly and answered in a quiet voice, "No one." Later I learned that my grandmother eventually ignored the split and asked for just enough corn to feed her chickens.

I am not for a moment approving the sharecropper system. I am saying that, within that economic system, this was about as well as it could be handled. Nor am I ignoring the racial prejudice that pervaded the American South—as well as other parts of the country—at that time. Social separation tends to produce economic separation, something that Adam Smith was trying to ameliorate.

When Wim was a sophomore at Baylor University in Waco, Texas, his father became ill, and the young man had to come home to Mt. Lebanon to run the store for about a year. After returning to school and graduating in 1921 with a major in business and a minor in history, he moved to a nearby Louisiana town, Arcadia, and set up a wholesale grocery company with two partners, also marrying the daughter of the local hotel owner. By 1927, they had shifted the business and their home to Shreveport, just about in time to be hit by the Great Depression, and it was that very difficult period that brought out the best in him.

With his customers, who were grocery store owners, going broke by the score, the Commercial National Bank in Shreveport called in this young entrepreneur and demanded repayment of the loans they had extended to his business to finance inventory and purchases. He stood up to the bank and said, "No. I'm the only one who can liquidate this company and get your money out of it, and I'm not going to do it!" The bank relented, one partner walked away from the company, and the other said, "J.W.," as he was now called, "you can have my shares. Good luck."

My father built his wholesale grocery business to substantial size during the Depression with two techniques. First, all sales were "cash and carry." He persuaded hundreds of customers to operate without credit, keeping limited stocks and staying within their means. Second, he serviced his customers with however small quantities they could afford to buy, many times breaking a case in order to sell two or three cans of beans or pears or soup to them. He helped his customers get through the Depression, and they remained loyal to

him during that period and under the rationing of World War II and on into the 1950s.

The most important thing on Earth for J.W. Baker was to be a person of honesty and integrity and to be viewed in the community as exhibiting these traits. So far as I am aware, he never sued a customer who could not pay. He took his modest profits and invested in timberland in northwest Louisiana but never once bought a tract at a tax sale or a forced auction or took advantage of someone in distress and desperate to sell out. Paying the lowest price for his modest investments or selling at the highest price to his customers was simply not important; a fair price in all transactions was important. After his wholesale business was strong again and out of debt, he gave back at no cost the one-third shares given to him by his generous former partner who had continued to offer occasional advice and encouragement during the tough years.

Active in civic affairs for two decades, including service as local chairman of the Office of Price Administration during World War II, J.W. Baker was elected a director of the United States Chamber of Commerce in 1947, representing a six-state area. Traveling to Washington about every two months for six years, he rose to head the Chamber's national finance committee and became acquainted with many people in Washington and from other parts of the country.

In 1953, directors of the Commercial National Bank, which had earlier tried to force him out of business, called on him at his warehouse next to the railroad tracks along the banks of Red River, opened the conversation by saying that he was the best known Shreveporter outside of Louisiana, and offered him the presidency of the bank. As he described it later, "You could have knocked me over with a feather." He sold his wholesale business and assumed the position and continued through his banking career to be known by everyone as a person whose word was his bond.

My father exhibited the best of what Adam Smith wrote about, in both *Moral Sentiments* and *Wealth of Nations*. His ethics were firmly grounded in integrity, and his self-interest was entirely directed into hard work and frugality. He neither cheated nor dealt shrewdly with anyone and would have been completely mortified to be accused of ill dealings. Maximizing profits was never the most important thing in his life; maintaining an impeccable character and reputation was. Given this deep-

seated concern for exemplary behavior, there was, between his ethics and his self-interest, no conflict.

Das Adam Smith Problem? The supposed contradiction between *Moral Sentiments* and *Wealth of Nations* does not prevail in all people. It does manifest itself in society, but it is not an inherent flaw that cannot be overcome, either within a single person's character or in the scholarship surrounding Smith's two books. The author of these seminal works would have understood and respected J.W. Baker, and today Smith would turn to those puzzling over *Moral Sentiments'* ethical system and *Wealth of Nations'* economic system and say in his gentle manner, "You see, ladies and gentlemen, there is no problem, except as we may choose to create one."

THE TEARS OF ADAM SMITH

Theory of Moral Sentiments was subjected to widespread commentary, both during Smith's lifetime and deep into the next century after his death. One objection to his analysis focused on the concern that, seemingly, a sense of sympathy had to be prefigured within a person before sympathy could flow to another person. Some philosophers saw this inversion of order as a fatal flaw, which was in part addressed by Smith as he strengthened the role of the impartial spectator in later editions of the book. A more common criticism was that the ethical system leaves each individual in a position of being his or her own arbiter of behavior, producing variable standards according to circumstance and place. Related to this, another criticism was that the approbation of others, as an essential element in the system, subjected morality to group norms and pressures and worked against principled stances at odds with social values.

Whatever the merits of these assessments, there were at least two other factors that contributed, after its initial popularity, to *Moral Sentiments'* decline in readership. First, *Wealth of Nations* eclipsed the earlier work and became the book on which Smith's fame most firmly rested. And second, the fields of ethics and moral philosophy, following the active explorations of the Enlightenment period, faded as subjects of inquiry over the course of two generations following Smith's death. In fact, it was not until the 1971 publication of *A Theory of Justice* by John Rawls, commented upon in

Chapter 12, that moral philosophy and ethical theory again became richly debated. And with Rawls, Smith's *Moral Sentiments* reemerged as a book commanding careful attention.

Where did Adam Smith's own sentiments lie, with the rich building national wealth or with the poor seeking equity and justice? Carl Menger, an economist, answered this question in 1891, as follows: "A. Smith placed himself in all cases of conflict of interest between the poor and the rich, between the strong and the weak, *without exception* on the side of the latter. I use the expression 'without exception' after careful reflection, since there is not a single instance in A. Smith's work in which he represents the interest of the rich and powerful as opposed to the poor and weak."[35]

What is most important about Adam Smith is that in his person economics and philosophy were brought into a concordance well surpassing that found in any earlier writer. It is a legacy that has continued to this day. Yet at the same time, it is also the misfortune that has befallen his life's work. The reductionist misapplication of his free-market doctrine displaces the painstaking composition of moral underpinnings upon which he built capitalism's foundations. Economics and philosophy remain conjoined, but it is that other philosopher, Jeremy Bentham, whose work has supplanted *Moral Sentiments* and settled into the center of economic thought.

Adam Smith today would be appalled to see that the pursuit of fraudulent transactions and illegal profits has become utterly routine, unencumbered by the moral safeguards he envisioned, generated by people lacking the traits of character he knew were necessary for effective conduct of the free-market system. He would be heartbroken to find that the popular grasp of his economic thesis, while generating wealth, has promoted inconceivable income gaps, with three times as many people left in deplorable poverty as constituted the entirety of the world's population in his own time. If he chose to remark on the invisible hand, he would identify it now with international pickpockets lifting the purses of the poor for deposit into the far-flung accounts of the rich.

No, a resurrected Adam Smith is not a happy man. Remember, his first love, his first commitment, is to moral philosophy. He spends 50 years studying the subject, 30 years adding to and sharpening his ethical system. We take his free markets but ignore his ethics, precisely what he does not

want to happen. We grasp for profits without the attendant moral framework he forged.

Adam Smith was as smart, gracious, decent, and generous as any other figure in the past millennium. Observing the perversion of his core concepts would not enrage him; that was an emotion he did not exhibit. It would, however, deeply, deeply grieve him. Enormous concentrations of income, while billions of people are left behind in poverty, is exactly the outcome he sought to avoid.

CHAPTER 9

THE JOYS OF JEREMY BENTHAM

If Adam Smith is rolling over in his grave, Jeremy Bentham is overjoyed because he has never been put into his grave. Not only his body but also his philosophical notions outlasted those of his contemporaries. Bentham offered to the world a seemingly seductive ethical formulation that knocked Smith out of contention and inhibited developments in other schools of moral philosophy for the next 175 years. He may have had some engaging, even if inoperable, ideas in the eighteenth century, but his ramblings far outlived their usefulness by the twenty-first century.

Bentham was born in London in 1748, 25 years after Smith had entered the world. Whereas Smith was kidnapped while playing at age three, Bentham was found sitting at a desk reading history at age three. His father, a successful lawyer, introduced his child prodigy to Latin the same year and by age five he was playing Handel on the violin and by age eight learning French. A small, weak, and nervous child constantly pushed toward great achievements, Bentham later lamented the lack of familial feeling in his relationship with his father. Growing up with no friends of his own age, it was his mother to whom he turned for affection, and her passing when he was 11 was a severe blow.

Bentham matriculated to Queen's College, Oxford, at 13, graduated at 16, and took a master's degree at 18. He entered Lincoln's Inn in 1763, an institution by then already some 240 years old and now, going on 500 years, still one of the most prestigious of British societies preparing barristers for careers in law. During the next decade he was admitted to the bar

but, with growing passion for legal reform, chose not to practice. Provided by his father with a small farm and property that together yielded about £90 a year, he turned instead to the realms of jurisprudence, public policy, and philosophy.

Bentham spent six decades writing and promoting ideas on reform. Not particularly attracted to public lecturing and often neglecting his personal needs, he frequently labored at his desk for 10 to 12 hours a day, producing up to 20 manuscript pages. Repeated use of such invented terms as "maximize," "minimize," and "international" planted these words into everyday terminology. Not all of his work has been published, an ongoing project expected eventually to reach some 70 volumes.

JURISPRUDENCE

Bentham's exposure to English common law was upsetting. The lectures and writings of William Blackstone, the most noted jurist of his day, stressing tradition and elitism, lauding a mixed government of kings, lords, and commoners, "stuck in my stomach," as Bentham later wrote. Blackstone's *Commentaries on the Laws of England* was widely circulated and translated into other languages. Bentham took strong exception to such conclusions as, "It is well if the mass of mankind will obey the laws when made, without scrutinizing too nicely into the reasons of making them."[1] Contrary to Blackstone's fawning acceptance of British legal institutions and customary conventions, Bentham found that judges exercised widely varying interpretations of precedent, resulting in equally diverse exactions of remedies and punishments. Bentham's first major work, *A Fragment on Government*, published anonymously in 1776, was part of a larger criticism of Blackstone, finally produced in 1828 as *A Comment on the Commentaries*. Across much of his career he sought to replace arbitrary judgments with clearly structured legal codes, leading to greater consistency in decisions rendered from the bench. Interestingly, his ideas were well received in France and led to the Napoleonic Code, which also became the basis for law in many other countries, as well as in the American state of Louisiana. In 1792 Bentham, along with George Washington and others, was honored with the title Citizen of France.

UTILITARIANISM

It was Bentham's search for social justice through jurisprudence that led to his philosophical convictions. If law was to be simple and enforcement repeatable, then society needed a basis for deciding what was to its advantage. Reading extensively in philosophy, Bentham was struck by David Hume who had written on the concept of utility, that is, the usefulness of ideas and pursuits, and by his fellow Englishman Joseph Priestley and the Italian Cesare Beccairia, who had commented on notions of society's greatest good. Taking these concepts, Bentham produced his most important work, *An Introduction to the Principles of Morals and Legislation*, published in 1789. In it he laid out a utilitarian philosophy.

Utilitarianism has several interrelated features. First, it is anchored in the idea of the greatest happiness for the greatest number. As Bentham wrote: "The interest of the community then is what?—the sum of the interest of the several members who compose it."[2] The function of society is to maximize its total advantages, and the gains of individual members are viewed as contributing factors to the larger good of the whole. At the time in aristocratic England, the notion of such sweeping social concern was strange to many members of the elite, who frankly felt that the function of lower ranks was to serve the upper class. It was against this tradition that Bentham, in part, fought.

Second, alternative actions are to be appraised on the basis of their utility. Bentham was concerned with the uses and merits of ideas, institutions, traditions, laws, rights, properties, or other components of community. Possible actions are to be weighed in terms of their anticipated advantages and disadvantages. Choices are to be rooted in rationalism. There is no separate ecclesiastical authority and, for that matter, no body of simple customs that can direct choices. Determining utility is within the powers of the mind of man.

Third and derived from the second, it is the consequences of actions that determine their utility and therefore their contributions to the greatest good. No before-the-fact moral stricture is overriding. After-the-fact outcomes are determinative. Utilitarianism is a form of consequentialism, a philosophy focused upon projected or actual results, not controlled by some preconceived set of religious or traditional intuitions.

Fourth, Bentham's utilitarianism embraces the notion of selective sacri-

fice. In setting forth the greatest happiness of the greatest number as his governing principle "in so far as possible," he says that on "every occasion on which the nature of the case renders it impossible . . . make sacrifice of a portion of the happiness of a few to the greater happiness of the rest."[3] In other words, if society's total gain is enhanced by requiring loss by some, say, indentured laborers, then so be it. It is the sum of advantages across the whole of the society that is important.

Fifth, in order to measure advantages and disadvantages, a system is required that can put a number or a ranking on every aspect of society's tangible and intangible characteristics. Such a "felicific calculus" as it came to be called (though never developed), would weigh alternatives for their respective contributions to happiness or unhappiness and reduce decisions to mathematical summations of society's calculated good.

Thus, with (1) rationalism, (2) a single guiding light—utility—illuminating society's aim, and (3) a proposed measuring rod to record progress, Bentham's utilitarian philosophy was essentially complete. He laid it out in the first half of his book on *Morals and Legislation* and devoted the second half to a dissertation on offenses, punishments, and jurisprudence.

Bentham's own words round out his utilitarian concepts. He opens *Morals and Legislation* with the following: "Nature has placed mankind under the governance of two sovereign masters, pain and pleasure. It is for them alone to point out what we ought to do as well as to determine what we shall do."[4]

Bentham goes on to list types of pleasures, including those of the senses as well as wealth, skill, amity, reputation, power, piety, benevolence, memory, imagination, expectation, association, and relief. Pains are generally the opposite, including those of the senses, plus privation, desire, disappointment, regret, awkwardness, ill repute, enmity, malevolence, memory, and more. Measuring the value to be placed on any pleasure or pain encompasses seven variables, including intensity, duration, certainty or uncertainty, proximity or remoteness, possible replication, purity, and extent across other people.

Taking his analysis of pleasures and pains to a logical conclusion, he then writes:

> Sum up all the values of all the pleasures on the one side, and those of all the pains on the other. . . . Take the balance; which, if on the side of pleasure, will give the general good tendency of the act, with respect to

> the total number or community of individuals concerned; if on the side of pain, the general evil tendency, with respect to the same community.[5]
>
> The general tendency of an act is more or less pernicious according to the sum total of its consequences, that is, according to the difference between the sum of such as are good and the sum of such as are evil.[6]
>
> Pleasures then, and the avoidance of pains, are the ends which the legislator has in view: It behooves him therefore to understand their value.[7]

Consolidating his view of pleasures and pains, advantages and disadvantages, into his theory of utility, Bentham goes on to say: "By utility is meant that property in any object, whereby it tends to produce benefit, advantage, pleasure, good, or happiness, . . . [or] to prevent the happening of mischief, pain, evil, or unhappiness . . ."[8] "An action then may be said to be conformable to the principle of utility . . . when the tendency it has to augment the happiness of the community is greater than any it has to diminish it."[9]

Bentham has little doubt that his analysis is correct: "If the principle of utility be a right principle . . . whatever principle differs from it . . . must necessarily be a wrong one."[10] He goes on to recognize that the principle of "sympathy," without mentioning Adam Smith's *Theory of Moral Sentiments*, is often opposed to utility.

Bringing his theory home to the business of legislation and government, Bentham concludes: "The general object which all laws have or ought to have in common is to augment the total happiness of the community . . ."[11] "The business of government is to promote the happiness of the society, by punishing and rewarding."[12]

In the late 1700s and early 1800s, these were radical ideas. Accordingly, Bentham drew into his circle like-minded thinkers who became known as—what else?—the Philosophical Radicals. Closest to Bentham was James Mill, a product of the University of Edinburgh, ex-Church of Scotland minister, writer on history and economics, and for awhile Bentham's tenant. At one time, the two concocted a plan to uproot and move to Venezuela. Prominent also among Bentham's inner circle was the economist David Ricardo and a legal theorist John Austin. Francis Place, an early advocate of workers' rights, and Ramsey McCulloch, an economist, were identified with the group, along with others. Mill and Bentham established the *Westminster Re-*

view in 1824 as an outlet for their ideas. Intended to counter Whig policies advocated in the *Edinburgh Review* and Tory opinions expressed in the *Quarterly Review*, this important journal published works by Byron, Tennyson, Coleridge, Carlyle, and many others. Taken over by James Mill's son, John Stuart Mill, in the mid-1830s, it continued publishing until the beginning of World War I in 1914.

RELATED INTERESTS

Comfortably fixed with properties generating some £500 to £600 a year after the passing of his father, Bentham's active mind turned to many other projects. In the late 1700s, the American Bill of Rights and the French Declaration of the Rights of Man and of the Citizen incensed him. He wrote (though it remained unpublished for many years) a scathing *Critique of the Doctrine of Inalienable, Natural Rights*, finding the very concept completely illogical, since such preexisting endowments could fall outside the framework of measurable utility. Obviously enjoying the use of language, he opined: "Natural rights is simple nonsense: natural and imprescriptible rights, rhetorical nonsense—nonsense upon stilts."[13] Carried too far, Bentham saw natural rights producing ridiculous outcomes: "If a constable call upon you to serve in the militia, shoot the constable and not the enemy; . . . If a bailiff, throw him out the window. If a judge sentence you to be imprisoned or put to death, have a dagger ready, and take a stroke first at the judge."[14]

In a 1798 proposal entitled *Pauper Management Improved*, Bentham demonstrated how far he was prepared to subordinate rights to society's greater good, as he saw it. He proposed establishing a nationwide system of "industry-houses," 250 in number, each with 2,000 confined poor, thus serving 500,000 of England's indigent. His scheme gave power "to anyone to apprehend a beggar begging in any public place and conduct him either to a constable or to the nearest Industry-house." In fact a reward of 10 to 20 shillings would be paid for each person delivered and such costs "charged to the beggar's account."[15] Bentham then called for "the extraction of labour to as great a value as may be, consistently with the regard due to health, customary relaxation and the observance of religious duties. . . . When ability adequate to the task is certain and laziness apprehended, no

meal given till the task by which it is earned has been first performed. . . . [T]he better he works, the sooner he is out; the less he works, the longer he stays."[16] Bentham goes into excruciating detail about food, clothing, lodging, bedding, child nursing, work, punishment, reward, management, and accounting for his National Charity Company. As the philosopher Gertrude Himmelfarb wrote in 1965: "There was no question of the 'rights' of prisoners and paupers, for there was no such thing as rights at all. There were only interests, and the interests of the majority had to prevail. The greatest happiness of the greatest number might then require the greatest misery of the few."[17]

One of Bentham's pet projects was prison design. He conceived of a privately-owned prison in the round, where all inmates could be observed at all times by centrally-situated guards. Named the Panopticon, he tried to sell his idea first in Russia and then for 20 years in England, spending a great deal of his own money. To be sited in London on land now occupied by the Tate Gallery, Bentham finally gave up in 1813 and was reimbursed £23,000 by Parliament for his fruitless promotional efforts. More than a hundred years later, his design was used to build Joliet Prison in the United States.

In 1830 Bentham published a work entitled *Constitutional Code for the Use of All Nations and All Governments Professing Liberal Opinions*. If pleasures and pains, advantages and disadvantages, are largely the same across all people and subject to measurement, then every nation can be served with a similar constitutional code grounded upon utilitarian principles. The product of 10 years of effort, it grew out of legislative proposals to and correspondence with leading figures in Portugal, Spain, Greece, the Barbary states, Argentina, Guatemala, Símon Bolívar in South America, and Thomas Jefferson in the United States. Bentham makes his philosophy clear from the outset: "Of this constitution, the all-comprehensive object or end in view is from first to last the greatest happiness of the greatest number . . ."[18] His exhaustive *Code* goes on to elaborate on sovereignty, the legislature, the prime minister and other ministers, the judiciary, defense forces, local officials, and public and private offenses. While influential, his *Code*, which was far too exacting in its hundreds of pages of details, was never adopted by any state and was overtaken by the U.S. Constitution, which subsequently served as a model for many states.

Bentham's ideas were not all outlandish. He advocated universal suffrage for women, a century before this notion took hold. Secret balloting received his support. He worked to end child labor and to promote wider education. Canals across Panama and the Isthmus of Suez were proposed. Influenced by Francis Place, he added labor reform to his agenda. He even suggested a world court.

JOHN STUART MILL

With only a fraction of his writings published during his lifetime, Bentham's work was carried on by his intellectual followers. His godson John Stuart Mill was foremost among these. Like Bentham, Mill was a child prodigy. His father began teaching him Greek by the time he was four, Latin and mathematics at eight, and logic and political economy by 13. He absorbed Plato, Aristotle, Virgil, Cicero, Caesar's Commentaries, Euclid, and the writings of many other early figures. He seldom moved outside the adult circle comprising his father and Bentham and their utilitarian ideas, becoming in the process "the subject of one of the most singular educational experiments on record."[19]

At age 15, having returned from a year in France with Jeremy Bentham's brother, Mill began studying law under John Austin, one of the Philosophical Radicals. In 1823 at 18, he took a clerkship position with the East India Company, where he remained for 35 years, leaving him ample time for reading and writing. He immediately began contributing essays to the *Westminster Review* and shortly turned to editing Bentham's works.

Then he fell into a two-year depression and perhaps contemplated suicide. Being "kept in a state of severe intellectual tension from his earliest infancy"[20] had apparently caught up with him by age 20. Mill later said that the poetry of Wordsworth helped him out of his gloom; however, he had occasional relapses and illnesses for the rest of his life.

Perhaps an element in Mill's depression arose from questions he began to ponder about utilitarianism, the philosophical commitment of Bentham and his father on which he had essentially been force-fed. If so, his revised thinking came out only slowly and was not fully articulated until his essay entitled "Utilitarianism" appeared in 1861. In it Mill makes the

case that it is not only quantities of pleasure and pain that are to be considered but, more importantly, their qualities: "[T]here is no known . . . theory of life which does not assign to the pleasures of the intellect, of the feelings and imagination, and of the moral sentiments a much higher value as pleasures than to those of mere sensation. . . . It is quite compatible with the principle of utility to recognise the fact, that some kinds of pleasure are more desirable and more valuable than others. It would be absurd that . . . the estimation of pleasures should be supposed to depend on quantity alone."[21]

Stressing the importance of quality in the utilitarian calculation, Mill goes on to note that most people have a ". . . marked preference to the manner of existence which employs their higher faculties. Few human creatures would consent to be changed into any of the lower animals, for a promise of the fullest allowance of a beast's pleasures; no intelligent human being would consent to be a fool, no instructed person would be an ignoramus, no person of feeling and conscience would be selfish and base, even though they should be persuaded that the fool, the dunce, or the rascal is better satisfied with his lot than they are with theirs."[22]

In an often-quoted line, Mill writes: "It is better to be a human being dissatisfied than a pig satisfied; better to be Socrates dissatisfied than a fool satisfied. And if the fool or the pig [is of] a different opinion, it is because they only know their own side of the question."[23]

Driving home his extension of utilitarian theory beyond Bentham, Mill writes: "According to the Greatest Happiness Principle, . . . the ultimate end . . . is an existence exempt as far as possible from pain, and as rich as possible in enjoyments, both in point of quantity and quality; the test of quality and the rule for measuring it against quantity being the preference. . . ."[24]

Thus it was Bentham followed by his godson Mill who laid out utilitarian theory, placing the greatest good for the greatest number, measured first in quantity and then modified to include quality, at the center of English political thought and soon thereafter at the center of western economic thought. Appealing to a coterie of Philosophical Radicals, their ideas were at the same time not especially upsetting to the landed aristocracy and the emerging industrial class. With individual rights subordinated to total advantage, the wealthy saw little in these intellectual exercises that would materially change the social status quo.

PROBLEMS

What Bentham and Mill built came to be known as "classical" or "strong" utilitarianism. In this form the philosophy presented a number of serious problems.

1. With its singular focus on maximizing society's sum of advantages, the philosophy is often charged with advocating that ends justify means. In Chapter 3, I wrote "sometimes, yes," ends do justify means when dealing with situations that pose difficult choices. But strict utilitarianism responds differently to such alternatives and says, "nearly always, yes." The end, the consequence, of an act is the appropriate basis for judging the correctness of the means utilized to reach the end. With the possible exception of setting a precedent that could be harmful in future situations, current outcomes outweigh other considerations. There is little if any room for intuitive ethical presuppositions or traditional religious teachings that limit freedom of choice. The calculation leading to maximizing advantage or happiness is the appropriate frame of reference for evaluating options.
2. Utilitarianism does not offer an answer as to which aspects of advantage or happiness across the whole society are to be maximized. With competing concerns, how are we to make choices among peace, security, liberty, justice, standard of living, health, pleasure, and the balance between current needs and future obligations? For example, is economic growth to be maximized in preference to environmental protection, or should global warming and greenhouse gasses be attacked even at the expense of economic growth? Utilitarianism's simple answer—the greatest good—offers only marginal assistance in negotiating through complex choices.
3. Strict utilitarianism is often charged with discounting motive and intent. If you meant well with an act of kindness or charity but the consequences turned out badly, those consequences are the preferred basis for judging your action, rather than the original content of your objective.
4. Critics of strict utilitarianism contend that it gives inadequate weight to promises and commitments. If a promise given in the past no

longer serves to maximize good, then the promise can be broken. A popular example in the literature is the deathbed wish. A competent but dying person secures a commitment from a family member or friend to take some action after the funeral. If a greater good is served by breaking that commitment, the utilitarian position would generally approve outcome in preference to obligation.

5. One of the major complaints lodged against strong utilitarianism is that within its principles there is inadequate room for rights. Bentham vehemently opposed any notion of rights existing prior to or outside a utility calculation. To be fair, his primary targets were the clergy and their rigid moral certainties and the aristocracy and their special privileges. But in reducing rights to a question of utility he is seen by many to have sacrificed rights to the sum total of group interests.

6. Closely related, the idea of selective sacrifice is scorned by many commentators. Bentham's statement, "make sacrifice of a portion of the happiness of a few to the greater happiness of the rest," has led to the question whether strict utilitarianism would justify slavery if it could be shown to contribute to the greater happiness or productivity of the society as a whole. Within Bentham's formulations it is difficult to arrive at any answer other than yes.

Ends justifying means, selective sacrifice, greatest good. These features of strong utilitarianism emerged from the pen of Jeremy Bentham and his immediate supporters at the same time that capitalism's formative ideas of free trade and laissez-faire were being accepted. Arising simultaneously, capitalism and utilitarianism melded together into a structure that attempted to address several issues in English society: the Industrial Revolution, the clamor for wider political participation, a need for judicial reform, manifest poverty, and burgeoning city populations. Utilitarianism found in capitalism a system dedicated to maximizing advantages. Capitalism found in utilitarianism a creed that allowed selective sacrifice and approved ends justifying means. The two systems marched in tandem through the next two centuries, presenting future philosophers—and capitalists—with problems requiring careful reexamination.

Jeremy Bentham will forever be linked in spirit and, literally, in body to University College London (UCL). When he died in 1832 at age 84, earlier arrangements he had suggested for the disposition of his body were carried out. With friends in attendance his corpse was dissected. Then his head was shrunken. Then his skeleton was attired in gentlemanly clothes and seated in a glass case. The head appeared too small, so it was placed on the floor of the case and a wax head was affixed, looking rather like Benjamin Franklin. This Auto-Icon was moved to UCL in 1850, where its presence is still recorded at meetings of the College Council. Bentham is noted to be present but not voting, except in instances of ties among council members, when his vote is invariably "for" whatever motion hangs in the balance. Because Bentham's own head, disfigured as it was, became far too tempting an object for students from rival colleges, it was finally removed from the Auto-Icon case and stored in UCL's vaults.

An early biographer, Charles Milner Atkinson, found that Bentham's confidence in his simple doctrine was overbearing: "Armed with this principle of 'utility' . . . he deemed himself fully equipped to encounter any difficulty, to remove any obstacle that should present itself in the wide range of morals, politics or law . . ."[25]

Bentham's philosophy shriveled the influence of Adam Smith's *Theory of Moral Sentiments*. Instead, capitalism became linked with the emergent English attachment to utilitarianism and its founding notions of ends, means, maximizing, calculated good, and expediency. The linkage would last to the present day, contributing simultaneously to a greater sum of advantages, that is, global wealth, and to a staggering separation between rich and poor, consistent with the ideas of selective sacrifice and ends exonerating means. To put it simply, Smith's capitalism was hijacked by Bentham's utilitarianism. Eighteenth-century Bentham might be pleased with the outcome, but twenty-first-century capitalists should be deeply concerned.

CHAPTER 10

PHILOSOPHY BECOMES CULTURE

UTILITARIANISM HAS become embedded in the way European and North American societies live, work, and think. Natural and accepted, its presence is hardly recognized. If it is taken for granted by everyone else in western countries, why should you care? Because lurking within the normalization of outdated philosophical tenets lies acute danger for our much-changed twenty-first-century world. This chapter lays out how utilitarianism gained its place in western capitalism, advances my criticisms of its role and impact, and poses a final challenge.

The effects of prevailing philosophical dispositions can often be discerned in other societies but are more difficult to see in one's own. So first of all, the general point about philosophy becoming culture needs to be established.

Years ago it was fashionable to speak of "Asian values." Many scholars have noted that fundamental precepts of Confucianism, with origins dating back two-and-a-half millennia, remain visible in the fabric of Asian societies. Respect for authority, strong family relationships, and emphasis on education are seen as lingering influences of the ancient philosophy. Some feel that these cultural characteristics are traceable to economic outcomes such as high personal savings rates and modest income disparities, notably in Thailand, Malaysia, Singapore, South Korea, and Taiwan.

Japan adds to Confucianism its own blend of Zen Buddhism, with elements of self-effacement and meditation, and Shinto, with emphasis on ritual and honor. Some scholars see these philosophical and religious inputs evident in Japanese economic characteristics of long employment, corpo-

rate homogeneity, and the lowest income disparities among all industrialized nations.

Latin American scholars often look at exceptionally wide income gaps and an abiding persistence of poverty and believe they can see religious roots in such realities. The Church, with traditions of authority and hierarchy coupled with a strong male bias, is sometimes linked to the pattern of social and income stratification that pervades much of the region.

Perhaps no philosophy had such dramatic implications for economic affairs as Marxism. Shaking off czarist traditions, Russia leaped at the intellectual rationale for nationalizing private property and regimenting commercial life, achieving early success. But then the communist system, unable to motivate citizens, operate efficiently, and grow, collapsed beneath the weight of stagnation and demoralization.

Philosophy can also be overthrown in relatively short order. Mao Tse-tung was determined, no matter what the cost, to rid China of many Confucian traditions he saw as counterproductive. Some scholars see China's startling growth today as linked to its earlier demythologizing, though bloody, revolutions.

A rich body of literature surrounds these questions of philosophical attachments and economic results. My purpose is not to wade into specific debates but to make the wider point that, indeed, philosophy can and does become culture, and culture can and does become economic reality. In western societies, utilitarianism is so deeply entrenched that it often passes without notice. Yet there it sits, constituting a major part of the third station, which, along with illegality and inequality, forms capitalism's threatening continuum.

THE GREAT INFUSION

Jeremy Bentham synthesized utilitarian philosophy. John Stuart Mill made it somewhat more palatable by expanding the idea to include not just quantities but also qualities of pleasure and pain. It was now left to several transitional figures to anchor these notions into the core of western economic thought. While some of these individuals may be strangers to many readers, it is important to understand the path they trod in order to understand where they brought us.

The first of these was William Stanley Jevons. Entering Bentham's citadel, University College London, in 1851, Jevons intended to study mathematics and chemistry. Financial pressures forced him to depart, taking a position in Sydney, Australia, as an assayer of precious metals at the Royal Mint. Returning to England five years later via Peru, Panama, the West Indies, and the United States, he reentered UCL, finally receiving his master's degree in 1862.

The following year Jevons published his first work, taking off from Bentham and Mill and incorporating his own fascination with numbers. It was entitled *Pure Logic or the Logic of Quantity apart from Quality with Remarks on Boole's System and the Relation of Logic and Mathematics*. Within a decade Jevons built a logic machine, a forerunner of the computer, and Boolean algebra eventually became a fundamental tool in the design of computer chips and integrated circuits.

In 1866 Jevons took a professorship at Owens College in Manchester, and in 1871 he published his most significant treatise, *The Theory of Political Economy*. He set out to "treat economy as a calculus of pleasure and pain,"[1] in the same manner that "positive and negative quantities are treated in algebra."[2] But he found Bentham's seven measures of pleasure and pain to be cumbersome, so he reduced them to two—intensity and duration—thus simplifying mathematical applications. Summarizing, Jevons wrote: "Utility must be considered as measured by, or even as actually identical with, the addition made to a person's happiness. It is a convenient name for the aggregate of the favorable balance of feeling produced—the sum of the pleasure created and the pain prevented."[3] In other words, advantage and usefulness—utility—are equated with happiness.

Besides solidifying basic utilitarian commitments into economic analysis, Jevons was also one of three co-founders of the "marginal revolution." Recognizing that for a thirsty person the last sip of water conveys less pleasure than the first sip and for a wage earner the last shilling earned which might be spent on luxuries is less advantageous than the first shilling earned which might be spent on food, Jevons wrote that the "final degree of utility is that function upon which the Theory of Economics will be found to turn."[4] Diminishing marginal utility, much refined since Jevons' day, continues to be a key analytical concept.

In 1876 Jevons became professor of political economy at his alma mater, University College London. Throughout his career he was a workaholic, an

introvert, and not a particularly keen observer of society. He wrote widely on science, meteorology, music, gold, coal, trade, currency, taxes, trade unions, and married women in factories. He embarrassed himself attempting to relate sun spots to agricultural cycles. But he never wandered far from his utilitarian foundations, placing objective utility above all other considerations: "[T]hrow aside all supposed absolute rights or inflexible principles."[5] "The liberty of the subject is only the means towards an end; it is not itself the end; hence, when it fails to produce the desired end, it may be set aside, and other means employed."[6] "I conceive that the State is justified in passing any law, or even in doing any single act which, without ulterior consequences, adds to the sum total of happiness."[7] Thus, rights, inflexible principles, liberty, justice, all can be subjugated if they do not produce desired ends. "We must hold to the dry old Jeremy, if we are to have any chance of progress in Ethics."[8]

Jevons fixed utility at the forefront of economics and opened the door for mathematics to be the principal tool of analysis. He largely initiated the shift from political economy to pure economy. At the same time another shift was occurring, to Cambridge University, which came to dominate economic study for nearly 75 years.

A leading luminary at Cambridge was Henry Sidgwick, who was perhaps the last of nineteenth century thinkers able to converse with equal authority on both ethics and economics. He published *The Methods of Ethics* in 1874 and *Principles of Political Economy* in 1883, and then returned again to philosophy with *Practical Ethics* in 1898.

Sidgwick attempted to prove that utilitarianism's fundamental precept of the "greatest happiness for the greatest number" was superior to other philosophical hypotheses focused more inwardly. He referred to these two governing motivations as "duty" and "interests," constituting the "dualism of practical reason." Alas, he was unable to make an irrefutable case for the former, lamenting that "Utilitarian Duty . . . cannot be satisfactorily demonstrated on empirical grounds."[9] As he sadly concluded, "[T]he prolonged effort of the human intellect to frame a perfect ideal of rational conduct is seen to have been foredoomed to inevitable failure."[10]

This did not prevent Sidgwick from retaining utilitarianism at the center of his convictions. Attempting to apply his attachment to the greatest good, he tried to argue for more equal income distribution and against unbridled laissez-faire. But Sidgwick's innate conservatism and preference for

only "mild and gentle steps" meant that his rather timid musings on economics were quickly overtaken. He is most remembered today for the brilliance and breadth of his philosophical analysis in *Methods of Ethics* and the authority he conferred upon his followers at Cambridge.

The foremost of those tutored by Henry Sidgwick was Alfred Marshall. Born in London in 1842 and for awhile considering the Anglican ministry, he opted instead for mathematics at Cambridge. A loan of several hundred pounds financed his studies, given by an uncle who made money raising sheep in Australia utilizing convict and indentured labor. Perhaps this explains Marshall's later remark, "It is true that slavery was not always entirely without advantages."[11]

After teaching at University College Bristol and then at Oxford, Marshall received an appointment as professor of political economy at Cambridge in 1885, a position he held for 23 years. Despite a prickly personality and little involvement in university affairs, he nevertheless secured for Cambridge and for England primacy in the emerging science of economics.

Marshall's major work, *Principles of Economics*, appeared in 1890. An eighth edition of his continuously edited tome appeared in 1920, and two further books—*Industry and Trade* and *Money, Credit and Commerce*—were published in 1919 and 1923, respectively. These three established Marshall's dominion over his subject, extending decades beyond his death in 1924.

Marshall sought to combine the measurement of utility with his compassion for the poor to produce an advancing world. While subscribing to the objective of maximizing pleasure and satisfaction, he was critical of eighteenth and early nineteenth century utilitarian proponents, finding that ". . . their work is marred by a certain hardness of outline and even harshness of temper. These faults were partly due to Bentham's direct influence."[12] He had greater rapport with Bentham's successors: "A higher notion of social duty is spreading everywhere. In Parliament, in the press and in the pulpit, the spirit of humanity speaks more distinctly and more earnestly. Mill and the economists who have followed him have helped onwards this general movement."[13]

Marshall often toured poor urban and rural areas in order to hone his sympathies for England's millions living in deprivation. But he wanted economics to stand on its own two feet, separated from political and ethical overtones. His rationale went as follows: "Utility is taken to be correlative of

Desire and Want."[14] "The utility of a thing to a person . . . is measured by the extent to which it satisfies his wants. And wants are . . . not reckoned . . . according to any ethical or prudential standard."[15] "It is clearly not the part of economics to appear to take a side in ethical controversy."[16] In other words, what is useful is what is wanted, and ethics do not here enter into the calculation.

Marshall went on to strip away from the idea of usefulness and advantage any uncertainty as to its appropriate yardstick: " '[M]oney' or 'general purchasing power' or 'command over material wealth' is the centre around which economic science clusters; . . . not because money or material wealth is regarded as the main aim of human effort, . . . but because in this world of ours it is the one convenient means of measuring human motive on a large scale."[17]

Much of Marshall's *Principles of Economics* was taken up with earnest moralizing and technical footnotes, including a mathematical appendix on methods of analysis. Commenting on Marshall, F.Y. Edgeworth, an Oxford don of the time, wrote of the connection between utilitarianism as a philosophy and utility as a calculation as follows: "To procure the greatest possible sum of satisfaction for all is right. . . . There is certainly no logical connection between this principle and the economic art of measurement; and yet, as it seems to us, there is more than a verbal alliance. . . . [Marshall] lends the authority of an accredited science to defend at least the possibility of Utilitarian Ethics. It is not indeed demonstrated that the Utilitarian . . . principle is true, but there is created the conviction that it is not nonsense."[18]

As the twentieth century progressed, Marshall's ethical protestations were forgotten in favor of his math: "[T]he Marshallians concentrated their efforts on what they considered to be a value-free endeavour devoted to a sharpening of the analytical tools that Marshall forged."[19] "The precision and thoroughness of his formal analysis completely obliterated . . . his explicit policy conclusions. . . . [H]is engine of analysis pressed methodically onward to construct a painstakingly elaborate, logically impregnable, supremely aesthetic edifice . . ."[20]

Tracing a process more than a century long, Cambridge professor Tom Warke zeros in on what began to transform a philosophy into a science: "By what process did the utility concept in economics evolve from its Benthamite

to its modern form? [F]itness for mathematical analysis [was] the underlying principle of selection for this evolutionary success, exemplified in particular by the mutations of utility between Bentham and W.S. Jevons, and between Jevons and Alfred Marshall."[21]

Utility measured by money in a dispassionate science. Though not exactly what he wanted, this is Marshall's legacy.

A legacy that was carried on by his successor as professor of political economy at Cambridge, Arthur Cecil Pigou. Born on the Isle of Wight the son of a decorated British army officer, he was a scholar-athlete at Harrow and received his master's degree from Cambridge in 1900. A devoted follower, he ascended to his mentor's chair in 1908 at the age of 31, determined to extend Marshall's utilitarian philosophy and mathematical methodology. He remained a bachelor, became a conscientious objector during World War I, and increasingly withdrew from society.

Pigou's most important works were *Wealth and Welfare* appearing in 1912 and a further development of his thesis in *The Economics of Welfare* published in 1920. Welfare, of course, refers to society's total well-being. Proceeding from Marshall, Pigou reiterates the language of Bentham and Mill, referring to ". . . the term utility—which naturally carries an association with satisfaction."[22] He adopts Marshall's yardstick and scope of analysis: "[W]elfare [is] taken broadly to consist in that group of satisfactions and dissatisfactions which can be brought into relation with a money measure."[23] "Hence, the range of our inquiry becomes restricted to that part of social welfare that can be [correlated to] the measuring-rod of money."[24] Pigou's view of the world was social welfare as measured by money. Recall, this is not Amartya Sen's view of the world, as noted in Chapter 5.

Pigou then proceeds with Marshall in concentrating on what came later to be called gross national product: "Just as economic welfare is that part of total welfare which can be brought . . . into relation with a money measure, so the national dividend is that part of the . . . income of the community . . . which can be measured in money. The two concepts, economic welfare and the national dividend, are thus co-ordinate. . . ."[25] "The [national] dividend constitutes the kernel of economic theory . . . It is to an analysis of this that we are driven when . . . [we] demand from social science guidance to social reform."[26]

Thus, from the late 1700s to the early 1900s, utilitarian philosophy became embedded in capitalism and the utility calculation became embedded in economics. Briefly, it went from:

- Bentham's greatest good for the greatest number, coupled with ends justifying means and selective sacrifice, to
- Mill's expanding utility from quantity to quality of advantages, to
- Jevons' focusing on the "calculus of pleasure and pain" and admonishing that "we must hold to the dry old Jeremy," to
- Sidgwick's trying to bridge both utilitarianism and economics at Cambridge, to
- Marshall's locating money and "mathematical fitness for analysis" at the center of an unbiased economics discipline, to
- Pigou's fastening these components onto gross national product.

Utilitarianism arose at the same time as capitalism, was seen to be far more accommodating than Adam Smith's ethics, and supported the drive toward "maximizing," however narrowly anyone chose to interpret outcomes. It allowed ends to vindicate means and recognized the usefulness of selective sacrifice. It reinforced the supposed "calculus" of summed advantages and thus easily meshed into already preferred patterns of trade and investment. There utilitarianism continues to reside today within western capitalism. We never give it a moment's thought.

And the philosophical underpinnings of capitalism have not essentially changed since their early formation. Economics has greatly matured, but capitalism is stuck in a set of rationalizations that reach all the way back to the 1700s and 1800s.

TWENTIETH-CENTURY UTILITY

So what happened to utility and utilitarianism in the twentieth century? Briefly, attempts to produce utility calculations, summing up usefulness and advantage, contributed to pushing economics along the path to becoming a science. Utilitarianism itself split into a dozen competing branches. Capitalists

benefited from the first, the refinement of economics, and ignored the second, the fragmentation of their system's supporting tenets. I comment on the economics in this section and on the philosophy in the next section.

In 1893 a young woman in her twenties published an article in Britain's *Economic Journal* that threw her dour Victorian male counterparts into a frothing hissy-fit. Caroline Foley chided professionals for overlooking "Fashion," the title of her piece. Much more than that, she pointed out that efforts to calculate utility to an individual and demand for goods and services are affected by the utilities and demands of others. Utility and demand are not simply "intrasubjective" to an individual, based only on his or her own needs. Rather, they are "intersubjective," that is, influenced by the utilities and demands of friends, acquaintances, and the wider population. She identified various ways that demands reach outside mere needs, such as a desire for imitation or conformity, a yearning for distinctiveness, and a preference for change regardless of need. What this meant was that an individual's demands and consumptions are swayed by the demands and consumptions of countless other people and therefore are incalculable. Quite simply, the utility measurement for a person cannot be accurately performed because it is subject to too many extraneous variables. The establishment scholars of the time were left yanking on their beards, trying to determine how to get out of this analytical box. A recent commentator summed up the jolt to the Cambridge school as follows: "[T]o express a utility function that reflects intersubjective determinants, as well as intrasubjective ones, requires a construction of almost unimaginable complexity. . . . Pigou concludes that . . . the individual's utility function for a commodity is undefined."[27]

The "unimaginable complexity" of the utility calculation contributed to several important developments in economics during the twentieth century. First, it advanced the mathematization of the subject, drawing on statistical resources and employing modeling methodologies. As Alan Blinder, an economist at Princeton, put it: "[T]he statement that economics became a science during the twentieth century is almost equivalent to saying that economics became a data-driven, econometrically-oriented discipline . . ."[28]

Second, together with its growing mathematical sophistication, the locus of the profession shifted from England to the United States. In the early decades of the twentieth century, the field was dominated by Cambridge, and Cambridge was dominated by utilitarians. John Maynard Keynes was the last of the truly great figures from the Cambridge school. After World

War II and in the decades since, outstanding work in economics has been done at universities such as Harvard, MIT, Yale, Princeton, Michigan, Berkeley, Stanford, Chicago, Columbia, Texas, and many other schools, government departments, organizations, and, of course, at the Brookings Institution, under whose roof I am writing this book.

Third, the "unimaginable complexity" of the utility calculation helped spawn game theory and behavioral economics. These research techniques are often directed to grasping the interplay between inter- and intrasubjective components of utilities, demands, decisions, and consumption patterns.

Fourth, perhaps stretching a bit, the difficulty in individual utility calculations may have had some small role in shifting attention to the national utility calculation. If the measure of utility for an individual is too problematic, then the measure of utility for an entire nation offers a welcome refuge. Some economists have spoken of the usefulness of a single number to summarize advantages for a group or state. Tom Warke noted that "unambiguous optimization requires a one-dimensional maximand," that is, a single number that can sum up an array of data.[29] In fact, such a number has been adopted—gross domestic product, or, more exactly, growth in GDP. This has become, for many people, an acceptable norm for gauging economic progress and, for others, even a satisfactory indicator of social progress. I am all for growth in GDP but such a "one-dimensional maximand" carries with it the relegation of rights and justice to inferior status.

TWENTIETH-CENTURY UTILITARIANISM

Meanwhile, the philosophy of utilitarianism was splintering into multiple pieces. Many thinkers found the central tenet of the greatest good for the greatest number, judged by the aftermath of specific acts, to be entirely too restrictive. They sought variants with different maximizers and different measures, as they struggled to recast utilitarianism into a more tolerable framework. My purpose in this section is not to elaborate on each subset that arose within the scheme, but rather to illustrate briefly the centrifugal force that seems to be spinning utilitarianism into less pertinent and ever smaller divisions.

In 1959 Richard Brandt, later at the University of Michigan, introduced the terms "act" and "rule" to distinguish between two forms of utilitarianism.[30]

Act utilitarianism reaches back to Bentham and his assertion that acts are to be judged on the basis of their direct consequences. Recognizing that calculating consequences for every act is cumbersome, indeed impossible, others have advocated rule utilitarianism, whereby one evaluates the results of following particular rules. For example, rule utilitarianism might say, "Always keep promises," whereas act utilitarianism might respond, "Only if doing so serves the greater good."

If act and rule are the two major subdivisions of utilitarianism, there are several other strains that have emerged, as noted in the accompanying box. I have resisted the temptation to go into detail on these variations because conveying more information on alternate schools is not the point.

Preference-Satisfaction: What should be maximized is the satisfaction of preferences of people informed of their choices. The philosopher John Harsanyi, a Holocaust survivor with Ph.D.s in both philosophy and economics and a Nobel laureate, is often identified with this school.

Ideal: Rather than just acts maximizing pleasure or happiness, there are friendships and aesthetic experiences that are innately agreeable regardless of any maximizing intent. The British philosopher A.C. Ewing is associated with this view.

Motive: Motives count beyond aftereffects, and one set of motives can have more utility than another. R.M. Adams at Yale University is sympathetic to this argument.

Negative: Trying to produce good at all times is burdensome. The aim should be only to remove evil. Karl Popper, notable in the philosophy of science and for many years a professor at the London School of Economics, is linked to negative utilitarianism.

Objective: Mere pleasure and preference are inadequate. There are features of human well-being that are intrinsically valuable, such as reason and community, and extrinsically valuable stemming from comfort, education, and freedom. David Brink at the University of California, San Diego, has been aligned with this position.

Besides these, other derivations include positive utilitarianism, theological utilitarianism, restrictive utilitarianism, and some types of hybrid utilitarianism.

The point is much simpler. In the view of many philosophers, a view I share, utilitarianism in its original form or in its more recent mutations fails to provide a satisfactory ethical basis. Dozens of philosophers have been trying to salvage Bentham and breathe life into his displayed corpse over much of the past century. In particular, some advocates of rule utilitarianism are prepared to apply restraints and entrench rights, even if these function as secondary principles. Many of these efforts have produced brilliant, sophisticated constructions, stirring rich debate. The intellectual exercise deserves admiration and respect. But the product is unpersuasive. Utilitarianism is a fractured philosophy, struggling for relevance at a critical time in history when its defects appear to far outweigh its merits. The effort to rescue utilitarianism with increasingly arcane redefinitions and limitations may be ongoing, but it is being overtaken by other philosophies that reject or reorder the maximizing standard.

What I want to turn to now is my final round of objections to utilitarianism. The philosophy's many rationales may be debatable, but its impact on capitalism is not.

INOPERABLE DOCTRINE, DEADLY PRACTICE

In the preceding chapter, I outlined problems that have been identified in utilitarianism, a philosophy that generally focuses its outlook on the greatest good for the greatest number. These include ends legitimizing means, lack of guidance for making complex choices, discounting of motive and intent, inadequate weight given to promises and commitments, little room for rights, and selective sacrifice of the interests of some to the greater interests of others. All of these issues can be seen in the explication of utilitarianism without reference to the real world.

Yet it is in the real world that these and other systemic shortcomings become even more vividly clear. I will elaborate on four aspects of utilitarianism I find most unsettling, namely that (1) justice is subordinate to other advantages, (2) the philosophy cannot be operated in practice, (3) it can only be misapplied, and (4) it has no mechanism for self-correction.

Justice Is Subordinate

Utilitarianism starts at the wrong point. It stresses the priority of utility over fairness. As philosopher William Shaw says: "It is true, of course, that for

utilitarians the goal of maximizing well-being ultimately determines what is just and unjust."[31] "For utilitarians, it is not rights, but the promotion of welfare, that lies at the heart of morality."[32] "As . . . critics argue, utilitarianism too easily permits one person's happiness to be sacrificed for the benefit of others. It ignores considerations of justice and fairness or, at best, subordinates them entirely to the principle of utility."[33]

Utilitarianism places utility—usefulness, the sum of advantages, the greatest good—above other considerations. It makes justice an ancillary issue, deflected and demoted to a matter of lesser substance. If the greatest good is served by withholding justice from some, then justice can be sacrificed to expediencies that serve the greater good of others.

I do not find within utilitarianism—a philosophy that approves selective sacrifice and ends warranting means—adequate reason to avoid harming others if that serves by a larger factor to benefit myself. A utilitarianism that does not start with justice finds it very difficult to end with justice.

Much of this book is about rampant illegality and resulting global poverty and inequality. In other words, ends absolving means for some and pernicious consequences for others. This is the essence of my criticism of utilitarianism: Making justice secondary to anything contributes to an unjust world.

In the Congo section earlier, I wrote about captive labor being forced to mine coltan, a mineral used in cell phones and other electronic devices. There are other sources of the ore, but these sites and their production methods are particularly low cost. What do utilitarians say about this? "Suppose for instance that sacrificing the basic interests of one person somehow saves each of a large number of other people from some small loss, and that these losses, though individually slight, are cumulatively sufficient to justify the cost imposed on the one person. Critics [of utilitarianism] charge that it would be unfair to sacrifice this person for the benefit of others. Would it? . . . [U]tilitarians can accept the idea that in principle we would be justified . . ."[34] "Justified" in maintaining captive labor so the purchase price of your cell phone and the phones of I-don't-care-how-many others can be a few cents cheaper? It is the willingness to justify such acts under any circumstances that leads easily to justifying such acts under many circumstances.

Justice and rights make utilitarians uncomfortable, because they are a priori, subjective and not easily calculable. Some modifications to the stan-

dard model attempt to incorporate these concepts but still hesitate to place them ahead of beloved utility.

Utilitarianism rationalizes unjust results. In my view this subordination of fair play to maximizing outcomes voids any possibility of success for utilitarianism in the real world that I know. The justification of injustice is a fatal flaw.

Cannot Be Operationalized

My second objection is that there is no way to make the doctrine function in daily life. Measuring utility is dependent on calculations of pleasure and pain, advantage and disadvantage. Since Jeremy Bentham, 200 years of effort have failed to produce even a vaguely sensible mathematical formula. The young Caroline Foley showed that utility calculations are impossibly complex, and no one has since solved the problem. The theory is conditional on summing up or ranking happiness, pleasure, advantage, whatever, and it cannot get to that point.

Not all philosophers feel it is necessary to offer ideas that can realistically be put into general use. I fully respect the satisfaction of pondering a problem whether such an exercise has any application at all. However, Peter Singer, a distinguished utilitarian philosopher at Princeton, argues the opposite case: "[A]n ethical judgment that is no good in practice must suffer from a theoretical defect as well, for the whole point of ethical judgments is to guide practice."[35] For his own philosophy, then, the "theoretical defect" is the fact that the "ethical judgment" cannot be put into "practice." The ethical judgment cannot be made because it is dependent on a calculation that cannot be performed.

Utilitarianism starts on the wrong foot and lays out a path that cannot be traversed. It wants to sum advantages but cannot say how to do so. On just these grounds, it has already overstayed its welcome.

Can Only Be Misapplied

A third objection to utilitarianism is that inherent in the program is its own inevitable misapplication. A formula that calls for the greatest good for the greatest number is impossible to implement. What happens then is that the formula is almost always reinterpreted to mean the

greatest good for my number—me, my family, my community, my company, my country. Utilitarianism leads to abuse, rarely to adherence. It cannot, in fact, be followed, let alone perfected. Infidelity is built into its interpretation.

Utilitarian precepts of "make sacrifice" and "greatest good" can only realistically be deployed into the global community in terms of your sacrifice and my good. Utilitarianism's operational failure rests within its unavoidable misapplication. While the goal of the greatest good is well-intentioned, the utility calculation necessary for getting to such a point cannot be performed, and therefore failure in utilization of utilitarian guidelines is inescapable.

I have known many bankers and businesspeople who believed they were doing the right thing, serving the greatest good, when they helped Mobutu, Suharto, Abacha, Marcos, Montesinos, Pinochet, or other tyrants, as well as countless corporate and individual tax evaders, move money out of poor countries into rich countries. I am not suggesting for a moment that every one of these people knew that what they were doing was hurting others. On the contrary, many instinctively felt that protecting wealth, providing stable return on investment, was the right thing to do. Hardly ever was a passing thought given to how many people might be injured by such a process. Utilitarianism contributes to condoning both the conduct and the consequence. It cannot constrain its appetite for summing results and cannot constrain its localization of the greatest good.

Utilitarianism says to the business community that maximizing is the first order of business. Capitalists take this as justification for an overriding concentration on profit maximization, prior to other considerations. This is my most basic criticism of utilitarianism. The focus on maximizing prior to other concerns is inevitably taken to excess. To those lingering utilitarians who think their philosophy is basically sound, just misapplied, my answer is, there is no way to prevent it from being misapplied, and that is why it is basically unsound. Misapplication is inescapable; therein is its downfall.

Is Not Self-Correcting

A maximizing philosophy lacks the capacity to be a moderating philosophy. Look back at Figure 5.1, illustrating the separation between rich and poor over a span of 160 years. By following Adam Smith, this would not be the historical reality. By following Jeremy Bentham, this is the reality, and utili-

tarianism, operating through tenets of maximizing and ends rationalizing means and selective sacrifice, is in part responsible for the results. Having contributed to the problem, utilitarianism is not simultaneously the way out of the problem.

The political scientist John Plamenatz recently wrote that theorists "today no longer speak, as Bentham and his disciples did, of 'maximising happiness,' but they still speak of 'maximising' . . ."[36] Milton Friedman, a Nobel Prize winner in economics, finds anything other than maximizing to be irresponsible: "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. . . . If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is?"[37] Take that sort of reasoning, slowly feed it into business school curricula, wait a couple of decades, and you will get the Enrons and WorldComs and hundreds of other outrages that have damaged the market's reputation and performance in recent years.

As we move further into the twenty-first century, moderation of global income gaps is necessary, and utilitarianism, inevitably misdirected to one's own maximizing, lacks the capacity to be a moderating influence. At the same time, substantially curtailing illegal activities is required, and utilitarianism, with ends forgiving means, lacks the capacity to be self-correcting of the excesses it has helped create.

Today's capitalism, sustained by eighteenth and nineteenth century utilitarianism, sees little need for correction or moderation. The philosophical system backing capitalism has to change. Justice has the ability to be self-correcting, and it is in the direction of greater justice that capitalism must move.

DISUTILITY

In the Prologue I wrote about sitting on my patio next to Five Cowrie Creek, in the Ikoyi residential section of Lagos, looking across the half-mile of water at the American and Soviet embassies. With one representing capitalism and the other representing socialism, I asked myself repeatedly why neither was working satisfactorily in the poorer countries of the world. And

I realized years ago that I needed to come to some sort of answer to this question in order to grasp fully what was happening in the interplay between illegal activity and resulting poverty that I saw all around.

Marxism, which guided the affairs of billions through much of the twentieth century, failed because of flaws built into the ideology and its application. Within its codification as interpreted by Lenin was an internal contradiction, a necessity that the masses be governed by an elite party, which inevitably became corrupted. And in application the Marxist creed ultimately could not motivate people to effort, productivity, and achievement. Tens of millions died unnecessarily in this joyless straitjacket, and billions more struggled through shabby, unfulfilled lives. Marxism's departure from respectable company is a most gratifying development.

Capitalism's own shortcomings need to be appreciated. Even in countries that remained outside the communist orbit, capitalism has certainly not worked for everyone. Why? Take Adam Smith's free-market system, forget the ethics he knew were necessary for its proper operation, adopt instead Jeremy Bentham's notions of maximizing, selective sacrifice, and ends exonerating means, lock this concoction in place for 200 years, and what results is exactly what we have now—enormous wealth for a few, poverty for many, a structure of illegitimacy excusing both these outcomes, and social tensions straining the fabric of civilization. A bit of an oversimplification, admittedly, but not by much.

Some philosophers imagine that utilitarianism is theoretically salvageable. I seriously doubt it. It is not practically salvageable. Of this I have little doubt. I see utilitarianism as a major contributing factor to the breathtaking disparity that arose during the nineteenth and twentieth centuries. I see little possibility that utilitarianism will meet the tests of the twenty-first century.

Some philosophers also assert that no one remains a strict utilitarian today. If so, no one told the capitalists themselves, who still embrace the strong, original tenets of the system. A few of the many permutations on the utilitarian theme have moved well beyond the philosophy's early canons. Yet utility remains first, and rights and justice are second, arising after utility is maximized. Just as Marxism saps incentive, utilitarianism saps justice. It cannot do otherwise.

One of the more damaging perversions in western thought is the comforting idea that utility equals morality. Whatever produces the greatest advantage is the correct thing to do. This creates a gaping hole in western ethics, big

enough to accommodate the hugely successful global structure facilitating illegal dealings and at the same time a concentration of global income at the top, unimaginable to Adam Smith, and unparalleled in history.

Utilitarianism is exhausted. It is unable to address current problems. Marxists believed their philosophy could promote incentive. It could not. Utilitarians believe their philosophy can promote justice. It cannot. This is a spent doctrine. It has no poetry, no stirring stanzas, no language to lift the soul.

But it still sits in the middle of capitalism, as the stuffed carcass of Jeremy Bentham still sits in a glass case. It contributes to focusing the attention of businesspeople and bankers first, foremost, and often exclusively on the bottom line. The calculated good becomes the ethical good. Profits are more important than how they are earned. A.C. Ewing put it well: "[U]tilitarian principles, logically carried out, would result in far more cheating, lying and unfair action than any good man would tolerate."[38] Only it is not "would" speculatively; it is actually happening in the real world. A fair proportion of corporate and banking profits are generated by abusing rather than honoring the way commercial and financial affairs are intended to operate.

With the failure of Marxism, the capitalism–utilitarianism combination has triumphed. Most unfortunately, this has brought out over the past 15 years the worst excesses of this union, with more corporate scandal, more illicit dealings, more crime, more trillions of dollars moving illegally across borders than ever before. Capitalism's conquest masks its ongoing problems. All of a sudden, it finds itself ill-equipped in its most basic underpinnings to face the demands for justice and fairness required by billions of people in the twenty-first century.

I am not attempting to make an original contribution to philosophy, but I am commenting on the application of philosophy. It may be arguable that utilitarianism served capitalism in the early years of the Industrial Revolution. Whether it was the best of philosophical options I leave to historians. But the utilitarianism in practice today, retaining its maximizing presumption first and relegating global justice to second, inadequately serves the 80 percent of the world who scrape by on 10 to 30 percent of global income. The capitalism–utilitarianism joint venture that sustains widespread illegality and massive inequality is poorly configured to meet the imperatives of this century. Capitalism must embrace justice within its basic commitments. Without overturning utilitarianism and prioritizing justice, capitalism will be an underachieving economic arrangement in the years ahead.

CHALLENGE

Reading Part I on illegality and Part II on inequality, you might conclude that this, quite simply, is the way the world works. But reading Part III on distorted philosophy, I hope it becomes clear that the way it works is in part a choice we have made, based on a set of rationalizations we find comforting.

I told the story at the opening of this Part III about the confrontation I had with the minister of industries in a poor country. She was intent on distorting capitalism to cheat one segment of her society in order to advantage another segment of her society. She was advocating Jeremy Bentham writ large: selective sacrifice, greater good, ends justifying means. The story may have seemed a bit curious then. Perhaps its relevance is more obvious now. That country teeters on the brink of state collapse. And whether it is one country or one world, the process of disadvantaging, defrauding, plundering a part of society for the supposed greater advantage of another part of society is flawed policy. Can anyone seriously argue that this is where we want capitalism to be?

My third challenge is directed to philosophers and others, not with a daring or defiant tone but with a plea for reflection grounded in reality.

Memorandum
To: Philosophers, Economists, Political Theorists, and Social Scientists
From: Capitalism's Achilles Heel
Subject: Challenge: New Foundations for Twenty-First-Century Capitalism

Integrating reality and theory, propose the contents of fresh philosophical underpinnings for the capitalist system. Consider in particular:

- The role of utilitarianism in nineteenth- and twentieth-century capitalism.
- Current trends in poverty, inequality, crime, terrorism, population growth, globalization, and connectivity.
- Relations of rich and poor nations.
- Relations of rich and poor people.

- The state of international law.
- New theories of global justice emergent in recent years.

From this grounding in world issues, formulate a revised set of philosophical concepts that can serve to enhance capitalism's contributions to global prosperity.

The past 30 to 40 years have been the most active period in history exploring alternative conceptions of justice. This has been conducted almost entirely behind ivied walls, unseen by the vast majority of participants in the free-market system. The challenge I pose does not rule out a utilitarian social contract, though I personally find those three words to be self-contradictory. I share the philosopher Bernard Williams' anticipated obituary for utilitarianism: "The day cannot be too far off in which we hear no more of it."[39] In place of utilitarianism, new concepts of justice provide a rallying point for twenty-first-century needs, commented upon further in Chapter 12.

The third part of capitalism's threatening continuum is distorted philosophical underpinnings. We have rejected Adam Smith's ethical prerequisites for operation of free markets and have adopted strict interpretations of Jeremy Bentham's utilitarian rationalizations. The capitalism–utilitarianism union has remained virtually unchanged for two centuries. It is unlikely to survive another century. There are alternatives far more conducive to world progress, and capitalism needs to enfold new thinking in order to refresh its mandate and lift the whole of humanity.

PART IV

RUN IT RIGHT: TRUST THE SYSTEM

Norms, ideas and practices migrate from the private sector to the public sector.[1]

—Alan Schick, 2003

Where ends are agreed, the only questions left are those of means, and these are . . . technical . . .[2]

—Isaiah Berlin, 1958

THE BANK OF AMERICA manager in Nigeria, Bill Riley, telephoned and asked that I come see him. It was 1965, and I was young and needed to get my teeth into something really challenging. He told me that the Speaker of the House of Parliament, Alhaji Jalo Ibrahim Mohammed Waziri, a Muslim northerner, had a trucking company, J.I.M. Transport, Ltd., that was in default on its loans and going out of business. He asked if my company would be interested in taking it on under a management contract.

I called on the Speaker at his parliament offices. He was a large man, warmly personable, and rather desperate to solve his financial problems so they would not damage his political career. I also went to J.I.M.'s offices, a hole in the wall in Yaba, a section of Lagos, and met the managers and some of the drivers, all Muslims. The company was down to seven decrepit trucks. Some 18 other vehicles being acquired on "hire purchase" arrangements with dealers had already been repossessed for nonpayment of

monthly installments. The business, scarcely more than a bucket of bolts, had one asset. The Speaker was a good friend of the local managing director of Guinness Brewery, and J.I.M. had a contract to haul stout from Lagos to a dozen destinations in the north of the country, in the Sahalian area at the base of the Sahara. Full loads up and empty bottles back was a good deal, if the business could be operated efficiently. Naïvely, I signed my company up as managing agent of J.I.M. Transport.

The first thing we had to do was get a life insurance policy on Jalo Waziri, with Bank of America as beneficiary. He went to a designated doctor, stepped on the scale, and smashed the pointer against the stop at 20 stones, obviously weighing well over 280 pounds. The doctor begged him to get off and refused to complete his medical report until an accurate weight could be obtained. I telephoned the managing director of Avery Scales, a British company, who suggested that near the parliament building was a horse scale at the racetrack. I thought about this for an hour, decided that taking the Speaker of the House to get on a horse scale was no way to start a relationship, rang the Avery manager back and asked him to come up with an alternative. An hour later he called back and suggested the scale at the Ministry of External Affairs used to weigh outgoing diplomatic pouches. This I could sell; we got the weight, the policy, and the loan extension from Bank of America.

I talked Mercedes-Benz, Fiat, Leyland, and Volvo into returning the trucks they had seized for missed payments. With the fleet reconstituted, J.I.M. was back in business. I fired Jalo Waziri's underperforming family members, much to his chagrin. Three months later, in January 1966, Nigeria's first coup d'etat occurred, as a group of Ibo army officers assassinated the prime minister, a respected northerner, and other prominent leaders. Parliament was suspended and Jalo Waziri adopted a low profile. A counter-coup eight months later put northern military officers in power, but civilian politicians were still out of favor. The country descended into civil war—the three-year Biafran conflict—killing perhaps a million people.

I quickly learned the realities of the trucking business in Africa. Once a vehicle is loaded and out of sight, you cannot control what the driver does. Overloading the truck by adding private cargo was the norm. Short hauling to unscheduled destinations was universal. Auctioning off cases of stout on every trip was standard procedure, claiming the goods were damaged in transit. Drivers sold their diesel fuel, claiming to run out, and then would

remain supposedly stranded until more money was received to fill up again. Even complete complements of brand new tires were sold off, as drivers returned with threads complaining that the roads were bad. Vehicles were quickly depreciated through collisions and carelessness. For three years I tried to operate the business just like every other trucking company was operating in the country, most owned by Syrians and Lebanese. We paid low wages to these terrible, dishonest drivers and raged at them for overloading, short hauling, accidents, loss of cargo, and selling off fuel, tires, and tarpaulins. We were barely surviving, in most months losing more money than we were making. The company was almost out of business again, and I, having swapped unpaid management fees for substantial ownership, was thoroughly fed up.

Now in my own desperation I called together three or four of the better drivers for a no-holds-barred set-to. This continued over several weeks and resulted in a totally fresh concept about how to run the business.

To make a long story short, we formulated a truck manager's contract, to be signed by the company and each driver. In return for no overloading, no short hauling, no cargo or equipment sales up country—in other words, in return for completely honest and reliable performance—we agreed to a series of pay improvements and benefits. We doubled the wages of the drivers. We also gave them a trip allowance in lieu of any petty claims, which they could spend as necessary on tire repairs or minor engine service or keep for themselves if no need arose. We also added a bonus for three round trips in a month, more for three-and-a-half, and a super bonus for four. With this package of incentives a driver could make much more money than recent university graduates. Then the smartest thing we did was add a huge award for the best driver of the year, an all-expenses-paid trip to Mecca to make the hadj and earn the name and status of "Alhaji."

Within four months we became the fastest growing and one of the most profitable transport companies in the country. We expanded and reequipped the fleet entirely with 18-wheel semis and all-steel-bodied trailers, including 400-gallon fuel tanks enabling 2,000 mile round trips with the diesel supplied. We immediately attracted the best drivers away from other companies, guaranteed our deliveries, raised our hauling rates, ran up and down the roads with safe and secure cargoes, and left our competition in the dust. As far as I am aware, overloading, short hauling, and other plagues of the trucking business ended altogether for us. Literally, in months we went from

the brink of bankruptcy to boom. Harvard Business School included this in its early 1970s case studies of my activities in Nigeria.

Can you imagine what I learned from this hard-won lesson, a lesson I applied in other businesses? When you run it right, you can trust the free-market system. J.I.M. achieved turnaround because out of loss and hostility arose dialogue, resulting in new thinking, shared stakes, and operational integrity. The elements of our success were communication, mutual respect, incentives, and profits. We applied these principles, and all of us—drivers, managers, my company, Jalo Waziri, and Bank of America which received its loan repayment—benefited handsomely.

Years later Nigeria "indigenized" the trucking business, forcing foreigners out and reserving the field for wholly Nigerian-owned entities. We altered the name of our company, shifted from transportation to leasing, and turned our fleet over to two firms formed out of J.I.M., one owned by the transport manager, Alhaji Baba Manu, and the second owned by the best driver, Alhaji Inuwa Kari. They kept the same management systems in place, prospered, and we bought many more trucks in our reconfigured vehicle leasing business.

One company does not illustrate the whole of capitalism, but it does make a point. When you operate it properly, with respect and fairness and shared benefits, the system works. This is essentially the subject of Part IV: Run it right; trust the system.

CHAPTER 11

CAPITALISM'S ACHILLES HEEL

FOR MORE than 300 pages I've talked about issues along the continuum threatening to global capitalism. We've covered a lot of ground—law, business, banking, economics, and philosophy, illustrated with country studies plus the yakuza and Al Qaeda. Hopefully, it's been an informative and entertaining read.

Illegality, inequality, and philosophy exist along a continuum because actions are linked to consequences, consequences are linked to rationalizations, and rationalizations are linked back to actions. At the intersections along this continuum there is overlap, as one part bleeds into another.

I'm reminded of a statement made by Anton Allahar, a sociologist: "The 'generalist' lives in constant fear of the 'specialist.'"[1] In order to assure that what you are reading is as accurate and correct as possible, I've sought the wisdom and advice of many specialists—lawyers, economists, and philosophers. In addition, others have advised on particular aspects of drugs, criminal groups, country studies, and government regulations.

On the contributions of generalists—those of us who ponder connections—Tom Friedman in *The Lexus and the Olive Tree* quoted Murray Gell-Mann, the Nobel Prize physicist, as follows: "[W]e human beings are now confronted with immensely complex . . . political, economic and social problems. . . . With a complex . . . system you have to break it up into pieces and then study each aspect, and then study the very strong interaction between them all. Only this way can you describe the whole system. . . . We have to learn not only to have specialists but also people whose specialty is to spot the strong interactions and entanglements of the

different dimensions . . ."[2] Indeed, we generalists who look at relationships between issues have our own role to play.

Concerning any mistakes in the text, two points are appropriate. First, they are my responsibility alone. And second, I would be delighted to receive from you, the reader, corrections and updates, as well as your stories about corruption, global criminality, and commercial tax evasion and your views on issues of inequality and philosophy. Tales, input, and feedback can be sent by accessing capitalismsachillesheel.com and clicking on the "contact us" button. I look forward to interacting with you.

Now, having acknowledged my appreciation of the specialists, defended the generalists who take a broad view, and invited your participation, let me reconfirm that I believe the basic thrust of this book is sound. Illegality is rampant, inequality is staggering, and distorted philosophy underpins both outcomes. These three features of today's global capitalism exist on a continuum, where each flows seamlessly into the others. This continuum is threatening to global progress, and the twenty-first century requires that the three realities be altered and the linkages between them be broken.

Earlier I referred to the "legitimization of illegitimacy." Dirty money has become a catalytic element in a transformed global dynamic. Whereas we formerly spoke of the north-south divide, the more accurate picture today reflects a rich-poor divide, with money as the unifying factor among the world's rich, far more so than education, culture, or savoir-faire. We have created an entire structure of entities and mechanisms designed to defraud and cheat our fellow members of the global community and evade our responsibilities to our own and other states. This structure is used by drug dealers, criminal syndicates, terrorists, corrupt officials, corporations, CEOs, and tax evaders. The instruments and their users undermine the capitalist system.

The richest countries are the biggest promoters of lawlessness in international trade and finance. In a process that parades as agreeable enterprise, illegal money in the trillions of dollars flows effortlessly. The money streams through mechanisms designed by western countries to bring hundreds of billions annually into western coffers.

Furthermore, North American and European countries, as well as other states, maintain legal loopholes that encourage illegal inflows. Gaps are left in statutes that keep open the doors to criminal and tax-evading money. As a result, every western nation fails in its anti–money laundering efforts. There

is no way to effectively curtail some forms of dirty money while at the same time rolling out the red carpet for other forms of dirty money.

More than 60 sovereignties sell their laws to criminal and commercial buyers. Well over a million dummy entities exist for the purpose of subterfuge and evasion. Much of the world's money passes through systems and sites designed to handle illicit proceeds.

Corporations ask their people to indulge in what may be criminal offenses, without ever batting an eye or informing them of possible risks. The point is not that employees may be caught. The point is that they may be criminals without ever knowing it, so normalized have become the abuses to trade and financial transactions. When corporations do it, they lend support to drug dealers, human traffickers, smugglers, arms merchants, and even terrorists who step easily into the same channels.

I left Part I with a very simple question. Can the case be made that it is worth it?

Illicit proceeds, the first station I have addressed along the continuum threatening to capitalism, morphs straight into poverty and inequality for billions of people, the second part of the continuum. The money that illegally passes out of developing and transitional economies into western accounts is two to three times the total amount of money available to the poorest 20 percent of the world. Dirty money causes disaster for millions and deprivation for billions. No other economic condition generates so much harm for so many people. A system that continues to support such massive illegal flows, sustaining poverty, and contributing to historically high levels of global inequality, requires fundamental rethinking.

I have repeatedly called attention to the 70 to 90 percent of global income that accrues to the richest 20 percent of the world's population. This is the biggest threat to capitalism, the concentration of income at the top that, unless dramatically altered, can bring the system down. But capitalism is seductive; when it makes us rich we lose our criticism of its shortcomings.

Many people believe we can ignore the gap between rich and poor and let trickle-down economics and other natural forces narrow global disparities over time. This is tantamount to betting the capitalist system on some future changes that are not now apparent. What are far more evident are processes at work that worsen the gap or forestall its moderation. Under current conditions, global economic convergence is hardly foreseeable.

And it is the conditions that sustain massive global inequality that must change if capitalism is to succeed in spreading prosperity.

The *Economist* is certainly one of the world's most respected publications, and therefore I would hope to see a slight qualification to a point made in a 2004 essay: "They are quite right, these champions of the world's poor, that poverty in an age of plenty is shameful and disgusting. But they are quite wrong to suppose . . . that the rich enjoy their privileges at the expense of the poor—that poverty, in other words, is inseparable from a system, capitalism, that thrives on injustice."[3] Poverty can obviously have its own causes. But capitalism as it is practiced today can generate injustices. That portion of poverty which arises from rank illegalities in which westerners participate is indeed unjust, as I think the *Economist* would agree. And from my analysis, that portion happens to amount to hundreds of billions of dollars a year.

How can changes in pervasive illegalities and debilitating inequalities occur when both outcomes are rationalized by capitalism's distorted philosophical underpinnings, the third part of the continuum threatening to the system? Frankly, Adam Smith has been trashed, as we preserved only his "invisible hand" to justify many other perversions of his moral philosophy and much of his free-market thinking. Smith understood full well the character of the people it would take to run his system properly, and he would be terribly disappointed today to find that illegal pursuits and enormous disparities have arisen from distortions of his ideas. We grabbed his free markets and shunned his ethics and produced exactly the world he sought to avoid.

Because coming along at about the same time was Jeremy Bentham with much more agreeable ideas. Life is all about maximizing, and the interest of the slow and unproductive can be sacrificed to the cumulative advantage of the quick and efficient. After all, ends justify means. The goal of the greatest good surmounts every objection.

Capitalism has embraced a strong utilitarian philosophy that is extraordinarily self-serving. With utilitarianism by its side, capitalism can explain away poverty and inequality and even anoint circumvention of the law where necessary to meet self-conceived maximizing goals. On the altar of justifying injustice, many outrages can be perpetrated.

Some readers may have initially been skeptical of the need to extend a hard look at global capitalism into the realm of philosophy. I hope it is clear

now. We have to seek an answer to the question, "Why are we where we are?" if we are going to answer the question, "How do we get where we want to go?" The third station along the threatening continuum, distorted philosophy, is a necessary component, perhaps the binding force, in understanding capitalism's Achilles heel.

If spreading prosperity to the whole of humanity is capitalism's ultimate goal, then let us turn to the question, "How do we get where we want to go?" Each of the three issues discussed in the preceding pages—illegality, inequality, and distorted philosophy—is addressed with recommended solutions in Chapter 12. Remember, if we run it right, we can trust the system.

CHAPTER 12

SPREADING PROSPERITY

RESOLVING THE three problems along the continuum threatening capitalism is a matter of will. It is not rocket science, not impossibly difficult, not something that should better be left to chance. Making up our collective minds may be challenging, but accomplishing agreed goals is, for the most part, readily achievable.

This chapter lays out proposed solutions to the serious strains evident today in global capitalism. Illicit dealings can be sharply curtailed, if we but choose to do so. Poverty and inequality can be cut with a properly functioning free-market system. And capitalism's distorted philosophical underpinnings can in time give way to the new focus on justice that is emerging from behind the walls of academe. Most of the approaches to resolving these issues are grounded upon our will to act, a determination that I hope is strengthened by all that has preceded in this book.

DELEGITIMIZING DIRTY MONEY

Part I on illegality was subtitled, "We Like the Money." The idea has to be replaced with, "Sorry, we don't want it." When we agree that it harms far more than helps us and our shared world, then we can substantially reduce it with a few strokes of the pen.

How? Say so. International financial transfers of proceeds that break laws in their origin or movement or are intended to break laws in their use are unwanted. There is no problem with admitting that we do not have laws

in place to catch all dirty money. There is a problem with cultivating and facilitating dirty-money inflows from other countries because we think they are good for us. When we decide we do not want it, say exactly that, and a lot of it will stop.

Now, let's put some teeth into this. Every western country leaves holes in its anti–money laundering laws in order to encourage the inflow of illicit proceeds from other countries. Frankly, it's ludicrous to try to stop drug and terrorist money while welcoming other forms of criminal and tax-evading money. Chapter 4 demonstrates the holes in U.S. law accommodating criminal funds arriving from abroad. Canada has done a better job than the United States in removing the difference between what constitutes money laundering, whether the illegal origin of the proceeds is domestic or international. European Union countries are being encouraged by the European Parliament to adopt wide definitions of cross-border money laundering. The United States must do the same thing. Step one is to pass national law along the lines of the current Canadian anti–money laundering statute that applies to proceeds "obtained or derived directly or indirectly as a result of . . . an act or omission anywhere that, if it had occurred in Canada would have constituted" an offense under Canadian law.[1] "Anywhere" is the operative word. If it's illegal arising domestically, then the same kind of money is illegal coming from abroad. No argument!

But there will be argument. Bankers will cry that they need all that dirty money in order to maximize profits, and elected officials need political cover in order to take courageous positions contrary to the banking industry. The following addresses both groups and their concerns. First, an appropriate congressional committee can call for a GAO study. In the Senate this might be Banking, Finance, the Permanent Subcommittee on Investigations, or the Caucus on International Narcotics Control. In the House, Financial Services would be most logical. The private sector—corporate and financial—should be invited to submit briefs addressing a very simple question:

> Which categories of illicitly-generated foreign proceeds now legally receivable in the United States do you wish to retain as legal coming into the United States? Analyze both the benefits and the costs of such funds in the recent past and in the foreseeable future.

In other words, make the case that dirty money or any part of it is good for the United States. Is it the proceeds of human trafficking, smuggling, counterfeiting, fraud, theft, or any one of dozens of other types of criminal proceeds that are vital to the U.S. economy? Make the case, or agree that we don't want it.

Second, with responses in hand, congressional committees can conduct hearings and consider legislation. The United States cannot continue to be an anchor holding back the full embrace of legal dealings. Congress has to put all criminal proceeds, domestic and international, under anti–money laundering legislation. The astounding growth in cross-border crime in recent decades demands a very firm response from western governments, and that response can only be taken seriously when 100 percent of criminally-derived proceeds are legally barred. This should be a non-negotiable no-brainer.

This still leaves commercially tax-evading money hanging out there, not now included as a specified unlawful activity in anti–money laundering legislation in the United States and in most other countries. Many lawmakers do not take seriously the issue of tax evasion by corporations and financial institutions and hesitate to bring strong legislation to bear on generating and handling money known to be tax evading out of other countries. Timing may suggest the wisdom of addressing criminal money first, as just discussed, but eventually tax-evading proceeds spirited out of poorer countries through cooperation between westerners and non-westerners must be dealt with as well.

Incredibly complex? On the contrary, what western countries are trying to do now is incredibly complex. We are trying to close doors to some categories of dirty money we don't want while at the same time soliciting and channeling dirty money we do want. And we have completely failed, achieving a 99.9 percent failure rate.

How could a policy of "Sorry, we don't want it" work? Four steps.

1. Banks should be required to inform in writing foreign account holders that incoming deposits are welcome for money that is legally earned and transferred and will be legally utilized and not welcome for funds that do not meet these criteria.
2. Foreign account holders should be required to sign that they have been so informed and will abide by the bank's directive.

3. Each responsible western nation should announce, through its finance or treasury ministry or through the office of its president or prime minister, that this is the nation's policy. Legal money—we welcome it. Illegal money—keep it or take it elsewhere.
4. Western financial institutions should be permitted to make temporary exceptions in cases that involve the safety or health of foreign account holders or their family members.

To those who decry overregulation, notice that none of the above steps is regulatory in nature, requiring an ongoing structure to administer. On the contrary, each is an expression of will put into practice. As I said earlier, the goal is not to stop all dirty money but to substantially curtail it. The most immediately effective step western countries can take to rein in illegal financial flows is to make it clear, "We don't want it."

Now, many private bankers confide that without tax-evading money from abroad they would be out of business. If an entire section of the financial industry is dependent on illegal resources for its continued existence, then that is indeed a sad commentary on the state of western capitalism. No objection is attached to private banking performed for clean money. But the indescribable damage done to billions of people by dirty money and by those who knowingly handle dirty money is most certainly objectionable.

Eventually the whole of cross-border illegal transfers, including tax-evading proceeds, must be cut. The only question is, until that day, how many millions will die from economic deprivation and how many billions more will be underachieving and how many states will be left weak and tottering due to illegal drainage of resources out of their countries?

I would like to see foreign journalists asking penetrating questions of western leaders in press conferences or interviews at home or abroad. "Are you willing to confirm that the United States/United Kingdom/France/Germany/Italy/Austria/Belgium/Netherlands/Luxembourg/Liechtenstein/Switzerland does not want to receive tax-evading money offered for deposit by citizens of my country? Are you willing to tell the people of my country that, if they have this kind of money, your country doesn't want it?" Western leaders need to be asked publicly to justify an indefensible position. That will help this dynamic begin to change.

TOUGHER ON CORRUPTION

In Chapter 6 it was argued that fighting corruption has to be a top-down exercise. The World Bank needs to put teeth into its anticorruption efforts, at the highest levels of offending states.

Borrowing countries should face a requirement. Elected and senior appointed officials are to declare their assets upon assuming office and pledge to declare their assets again upon leaving office. Some countries choose to require declarations now. The obligation should become normalized. If you want to be a public servant, be transparent. The people who are clean and intend to remain clean will not object. The poor in poor countries will add their thanks to the World Bank for contributing to honesty in government.

There is another step that should match this in the drive to clean up corruption in developing and transitional countries. Politically exposed persons (PEPs) should be barred from financial account activity in western countries. Anyone elected to public office or appointed to a senior administrative position in a foreign government should, for the period of time the position is held, have no transfers into or out of foreign financial accounts in G-7, G-10, or OECD countries. Banks do not have to return legally accumulated funds of serving officials, interest can still be earned, and principal can still be managed. But no incoming or outgoing transfers. Present anticorruption laws are not stopping raids on poor-country treasuries. Western financial institutions can sever their own receptiveness to such corrupt proceeds by freezing account activity while positions of public trust are held. Thieves like Abacha, Mobutu, Suharto, Marcos, Montesinos, Pinochet, Obiang, and thousands more should not be aided and abetted by responsible western institutions. We cannot control their venality, but we can control our cooperation with their venality. I've discussed freezing PEPs' accounts with bankers and found a refreshing open-mindedness to the concept. It is time major banks (such as the Wolfsberg group) did it now, without waiting years for global unanimity.

REINING IN THE SUPPORT STRUCTURE

In delegitimizing dirty money, there are additional steps that should be taken. The way to attack tax havens and secrecy jurisdictions is not frontally,

which gets into diplomatic issues, but obliquely, on what keeps them processing dirty money.

First, the U.S. Patriot Act took shell banks off the table, barring transfers into the United States from these camouflaged little subterfuges in the Caribbean, Channel Islands, the Pacific, and elsewhere. Now it's time to treat shell corporations, trusts, and foundations in exactly the same way. Entities that are hidden behind nominee shareholders, directors, and trustees must be equally off the table. No more transfers to U.S. or European financial institutions from disguised businesses and bank accounts.

Second, multinational corporations should be discouraged from using special purpose entities or international business corporations domiciled in tax havens. Every entity owned or controlled by a multinational corporation, together with its place of registration, should be listed in the firm's published annual report. Enron's 800 or so Caribbean financial dumps would have made very interesting reading.

Third, corporations should be required to file reports annually with tax authorities on the specific business purpose of any entity registered in a tax haven or secrecy jurisdiction, together with the entity's physical location and staff level. You may have a legitimate purpose, but the ball is in your court to explain it.

The thrust of these points is not aimed at attacking the sovereignty of island countries and tiny enclaves, thus incurring all sorts of diplomatic wrath. Instead, we make the secret and tax-evading entities that keep them in business much less attractive to the users.

Then the huge question is whether corporations should be required to publish tax returns. If they were, this would cut through many issues surrounding corporate tax evasion and would exert enormous pressures on corporations and tax havens to clean up their acts.

The argument is that a company that is chartered by the state, which belongs to the people, should be accountable to the state and the people. Furthermore, a corporation that is publicly owned should be publicly transparent, particularly in assuring that it is abiding by all laws, tax and otherwise, here and elsewhere, in its dealings.

In response, corporations claim that publishing tax information would reveal corporate information about where profits are earned and how costs and revenues are allocated. They want tax subterfuges to remain a competitive secret.

Some senior figures have advised me that tax confidentiality has in recent years become politically inviolable. I hope not. I find far more compelling the case that capitalism must cultivate and maintain public trust. With published tax accounts, many of the corporate scandals of the past decade would not have occurred and many more would be prevented in future years. Citizens and shareholders have a right to know that chartered public corporations are operating lawfully in all matters, including paying proper taxes in the home country and abroad. Corporations have misused tax confidentiality and in my view should now lose tax confidentiality. Capitalism will be much better off when its exemplars can be judged on how law-abiding they are in pursuit of profits. This issue will be around for some years to come.

Concerning both corporations and individuals, it's time for governments to exchange tax information. Earnings on accounts held by foreigners should be reported to home countries. Government-to-government sharing of financial data will go far toward curtailing illegal financial flows. This is the sort of step that is purely a matter of political will.

MISPRICING AND TRANSFER PRICING

How can mispricing in unrelated-party transactions and abusive transfer pricing in related-party transactions be reduced in international trade without regulating prices? The answer is straightforward. Demand honesty in pricing.

The first thing that has to be done is to bring both exports and imports under the same legal regime. Take the United States, for example. U.S. Customs administers laws on imports into the country but does not administer all laws on exports out of the country. Yes, Customs does collect the Shipper's Export Declaration, which identifies cargoes and states prices, but Customs does not own the data. The Commerce Department receives the information and does virtually nothing with it. Customs wants to assure proper pricing on imports in order to collect duties, but Commerce wants to ignore proper pricing on exports, which often brings illegal, tax-evading money out of other countries into U.S. coffers. False pricing can be significantly diminished when each nation treats imports and exports the same.

Existing U.S. laws that can be brought to bear on false pricing were discussed in Chapter 4. Briefly, with mail and wire fraud, making false statements, filing false customs declarations, and scheming to defraud, an ample number of statutes are available to attack this problem if the political will exists. Much the same is true in other western countries. And the World Trade Organization should put honest pricing firmly on its agenda, because false pricing distorts free and fair trade and moves more illicit money across borders than any other single mechanism.

Focusing on the United States for a moment, how many CEOs have informed their employees that participating in improper transfer-pricing decisions may be a felony offense? Suppose an executive, manager, or other employee addresses a letter to counsel, setting forth a scenario that involves substantially variant prices, use of mails and wires, and discussions of price or revenue manipulations for the purpose of altering tax obligations in one country or another. Suppose the inquirer asks for a one sentence letter in reply stating that the chance that such activity is or might be interpreted as a felony offense is zero. The writer does not want to take any chance of committing a felony or, more simply, just doesn't want to steal someone else's money, regardless of how slim the likelihood of a formal accusation or charge. Counsel is very unlikely to give a one sentence reply saying the chance is zero, for two reasons. One, it's not zero; law is evolving on this issue of cross-border tax evasion, as the earlier cases made clear. Deliberately cheating governments, whether one's own or another country's, via false pricing is in the courts. And two, no self-respecting lawyer ever writes a one sentence letter, unless it says enclosed is my many-pages-long memo. No; counsel cannot easily guarantee that false pricing is not a felony offense.

Where does this put CEOs of multinational corporations? With two classes of employees, those who will take felony risks and those who will not? The better answer would be to back away from abusive transfer pricing rather quickly. Prices should be based on costs, commercial opportunities, and uncertainties but should not be used to manipulate taxes through the pricing mechanism. Employees should not go home at night knowing or suspecting that they have committed a felony offense. And many employees may hesitate to remain with companies that ask them to take such steps. For both the corporation and its employees, it's simply not worth it.

If we really want honesty in pricing and integrity in financial reporting, CEOs and CFOs can be required to sign their annual reports containing statements that there have been no violations of laws pertaining to mail, wire, or customs fraud or making false statements. The declaration can even include a qualifier—except in situations where specific actions by a foreign government have made a temporary violation necessary. Not many multinational corporation executives could honestly sign anything approaching such statements today, which well illustrates a very serious problem in global capitalism.

For developing and transitional economies, almost all of which experience enormous cash drainage through false pricing, an instrument is available to curb this outflow—the pricing declaration. It can effectively curtail—not stop, but significantly decrease—mispricing and abusive transfer pricing. Incorporated into a country's required form of commercial invoice for imports or exports, to be signed by both buyer and seller, it covers the following points:

- Pricing conforms to world market pricing in arms-length transactions for the same or similar goods or services and contains no commissions or kickbacks payable into any external account.
- Pricing conforms to all tax, customs, and revenue laws of buying and selling countries and includes no element of mispricing or transfer pricing for purposes of manipulating taxes, customs, or revenues.

With this standardized declaration, a significant portion of false pricing is stopped in its tracks.

There is another approach that can be taken by governments of developing and transitional countries. Specifically in relations with multinational corporations, a contractual obligation can be required along the lines of the above pricing declaration that makes tax-evading transfer pricing illegal. If governments want to strengthen the contract, they can require that it be backed up by a resolution of the board of directors of the parent corporation affirming the policy.

There is a matching obligation that must be maintained by foreign governments. Remittances have to be prompt and routine, both on invoices for

goods and services and for interest, principal, and dividends from local subsidiaries and affiliates. No sympathy is due a government or its central bank that imposes unnecessary hassles on cross-border transactions. The answer is to insist on responsible corporate operations, including the pricing declaration, and then trust the system. By far the greater number of multinationals will not ask their people to violate a signed statement, and with two signatures much of false pricing can be eliminated.

One final point on pricing. Every developing and transitional state should have a law that bars foreigners from offering or providing illegal flight capital or tax-evasion schemes to local residents. The possibility of arrest and time in a foreign jail will stop many promoters of such mechanisms from plying their trade.

CAPITALISM'S CONTRIBUTION TO SLASHING INEQUALITY

I said in Chapter 4 that dirty money is the biggest loophole in the free-market system and in Chapter 5 that it is also the most damaging economic condition hurting the poor. Therefore the best thing that can be done to lift people out of poverty and cut inequality is to clean up the global financial system. Capitalism can make the greatest contribution to global prosperity, provided we run it right and trust the system.

Free trade is widely touted as the panacea for poor countries. I'm all for free trade. Provided it's legal. Provided it's trade and not surreptitious movement of capital out of poorer countries into richer countries by means of trade. Yes to free trade, provided we rein in the mispricing and exaggerated transfer pricing and kickbacks into western accounts that currently drain hundreds of billions of dollars a year out of poorer countries, relocated permanently into richer countries. To make free trade work far better in promoting growth and reducing poverty and inequality, clean up the global financial system.

As a part of free trade, stimulating exports out of developing and transitional economies is touted as their path to wealth. Just look at growth in China. On the other hand, just look at stagnation in Africa. I'm all for export promotion out of poorer countries and removal of tariff barriers and agricultural subsidies in richer countries. Provided the export revenues get

back to the poorer countries. It does no good when western laws and commercial practices encourage export revenues to stay abroad and not be repatriated back to exporting countries. More important than encouraging exports, clean up the global financial system.

Doubling or tripling foreign aid is touted as the best thing richer countries can do for poorer countries. I'm all for foreign aid. Provided the aid-giving countries don't take vastly more illegally out than the aid they are putting in. At the moment, the ratio is about $10 out for every $1 in. But $10 out and $2 or $3 in doesn't make much better sense. Far more important than multiplying foreign aid, clean up the global financial system.

Foreign investment was in the past and, for many, is still seen as the strongest contributor to progress in poor countries. I'm all for foreign investment. Provided such investment is intended to earn properly declared profits and pay dividends to overseas shareholders, rather than simply serving as a vehicle for transfer pricing in order to shift untaxed earnings offshore. Foreign direct investment into developing and transitional countries has in recent years declined from earlier highs and has been limited to a handful of economies, particularly China. To make FDI work effectively, clean up the global financial system.

In fact, more important than all four combined—free trade, export promotion, economic assistance, and foreign investment—clean up the global financial system. Or, to put it differently, all four are made far more effective by cleaning up the global financial system. At an estimated $500 billion a year of illegal proceeds streaming out of poorer countries, the best thing the West can do for the rest of the world is to curtail this flow, thereby leaving hundreds of billions a year in poorer countries to stimulate investment, boost trade, improve tax collection, pay for education and health, reduce poverty, and stabilize weak states. Market institutions rather than governments have the major role to play. The constituency committed to reducing poverty and inequality must be broadened to include western corporate and financial sectors. Business and banking communities should themselves be saying, "If this is our contribution to a better world, a fairer and more just world, then so be it. This is a step we can and will take."

Running capitalism right means cleaning up the global financial system.

Then we can trust the system to stimulate growth and spread income, giving everyone a stake in shared prosperity.

"... WHEN YOU PAY ME WHAT YOU OWE ME"

Foreign debt—a trillion-and-a-half-dollars—hangs like a death sentence over developing and transitional economies. They incurred the debt and, through illegal financial transfers, the West received from poorer countries money that could have been used for debt repayment. In fact, western countries cooperated in pulling out far more than the total debt burden. There has to be a solution to the debt problem.

Before offering my approach I share a last story. First, let me make clear that neither I nor any company of mine has ever failed to pay a bank debt. I always insisted on borrowing terms that included no penalty for prior payment, and can recall only twice when I was even delayed in meeting a bank obligation. Once was when a factory in Nigeria that I largely owned burned to the ground. The next morning I called on the manager of the bank extending the company working capital funds, assured him of repayment out of insurance proceeds, and added my personal guarantee to the company's note. We imported new machinery and were up and running in rented facilities in three months and rebuilt an expanded plant shortly thereafter. Years later Citibank paid me a high compliment. On an unprocessed loan application for a million dollars, I was asked if I wanted any of it immediately. I said yes, $250,000 would allow us to begin one piece of business promptly. The next day I was handed the check, weeks before the signature documents were prepared. With my father a banker, the last thing I would ever do is fail to pay a bank debt.

Having said this, there was a situation where I reneged on an account payable. One of my companies entered into an arrangement with the Nigerian subsidiary of a major Italian corporation, whereby we purchased from them and they contracted to provide services to us. To make a long story short, we performed and they didn't. I asked their managing director to come see me and forewarned him that his division manager was not fulfilling the contract and that hell was going to break loose if he didn't force compliance. For whatever reason the situation continued. Okay, I

stopped paying against my company's purchases for three months, running up a bill for about a quarter-million dollars. They sent me a demand letter, and I replied with scalding words about how they, a European multinational, were trying to take advantage of our Nigerian-American joint venture, miserably failing to perform their obligations while we diligently performed ours, and I claimed from them twice what they were claiming from us.

The managing director reacted. He called me to his office and, in the presence of his division manager and an assistant and the company's Nigerian lawyer and his assistant, he demanded his money. I said to the glowering group, "All right, I'll pay you what I owe you when you pay me what you owe me." After a few more words, they repaired to the adjacent board room for discussions.

Now, for those who know Africa, I want you to appreciate the scene. Three voluble Italians and two argumentative Yorubas are screaming at the tops of their lungs for nearly an hour, producing more verbal violence than I've ever heard, short of a couple of riots. Finally the managing director slinks back into his office and says, "Okay, you win." He asks me to make a token payment as a face-saving gesture for them. I agree to about $10,000, and we sign a paper releasing each other of mutual obligations.

The burden I laid on them, "I'll pay you what I owe you when you pay me what you owe me," was indisputable and insurmountable. But the point of this story is not that I won; the point is what happened next. After we cleared the debts and made a fresh start, we did many times the volume of business that we had done earlier. With mutual cooperation we both prospered, a win-win outcome for all.

This is similar to the approach that can resolve the debt issue. It comprises three elements: (1) balance responsibility, (2) weigh claims, and (3) look to the future.

Balancing Responsibility

Jeffrey Sachs, an articulate spokesman for the global poor, has often suggested that, in light of grossly inadequate debt forgiveness, developing countries should prepare to unilaterally cancel their obligations. Jubilee 2000, the London-based advocacy group, worked to achieve substantial relief at the

turn of the millennium, without dramatic success. Reneging on debt may become necessary, but before this step is taken we should first move in the direction of balancing the scales of justice.

The challenge put forward to the World Bank in Chapter 7 contributes to this process. An estimated $500 billion of illicit proceeds flows out of developing and transitional economies into western coffers every year. I called on the World Bank to produce its own estimate, forewarning that its figure could be higher. Appreciating the magnitude of illegal outflows from poorer countries into richer countries is a key element in understanding the ridiculousness of the debt issue.

Parallel with this effort, careful consideration needs to be given to a basic question: Is debt repayment by poorer countries in the best interest of our shared global community? Specifically, the Secretary General of the United Nations should pose this question and name a Panel of Eminent Persons to address the issue. The panel, similar to the international group that helped achieve majority rule in South Africa, should be drawn from among people who have demonstrated a broad global view. And it should produce a clear conclusion: Out of developing and transitional countries, debt repayment is or is not a contributor to the common interests of humankind. With clarity on what benefits both debtors and creditors, this issue can begin to move forward.

To serve on this Panel of Eminent Persons, the following are recommended:

Vaclav Havel, former president of the Czech Republic.

Joseph Stiglitz, economist and Nobel Prize winner.

Bono, debt expert and humanitarian.

Vargas Llosa, Peruvian writer.

Nelson Mandela, former president of South Africa and Nobel Prize winner.

Mary Robinson, former president of Ireland and former UN high commissioner for human rights.

Fujio Mitarai, president of Canon Inc.

Bill Gates, global humanitarian.

Lawrence Summers, president of Harvard University and former secretary of the U.S. Treasury.

Mikhail Gorbachev, former president of the Soviet Union.

Hanan Ashwari, Palestinian spokesperson.

With this kind of prominence, firepower, and alternative thinking, what now appears to be an insoluble problem can move toward solution.

I come at the debt issue from the position that it is the equal responsibility of both debtors and creditors. Creditors have cultivated and facilitated outflows from poorer countries that make debt repayment impossible. Debtors have willingly sent trillions from their countries into western accounts. Neither side can speak of the duplicity surrounding the interplay between theft and corruption on one hand and abetting theft and corruption on the other hand. The debt issue is largely at a standstill, and occasional, reluctant cancellation of a few billion dollars of debt is evidence of this deadlock, not evidence of its resolution.

My own bias should be clear. I do not believe it is in the best interest of anyone, creditor or debtor, for billions of people to be held in bondage for obligations that are the responsibility of both parties and can never be repaid. This is an affront to human consciousness. A debtor's prison has no rationale. To break the impasse, people with expansive global goodwill, not a narrow financial view, need to make the point.

Nor can developing and transitional countries any longer sit back and rely on the occasional generosity of western creditors to take pity and relieve overwhelming financial burdens. Debt payments out of weak states kill people. Leaders of poorer countries must push the issue forward. There are five steps that can underline the poor person's power in resolving the debt issue.

1. Move Paris Club negotiations with official creditors, representing bilateral debt owed to western governments, out of Paris and to the capitals of indebted countries. Require the creditors to come to you. When you change the venue from the seat of the creditor to the home of the debtor, you change the negotiating dynamic. Requiring this revision to the framework of debt negotiations can be done unilaterally without much risk. Major countries such as

Nigeria, Brazil, South Africa, Egypt, Indonesia, and others can announce this as a step in future Paris Club talks. Alternatively, regional organizations can take the step *en bloc*. The African Union can simply resolve that, for all its members, Paris Club meetings will henceforth be held in each nation's capital. Likewise, the Latin American members of the Organization of American States. Likewise, the members of the League of Arab States. Likewise, members of the Association of Southeast Asian Nations (ASEAN). This dramatic gesture, to which Paris Club creditors are largely powerless to object, sends a strong message that the days of imbalance between debtor and creditor are drawing to a close. A new day of mutuality is dawning.

2. On arrival in Abuja, Brasilia, Pretoria, Cairo, Jakarta, or other capitals, the site of debt negotiations will be the office of the president or prime minister. The country's head will be presiding. The stature of the poor debtors then exceeds the stature of the visiting creditors.

3. The president or prime minister of the debtor nation requests the following information: How much interest is paid on deposits of this country's citizens and corporations in creditor-country bank accounts? Don't tell us this is difficult to compute. You've already agreed to compile cross-border interest information between European Union countries, and therefore with the push of a computer key you can compile cross-border interest information equally on non-EU countries. When this information is available, perhaps further debt renegotiation can take place in an improved atmosphere of mutuality.

4. How much illegal money continues to flow out of this debtor country into creditor-country accounts? Are the results of the World Bank's analysis available, or when will such results be available? Admittedly, we the poorer countries have weaker legal and administrative structures than you the richer countries. For your part, you are abetting illegal flows out of this country. How much do these illicit transfers in all forms amount to?

5. As part of future debt negotiations, we would like all illegal transfers coming out of this country to be illegal coming into your countries.

> All forms of criminal, corrupt, and commercially tax-evading money. If it's illegal coming out of here, we would like the knowing receipt of such money to be illegal arriving there. Surely this is not too much to ask, that is, if we are together serious about resolving this debt issue. Please make this adjustment to your laws. If it's illegal out, then it's illegal in.

Weighing Claims

In my punch-up with the Italians, I estimated that they owed my company twice as much as we owed their company. This got their attention and contributed to resolving the issue.

Do poor countries have any claim on rich countries? Do weak states that have been and often continue to be corrupt have any claim on westerners who facilitate the corruption and add to the plunder?

Severely and moderately indebted borrowers owe about $1.5 trillion, and this is almost certainly lower than the amount of money that has passed illegally beyond their borders into foreign accounts. A rough estimate was offered in Chapter 4 of such accumulated illegal resources outside developing and transitional economies at perhaps $5 trillion. There is no way to come up with a figure of illegal money abroad as low as $1.5 trillion.

Neither I nor anyone else knows how to compare their illegal and corrupt behavior to our knowing cooperation in their illegal and corrupt behavior. They stole it, but we helped them steal it, and we willingly received their stolen property. Does that make them twice as guilty or equally guilty or some other measure of culpability as compared to us? Whatever it does, it does not make us in the West innocent of some measure of accountability for staggering sums of money that have passed illicitly out of poorer economies into our economies. We were neither passive nor naïve. We knew what we were doing. And we're still doing it.

The point is not that the indebted countries have a claim that can be documented against the West. I don't know how to compile such a number. The point is that I don't think the West has a solid claim against the indebted countries. Lenders have obligations to borrowers, the least of which is not to undermine the capacity of the borrower to repay. When lenders go

over that line, it becomes very difficult to argue that the debt instrument remains intact. In my opinion, both the Paris Club of official creditors and the London Club of private creditors have, by their own actions, weakened, diluted, and largely lost the legitimacy of their claims against the severely and moderately indebted. When I hear about "debt forgiveness," my question is, who will forgive the creditors?

Looking to the Future

In my story I told how, after clearing off our mutual debt claims, we went on to do many times the volume of business we had done earlier. Can you imagine a market of nearly five billion people released from a $1.5 trillion debt they can never repay anyway? How many cell phones or computers or textbooks or vaccines will that buy from the West? How much foreign exchange will that leave in the country to promote investment? How many jobs in commerce and industry will it create? How much will debt relief contribute to strengthening fragile democracies? How much better off will western countries be because non-western countries are more productive? These are the kinds of questions that a UN panel can address. Look at a world relieved of this mutual burden and recrimination and tell us if we can together have a brighter future.

Having said all this, outright cancellation is probably not the most effective approach. Debt offset is preferable, as other groups have also suggested. Increase domestic expenditures on education and health, and that will serve as an offset of an equivalent amount of foreign debt. Here's how it should work.

Take the central government's annual expenditure on education and health as a base line. Perhaps an average over the most recent three years can serve. Increase expenditures on education and health (perhaps also housing and conservation) above this base line, and the added amount spent internally on these services will cancel an equal amount of debt externally. The foreign debt gets liquidated through expanded social expenditures domestically. Annual expenditures would be inflation adjusted. The local World Bank office can monitor the process. Paris Club official creditors take the lead in setting up the arrangement, and London Club private creditors are subject to a "cram down" by the official creditors, that is, no

choice; they are forced to accept the same terms. As long as the indebted country is spending more on education and health than the base line, a portion of its foreign debt is being liquidated.

What does this do for capitalism? It strengthens the market's opportunities among five billion people. Every multinational corporation that produces a product that can be bought in developing and transitional countries should favor debt relief. Corporate interests are not the same as the interests of the financial community. More than 80 percent of the world's population will have greater purchasing power when the unpayable debt is lifted. A win-win outcome for poor and rich alike.

Debt is a roadblock to global progress. It's time to stop playing penny ante and put all the chips on a bet that the world will be better off when it's gone.

RECONSTITUTE THE WORLD BANK

As stated in Chapter 7, the World Bank has never put the whole of the financial equation for development on the table. It has never analyzed the full range of illicit outflows into western accounts, causing deprivation and slowing growth in poorer countries. On the principal reason for its existence, it has not asked the right questions. David Reisman, an economist, once said, "[T]here is more merit in being fuzzily right than in being precisely wrong."[2] My estimate of $500 billion a year passing illegally out of developing and transitional economies into western coffers may be fuzzily right, but the World Bank, which has failed even to ask the question, is precisely wrong. What assurance can we have that fuller, deeper, more challenging queries will be posed in the future?

Reconstitute the executive directors of the World Bank. They and other senior ranks need to contain many more sociologists, political scientists, psychologists and, yes, philosophers, people who will ask a wider range of development questions than the World Bank has been willing to ask to date. At the moment the Bank is data driven ad nauseam. I'm all for data. But dependency on statistical analysis means that where there are no statistics there is no analysis. The Bank has allowed the availability of data to shape the questions, rather than having questions determine the pursuit of data. For the future, broaden the range of expertise and dis-

cipline that is available to analysis and decision making. The poor clearly deserve to have every economic consideration that makes them poor on the Bank's agenda.

JUSTICE FIRST

Capitalism is in lock step with utilitarianism, the third part of the continuum threatening to the system. Part III concluded with a request for reflection on this linkage and practical ideas on recasting capitalism's philosophical underpinnings. The fact is, the traditional foundations of capitalism are being shaken, but the capitalists themselves have not noticed.

An enormous separation has arisen between existing policy and new philosophy, between what is being practiced and what is being taught. The past third of a century has been the most active period in history pursuing ideas of justice, both within western countries and concerning their relations with poorer countries. Very little of this has seeped into boardrooms and CEO offices or has affected the way businesspeople rationalize their mandate. The intellectual ferment taking place outside capitalism needs to be appreciated, and then what this new thinking means for capitalism can be addressed.

The pivotal point in twentieth-century philosophical revitalization was the 1971 publication of *A Theory of Justice* by John Rawls. With a compelling argument, he challenged utilitarianism's 175-year reign and opened up political and moral philosophy to fresh examination.

Rawls was born in 1921 in Baltimore, Maryland, to a well-to-do family. The second among five brothers, two siblings died of infections caught from him, which contributed to his lifelong stutter. After graduating from Princeton University in 1943, he served in the U.S. Army for two years and was active in campaigns in New Guinea and the Philippines. Returning to Princeton, he earned a Ph.D. in philosophy in 1950, much influenced by the ethical content in the writings of Henry Sidgwick (Chapter 10). Following stints at Princeton, Oxford, Cornell, and M.I.T., he was appointed professor of philosophy at Harvard in 1962, where he remained for the rest of his life, mentoring students with inspiration and courtliness.

Rawls is clear in his purpose: "Perhaps I can best explain my aim in this book as follows. During much of modern moral philosophy the predominant systematic theory has been some form of utilitarianism."[3] In its place, Rawls seeks to "work out a conception of justice that provides a reasonably systematic alternative to utilitarianism, which in one form or another has long dominated the Anglo-Saxon tradition . . ."[4]

Rawls states his position:

> I do not believe that utilitarianism can provide a satisfactory account of the basic rights and liberties of citizens as free and equal persons, a requirement of absolutely first importance . . .[5]
>
> Each person possesses an inviolability founded on justice that even the welfare of society as a whole cannot override. For this reason justice denies that the loss of freedom for some is made right by a greater good shared by others. It does not allow that the sacrifices imposed on a few are outweighed by the larger sums of advantages enjoyed by many. . . . [R]ights secured by justice are not subject to . . . the calculus of social interests.[6]

Whereas Bentham deprecated rights and liberties, subordinating them to utility, Rawls puts rights and liberties in the position of "absolutely first importance."

Rawls poses a thought experiment. Suppose that rational people meet in an "original position," a position without precedent where they can negotiate the terms of their association. Furthermore, suppose they meet behind a "veil of ignorance" where the participants do not know their own class, status, fortune, ability, intelligence, strength, race, sex, and the like. From this original position behind a veil of ignorance, the principles of justice are to be chosen. The principles that emerge will be those that "free and rational persons concerned to further their own interests would accept in an initial position of equality as defining the fundamental terms of their association. These principles are to regulate all further agreements . . ."[7]

Rawls cogently argues:

> [I]t hardly seems likely that persons who view themselves as equals, . . . would agree to a principle which may require lesser life prospects for some simply for the sake of a greater sum of advantages enjoyed by

> others. . . . [N]o one has a reason to acquiesce in an enduring loss for himself in order to bring about a greater net balance of satisfaction. . . . [A] rational man would not accept a basic structure merely because it maximized the algebraic sum of advantages irrespective of its permanent effects on his own basic rights and interests. Thus it seems that the principle of utility is incompatible with the conception of social cooperation among equals for mutual advantage. . . . These principles rule out justifying institutions on the grounds that the hardships of some are offset by a greater good in the aggregate.[8]

This is a stunning concept, challenging utilitarianism and therefore the capitalism–utilitarianism union at its heart. Rawls is saying (and these are my words, not his) that if humankind could start again, we would never adopt the system we have in place now. We would not position utility ahead of justice and would not accept selective sacrifice, ends justifying means, and summing group advantages at the expense of individual rights. Bentham's system simply does not accord with what rational people would choose among their first principles of association.

There is no suggestion here that businesses should not be maximizing profits, operating efficiently, and competing. The point is much simpler: Capitalism should not place these aims ahead of justice in its institutions and transactions. Justice must be a prior condition, and then the maximizing instinct can more effectively lead to shared prosperity.

Rawls' book goes on for more than 500 pages laying out his theory of "justice as fairness," articulating his argument for "the priority of justice over efficiency and the priority of liberty over social and economic advantages."[9] He makes it clear that, while his original position and veil of ignorance are hypothetical conditions, he does seek "to derive a conception of a just basic structure, . . . that can serve as a standard for appraising institutions and for guiding the overall direction of social change."[10] "From the standpoint of the theory of justice, the most important natural duty is . . . to support and to further just institutions. This duty has two parts: First, we are to comply with and to do our share in just institutions when they exist and apply to us; and second, we are to assist in the establishment of just arrangements when they do not exist . . ."[11]

A Theory of Justice is intended primarily for "well-ordered societies" where there is a "public conception of justice."[12] Rawls sought to expand

his thesis internationally with *The Law of Peoples*, published in 1999. Drawing again on the model of the original position and the veil of ignorance, representatives of well-ordered societies would negotiate the terms of association between their peoples, likely to include respecting freedom and independence, observing treaties, honoring human rights, not intervening in each other's affairs, and helping people living under unfavorable conditions. Rawls is less surefooted in the global arena, and others have taken up the challenge of extending his concepts of justice as fairness to the world community.

Thousands of papers and books have been written on Rawls' *Theory of Justice* and his other works, and it is beyond my intent to critique this monumental set of commentaries. Suffice it to say that praise has been exceptionally effusive, and criticisms have typically focused on issues in his methodology. Rawls salvaged moral and political philosophy from the deep freeze into which they had fallen and laid down, supported by other writers, a powerful criticism of utilitarianism from which it probably cannot recover.

Among dozens of philosophers who have agreed with, expanded upon, or taken exception to Rawls' thinking, I comment on the works of just two. Robert Nozick, also at Harvard, offered in response to Rawls a libertarian perspective with *Anarchy, State, and Utopia* published in 1974. His "entitlement theory" regarding holdings of wealth and property requires (1) justice in acquisitions, (2) justice in transfers, and (3) rectification in situations where (1) or (2) is unjust. With rectification as a principle, should it then be assumed that libertarians favor returning trillions of dollars of ill-gotten and illegally transferred wealth back to poorer countries and cancellation of the foreign debts of impoverished nations?

Thomas Pogge, earlier encountered in Chapter 5, at Columbia University has been called an "ultra-Rawlsian philosopher," extending justice as fairness quite determinedly into the realm of relations of all peoples in the global society, not merely relations between states. Among his many writings, *Realizing Rawls* published in 1989 is dedicated to his former teacher at Harvard. Pogge challenges the view that ". . . truly grievous injustices exist only in the past or in distant lands and so need not concern us here and now. I conclude that we are advantaged participants in an institutional scheme that produces extreme poverty on a massive scale so that many persons are born with no realistic prospects of a life without hunger, malnutrition, and oppression. The

scheme is imposed upon these, its most disadvantaged participants—and imposed not by fate or nature but by other, more advantaged participants, ourselves included."[13] In another writing, " 'Assisting' the global poor," Pogge adds, "[T]he causes of the persistence of severe poverty do not . . . lie solely in the poor countries themselves. The global economic order also plays an important role. . . . [T]his order is shaped to reflect the interests of the rich countries and their citizens and corporations."[14] In countless other works, Thomas Pogge has consistently demonstrated a unique sense of reality in applying philosophical tenets to real world problems.

With Rawls as the takeoff point, theories of justice have now become the most active line of philosophical investigation. Capitalism cannot and will not be immune to these intellectual developments. Already, elements of the justice movement are beginning to filter, however hesitantly, into corporate agendas. The Caux Round Table of global business leaders, led by George Vojta, former vice chairman of Bankers Trust in New York, is pushing for fair play and honest standards on six continents. The UN's Global Compact urges corporations to exercise high standards in trade and investment, though as yet the Compact has been signed by only some 1,800 of the world's approximately 65,000 multinationals. The corporate social responsibility movement is growing, though Europe and Japan are ahead of the United States in the scope of what these company departments are able to influence. In short, whether spurred by the academy of philosophers or other factors, business and banking communities are beginning to sense that there are new patterns of thought and behavior that will grow. But ultimately we must penetrate beyond the outer layers of these issues and get to the core—the dominion of utilitarianism over capitalism.

In my view, utilitarianism has run out of gas. It may still be coasting, but it has no remaining explosive energy to propel it forward. It is, or is being, replaced by theories of justice that position justice as a priority before utility.

Capitalism must not only recognize but embrace this trend. We can keep our maximizing instincts, but we apply them after we have achieved justice in transactions, not before. The global dirty-money structure is unjust. The massive concentration of global income at the top—70 to 90 percent—contains a portion that is unjust and is self-defeating in its limitations on shared prosperity. Capitalism can be self-correcting when it puts justice ahead of maximizing, when it breaks the dead utilitarianism linkage.

How? Teach philosophy. Expose undergraduate and graduate students in business, law, economics, politics, and other fields as well, to philosophy.

Today, almost all business schools convey a basic lesson—the priority of maximizing. In other words, the capitalism–utilitarianism union is accepted as a given and transferred to young minds as an essential element in their understanding of the world. Strict utilitarian philosophy and its stuffed progenitor Jeremy Bentham are rarely mentioned, but students nevertheless learn to act in ways that are not articulated at a philosophical level. Fundamentally new currents of thinking that are flowing in other academic departments do not often reach into these classrooms.

If widespread corporate scandals and ongoing rampant illegalities have demonstrated anything it is that the teaching of ethics or organizational integrity or business responsibility or whatever else it may be called is not sufficient. Students I have talked to say that about half their classmates emerge from ethics courses thinking they have an obligation only to narrowly obey the law, with the other half thinking that occasionally they have responsibilities slightly beyond the law, but seldom are they exposed to inquiries that go much deeper than the status quo. The biggest mistake that learning institutions can make is to produce graduates without deeply inquisitive, intensely curious minds. My question to ethics departments in business, law, and economics is: How many of your students are graduating with an awareness that the utilitarian underpinnings of the past two centuries are under attack and that new concepts of justice are rapidly emerging, potentially having a huge impact on the way we think about the global community, operate capitalism, do our jobs, and live our lives in decades to come?

Thomas Pogge nails this point: "We as individuals have no hope of coping with . . . complexity and interdependence if we take the existing ground rules for granted and merely ask 'How should I act?' or 'What should I do differently?' We can cope only by attending to this all-pervasive scheme of ground rules which shapes the way persons act and co-determines how their actions, together, affect the lives of others."[15]

The teaching of ethics should segue into the teaching of philosophy. Students who have some understanding of Adam Smith, Jeremy Bentham, John Rawls, yes Robert Nozick, and perhaps also Ronald Dworkin, Michael Walzer, and others will be better equipped to deal with the changing world

of the twenty-first century than those who are taught only how to function within the ethical framework of the past two centuries.

The greatest challenge for tomorrow's leaders in business, law, economics, and also politics is the transition from utility to justice. And it is a challenge that is hardly on our radar screens. This means transitioning from the priority of utility and all it entails—maximizing, summing advantages, ends justifying means, selective sacrifice and more, to the priority of justice and all it entails—fairness, paying taxes, avoiding paths trod by criminals, abiding by the intent of the law, maintaining the highest standards beyond the law, spreading global prosperity, and more. To meet this challenge, preparation must begin by introducing students, however briefly or intensely, to a wider universe than now characterizes the teaching of narrow, situational ethics. Leadership will be the reward for those who most successfully navigate the transition to justice.

CHAPTER 13

RENEWING CAPITALISM

SHORTLY AFTER finishing graduate studies, I took the finest business education available and applied it in the poorest continent on Earth. Little of my schooling or experience prepared me for the realities I encountered. Some four decades and 60 countries later, I stepped out of the commercial world and into the think-tank world with a key motivation—to get reality on the table. As I note in the Prologue, the instrument for accomplishing this is the bright light of day shining on the issues at stake.

With illumination of problems, most people interested in change will do so for one or a combination of three reasons—fear, humanity, or self-interest. These motivations are not mutually exclusive, but they do offer a framework within which to encapsulate why we should undertake a renewal of capitalism. This potentially wonderful but currently underperforming system needs a major overhaul.

The first reason for change is fear. Drugs, crime, and terrorism have grown astronomically over the past 30 or 40 years, bringing great harm to western societies. The mechanisms and channels that convey dirty money and sustain these scourges are the same as those that facilitate false pricing, illegal transfers, and tax evasion by multinational corporations. Drug dealers win the end game almost every single time, getting their money into the legitimate financial system. There is no chance of effectively fighting the drug problem as long as this success ratio prevails. Criminal syndicates thrive on human trafficking, smuggling, counterfeiting, arms trading, fraud, and much more, with cross-border movements of illegal money assuring success for nearly every gang of thugs. Terrorists lost most of their bank accounts in

the months following 9/11, but the financial structure to enable them to create new accounts and dummy entities is still very much in existence. Money laundering drives drugs, crime, and terrorism, not because it is possible, but because it is so easy. There will be little dent in global drugs and crime, and the struggle against terrorism will be waged with the lives of men and women in uniform, as long as our financial structure remains intentionally riddled with loopholes. This is not a problem that can be solved incrementally. Either we deal with all dirty money, or we succeed in suppressing virtually none of it.

Western corporations can enjoy a competitive advantage in lawful operations. They cannot be as successful as others in lawless operations. Responsible business interests should understand that they have much more to gain from supporting and extending rather than from subverting and weakening legal structures.

Illicit, disguised, and hidden financial flows create a high-risk environment for capitalists and a low-risk environment for criminals and thugs. When we pervert the proper functioning of our chosen system, we lose the soft power it has to project values across the globe. Capitalism itself then runs a reputational risk. As it is now, many millions of people in developing and transitional economies scoff at free markets, regarding the concept as a license to steal in the same way as they see others illicitly enriching themselves. Our own security and prosperity are in part dependent on others having a solid stake in the legitimate free-market system.

We have a choice to make as a society. Which is more important to us: fighting drugs, crime, and terrorism with all reasonable and legal means at our disposal, or continuing to cultivate and facilitate dirty money surging in from around the world? Thus far the choice has been we like the money.

This is not a liberal or conservative issue. One of my most politically conservative friends asked me the key question about dirty money, "Why should any of it be legal?" With this book, the burden of proof is shifted to those who want to keep taking it in. The challenge has been posed to western business and banking communities: Make the case that dirty money or any part of it is good for your country.

The second reason for change is a sense of humanity. Earlier I told the story of Mary, weeping, on her knees, begging to give up her child. I asked you to imagine that you were in that hotel room and to keep the image in mind through the pages that followed. From this perspective,

try to justify to Mary her current plight, while representing the worst of our operating system's underpinnings: "We have to do what's best for the whole world. Yes, we're taking tens of billions of dollars out of your country. This enables us to protect this money and help it grow. If we left it here, it could be lost through waste and inefficiency. It's a pity that you and your child suffer from this process, but we do hope you understand that the ends justify the means." I could not deliver such lines, and I suspect you could not either.

A system that drives Mary to the floor and then rationalizes this outcome is a system that belittles us. "Why should we care?" as has been said to me many times does just that; it belittles us. Most Americans and Europeans would not deliberately inflict harm on the distant poor. We may do so because we are uninformed or desensitized but, for most, not because we are completely indifferent to the suffering caused.

Benefit for all is derived from earning fair and honest profits out of creative and productive endeavors. Harm for all is derived from earning dishonest profits out of illicit transactions. Mary has a right to live in a country where her fellow citizens and our fellow citizens do not cooperate in illegally removing resources from her society. And her right and the rights of billions of others like her are superior to any calculation of utility, advantage, or greater good that purports to arrive at a contrary conclusion.

The past 30 or 40 years have witnessed enormous financial transfers from poor to rich. Across this same period, the World Bank has been largely silent on the movement of, cumulatively, trillions of dollars out of poorer countries into western coffers. Some in the Bank seem to be intuitively aware of this phenomenon. But in the absence of available statistics, the subject remains off the Bank's agenda.

Mediating between intuition and data is a duty to ask the right questions. This is the essence of my criticism of the World Bank. For decades it has failed in its duty to ask the right questions, and the poor have suffered deprivation and death as a result.

The enormous gap between rich and poor threatens our basis for common humanity and undermines our thrust for shared prosperity. One billion rich and several billion poor living together on our small planet is unwise, unstable, and unsustainable. Dramatic disparities hold us apart, and the rich have more to gain than anyone else from processes that bring us together.

Development scholars often argue that, when it comes to alleviating

poverty, the global gap between rich and poor does not matter. I find this flawed reasoning, and I would genuinely appreciate an opportunity to debate this point on neutral ground with any prominent development expert. The gap limits capitalism, and capitalism properly run can do more for the poor than foreign aid can ever do.

The following quote struck me years ago: "The traders herein have as much to plead in their own excuse as can be said of some other branches of trade, namely the advantage of it. From this trade proceeds benefits far outweighing all mischiefs and inconveniences, and let the worst that can be said of it, it will be found with a mixture of good and evil." This, with minor punctuation edits, is from a slave trader in the eighteenth century, as recorded in William Snelgrave's 1973 book, *A New Account of the Slave Trade*. The human plunderer of yesterday has his counterpart in the financial plunderer of today, each with their rationales. Both debase our humanity.

The most compelling motivation for change is the third—self-interest. The protection of capitalism is in our interest. Nothing releases human energy so effectively as incentives operating within free markets. Capitalism, if we run it right and trust the system, can lift all humanity.

The mechanisms and structures that support falsified pricing and illegal dealings are designed and used by those who do not trust the system. And the very rapid rise in illicit and opaque dealings, perhaps now involving half of cross-border transactions, signals a concomitant loss of faith in legitimate trade and investment. These are activities that have to rest on a foundation of trust, and that trust is being badly eroded. Too many practitioners demonstrate relentlessly that they do not rely on transparent processes to produce fair returns out of lawfully conducted transactions. Growing distrust fueled and evidenced by growing subterfuge undermines our economic system. Indeed, we have lost the distinction between what is legal and illegal, and in so doing have lost the distinction between what serves the commonweal and what promotes injustice.

The most threatening condition facing global free markets is the chasm between rich and poor. Capitalism widened the gap when it powered industrializing nations ahead, and it must now narrow the gap by bringing developing and transitional economies along as rapidly as possible. This is not accomplished with shifts of wealth into western accounts; it is accomplished by leaving wealth in poorer countries where it can be reinvested, spent, and multiplied.

The one thing capitalism cannot abide is a sustained inability to correct severe, long-term income disparities. Thus, narrowing the gap between rich and poor is a risk-aversion strategy. Much of our future is dependent upon spreading prosperity to an increasingly impatient world. Illegitimacy slows growth, widens gaps, and stalls prosperity; legitimacy enhances growth, narrows gaps, and spreads prosperity. Capitalism must build on its strengths rather than pander to its weaknesses.

Putting it concisely, the future of capitalism is linked to justice, in principle and in practice. The subordination of justice embedded in strict interpretations of utilitarianism has run its course and needs to be replaced with new underpinnings for capitalism grounded on prioritizing justice as a first commitment. The injustices foisted upon billions of people by illegal transactions in which the West is a willing and able participant have to be curtailed.

Furthermore, justice is a growth strategy. A just world that spreads purchasing power and prosperity to billions more will have a faster growth rate and a higher GDP than an unjust world that illegally relocates resources continuously to the rich. In the twenty-first century with the triumph of capitalism, we have reached a point where prioritizing justice can contribute to maximizing utility, but prioritizing utility cannot contribute to maximizing justice.

A just world is also a safer world. Capitalism has the capacity to draw billions more into a common economic arrangement, giving everyone a stake in free markets and lessening the tendencies for alienation, dissociation, and resentment that characterize terrorism and crime. Terrorists, criminal syndicates, and drug kingpins operating outside the legal free-market system are simply taking their cues from others who operate illegally within the system. We cannot close off their channels for moving illicit funds while holding on to our channels for doing the same thing. Capitalists must opt for legality, honesty, fair play, and transparency in practice and in principle if our economic system is to achieve its potential and make its full contribution to a secure world.

Capitalism and democracy are intimately linked. A grand bargain exists between these two ideas: Democracy will give an equal share of political rights to each person, and capitalism will offer a fair share of economic benefits to each person. Globally, capitalism is not holding up its end of the bargain. Democracy is being undermined in many developing and transitional

economies in part because its free-market corollary is operating with inadequate benefit to billions of people. Democracy is dependent on the rule of law. Capitalism is increasingly operating outside the rule of law. An ideological tension has always existed between these two concepts, but today that tension appears to be growing. Some fundamentalists favor weakening the state in favor of strengthening the market. The worst thing that can happen to capitalism is to have this wish come true. A system committed to increasing lawlessness risks self-destruction. Furthermore, to the extent that capitalism seeks to distance itself from the rule of law, it places democracy at risk. A world severely divided in income yet somehow united in democracy is a chimera. Between these two grand schemes, it is the ideal of democracy that must be sustained and capitalism that must evolve closer to democracy's commitment to equal rights. Capitalism has to contribute its fair share to democracy, security, and peace, and that obligation is not at this time being sufficiently met.

Today, we face a level of challenges similar in magnitude to those that had to be confronted in the latter years of the Industrial Revolution. Then, the problems were widespread poverty, low wages, child labor, cramped cities, poor sanitation and health, and growing inequality. Over a period of decades in the second half of the 1800s and early 1900s, governments and private sectors together in the industrializing countries responded with public education, sanitation and transportation, unemployment insurance, pension schemes, health care, child labor laws, antitrust laws, progressive income taxes, and more. Those problems were local and national.

Now problems are international. Capitalism's victory over socialism and, following that, the rapidly emerging process of globalization is presenting a set of challenges every bit as daunting as those in the Industrial Revolution. Widespread poverty and massive inequality are still with us, though in the developing and transitional economies more than in the industrialized economies. In addition, the planet's population, which was barely one billion at the beginning of the earlier era, is currently past six billion and moving toward eight billion in this century. Couple this with drugs, cross-border crime, terrorism, ethnic wars, state collapse, HIV/AIDS killing tens of millions, and a parallel financial structure crippling progress for scores of countries, and the problems in the globalization revolution are as momentous as those in the Industrial Revolution. Capitalism, to be sustainable, must come forward with equally bold reactions to these current challenges.

Triumph over socialism was an extraordinary historical accomplishment. But we have to finish reveling in our recent conquest and begin reshaping our immediate future. Self-justification should give way to reexamination. Excess needs to yield to the better nature we espouse but very often do not practice.

The repair and renewal of capitalism must now extend across the largest arena—the world community. The rich have an enormous stake in this renewal. We need the poor on board in the basics of our economic arrangement, and they will be inclined to participate more fully when they understand that the rich are committed to a fair and just system and, more importantly, when they share in prosperity. Three, four, or five billion poor will eventually "outvote" one billion rich in the validity of their claims on resources, and it is in the self-interest of the rich to see that the calls of the poor are recognized at a faster pace than their discontent rises.

By far the greater part of the responsibility for reshaping the free-market system rests with those in the wealthy western world. For us, there are three tipping points in capitalism's global renewal, three points that, when reached, will signify that further change is likely.

The first tipping point is when the free-market's greatest proponent, the United States, enacts legislation requiring that foreign money is to be treated the same as domestic money. Knowingly handling gains from crimes committed outside the United States must be barred in the same way that they are barred when such crimes are committed in the United States. Intentionally servicing money derived from a crime has to be a crime, regardless of where the act is committed. This still leaves the inflow of tax-evading money largely uncovered, but it opens the door for North America and Europe to approach the gamut of tax-evading funds next. Eventually, all illegally earned, transferred, or utilized proceeds have to be dealt with as violations of the rule of law. The tipping point toward that day is when the United States delegitimizes all forms of criminal money, wherever they are generated.

The second tipping point rests with the World Bank. When the Bank puts the whole of the financial equation for poverty alleviation and economic development squarely on its agenda, the issues of global poverty and inequality will have turned a corner. The Bank must do this without fear or favor, without being cowed by the financial community or by western governments. Hundreds of billions, cumulatively trillions of dollars streaming out of poorer countries have to be carefully examined and estimated and,

together with other institutions, purposefully addressed and diminished. Intellectual honesty is owed to the billions of poor living and to be born in this century.

The third tipping point will be in sight when far more students begin to emerge from colleges and graduate schools with an understanding that the world we have is a choice we have made and that alternatives exist for its change. A world steeped in a philosophy that subordinates justice can be succeeded by a world that prioritizes justice. Without proselytizing, teach the possibilities. We approach the tipping point when young people enter their careers with an informed grasp of the fresh directions in which our global society can move during their lives.

Three tipping points, all within reach.

As we renew capitalism, so the twenty-first century will in good part etch its history.

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In 1995 I decided to stick a toe cautiously into the waters of public opinion by writing a piece on global dirty money and attaching my name to it. Jodie Allen at the *Outlook* section of the *Washington Post* was kind enough to run it, for which I have thanked her several times. I also owe a debt of gratitude to the *Christian Science Monitor* for allowing me over a period of years to write many articles on economic corruption and political oppression, published under a pseudonym.

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NOTES

Interviews that are not for attribution are identified as to place but not as to date. All such interviews were conducted between 1997 and 2003, unless otherwise noted in the text or in the Notes.

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PART I Illegality: We Like the Money

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2. Quoted in "Usama bin Ladin Says the Al-Qa'idah Group Had Nothing to Do with the 11 September Attacks," trans. BBC Monitoring Service, *Ummat* (Karachi), September 28, 2001, www.khilafa.com/home/category.php?DocumentID=2392&TagID=2.
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CHAPTER 2 Playing the Game

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CHAPTER 4 Magnitudes and Misunderstandings

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2. Caroline Doggart, *Tax Havens and Their Uses* (London: Economist Intelligence Unit, 1997), 7.
3. Another way to get a feel for the annual flow of global dirty money is to look at domestic unregistered economic activity, that is, the grey market or underground economy. How big is it, and how much of it might feed cross-border transfers? A recent study of 21 wealthy OECD member nations estimated underground activity at 16.7 percent of recorded GDP. (Schneider and Enste, "Shadow Economies: Size, Causes, and Consequences," *Journal of Economics* 38, no. 1 (March 2000): 77–114. Applied to the total GDP of developed countries, some $25 trillion, this would suggest that unrecorded activity in the richer nations is more than $4 trillion annually. Various studies in developing and transitional economies place underground economic activity at 35 to 80 percent of registered activity. Taking a modest figure of 40 percent and applying it to the combined $6.5 trillion GDP of developing and transitional economies produces an estimate of $2.6 trillion in underground economic activity. For all countries, the sum of $4 trillion by the richer group and $2.6 trillion for the poorer group is $6.6 trillion in unregistered activity. Cross-border flows then would comprise (1) a percentage of $6.6 trillion in unrecorded domestic economic activity plus (2) the

combination of mispricing and abusive transfer pricing which moves as part of registered legitimate trade. Would the combination of these two reach $1 to $2 trillion, the figure for global cross-border dirty-money flows? In all likelihood, yes.

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5. ICC Counterfeiting Intelligence Bureau, "The International Anti-Counterfeiting Directory 2005," 11.
6. OECD, "The Economic Impact of Counterfeiting," 1998, 23, www.oecd.org/dataoecd/11/11/2090589.pdf.
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11. Illegal Logging web site, "The Scale of the Problem," www.illegal-logging.info/briefings.php?briefingId=11.
12. Francesca Columbo, "Animal Trafficking—A Cruel Billion-Dollar Business," InterPress Service, September 6, 2003, www.commondreams.org/headlines03/0906-06.htm.
13. Les Christie, "Much Money in Munch?" CNN/Money, August 23, 2004, http://money.cnn.com/2004/08/23/pf/munchtheft/.
14. Peter Reuter and Edwin M. Truman, *Chasing Dirty Money: Progress on Anti-Money Laundering* (Washington, D.C.: Institute for International Economics, 2004), 22.
15. *2002 National Money Laundering Strategy* (Washington, D.C.: Departments of Justice and Treasury, 2002), 27.
16. Stanley Morris, former director of the Financial Crimes Enforcement Network (FinCEN), a unit of the U.S. Treasury Department, said,

"There's no question that there's more money laundering going through the financial system of the United States than any other country of the world." Quoted in John Burgess, "15 Nations Cited as Havens For Possible Money Crimes," *Washington Post*, June 23, 2000.

17. Interviews by the author with a Swiss central banker, Zurich, Switzerland, and a German private banker, Frankfurt, Germany, respectively, not for attribution.
18. Suspicious Activity Reports (SARs) had been received earlier by the Federal Reserve Board and the Comptroller of the Currency, but Annunzio-Wylie strengthened reporting procedures and required banks to set up in-house anti–money laundering programs. FinCEN became the repository and analyst of SARs and currency transaction reports (CTRs)—more than 10 million a year. Apparently, only a few hundred reports annually are actively pursued. Furthermore, FinCEN has proven slow to complete investigations referred to it by the Federal Reserve Board and the Comptroller of the Currency and likewise slow to spread its reach to nonbank money-service businesses.
19. Joseph Kahn and Kurt Eichenwald, "House and Senate Leaders Clash on Banking Measure," *New York Times*, October 17, 2001.
20. Kathleen Day, "Banks Seek to Alter Bill," *Washington Post*, October 11, 2001.
21. Lucy Komisar, "Shell Game: Citibank Attacks Money-laundering Regulations," *In These Times*, November 12, 2001, 5.
22. Raymond W. Baker, letter to the editor, *Foreign Affairs* 80, no. 6 (November–December 2001): 198–199.
23. David Aufhauser, interview by the author, Washington, D.C., March 2, 2004.
24. David Aufhauser, at a conference entitled "Dirty Money and National Security," jointly sponsored by Center for International Policy, Caux Round Table and the Brookings Institution, September 10, 2003, Washington, D.C.
25. Mariano-Florentino Cuéllar, "The Tenuous Relationship between the Fight against Money Laundering and the Disruption of Criminal Finance," Stanford Public Law and Legal Theory working paper no. 47, September 2003, 414.
26. The U.S. Customs Service also launched "Operation Oasis" to interdict

bulk cash shipments. Some $26 million in both terrorist and drug funds were seized.

27. U.S. Treasury Department: Office of the General Counsel, Office of International Affairs, Office of Foreign Assets Control, Office of Terrorism and Financial Intelligence, Financial Crimes Enforcement Network, Internal Revenue Service Criminal Investigations, Internal Revenue Service Tax Exempt and Government Entities, Executive Office for Terrorist Financing and Financial Crime. Justice Department: Federal Bureau of Investigations Terrorist Financing Operations Section and Joint Terrorism Task Forces, Drug Enforcement Administration, Bureau of Alcohol, Tobacco, Firearms and Explosives, Criminal Division, Civil Division. Department of Homeland Security: U.S. Secret Service, Bureau of Immigration and Customs Enforcement, Bureau of Customs and Border Protection. State Department: Office of the Coordinator for Counterterrorism, Bureau of Economic and Business Affairs, Bureau of International Narcotics and Law Enforcement Affairs. National Security Council. Central Intelligence Agency. National Security Agency.
28. *2003 National Money Laundering Strategy* (Washington, D.C.: U.S. Departments of Justice and Treasury, 2003), 5.
29. United Nations Security Council, *Second report of the Monitoring Group established pursuant to resolution 1363 (2001) and extended by resolutions 1390 (2002) and 1455 (2003), on sanctions against Al-Qaida, the Taliban and individuals and entities associated with them*, S/2003/1070, December 2, 2003, 12.
30. Ibid., 13.
31. Ibid., 4.
32. Technically, a criminal does not have to "clean" prohibited criminal money in order to shift it into another country. All he or she has to do is make the origin of the money appear to be from a nonprohibited activity in the receiving country. Thus, prohibited criminal money comes into receiving countries simply disguised as allowable criminal money.
33. Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, *Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities*, 106th Cong., 1st sess., November 9–10, 1999, 79.
34. Relating to Europe and the United States, there is some evidence that drug dealers and racketeers are finding Europe increasingly attractive as

a place for laundering. This is, in part, because such groups often have millions in currency notes on hand for six months to a year or even longer. With the strengthening of the euro against the dollar since 2002, many criminals would rather hold euros than dollars until the laundering process can get the cash into bank accounts or investments. In other words, Europe is just as accommodating to dirty money as the United States. Some people with stacks of illegal bills apparently are making a currency arbitrage decision aimed at holding the value of their cash, a decision not influenced by differences between the two financial centers' money-laundering enforcement procedures.

35. A senior U.S. Treasury Department official, Daniel L. Glaser, Director, Executive Office for Terrorist Financing and Financial Crime, said on December 10, 2003, "If the purpose of an anti–money laundering regime is to stop dirty money at the door, we can't succeed." This certainly must be one of the purposes of the regime, together with discouraging it from getting to the bank in the first place. If dirty money is stopped at the bank once, it probably won't be brought back to the same place a second time. I am not criticizing Glaser. On the contrary, he is one of the most effective officers dealing with money laundering and terrorist financing issues.
36. Ronen Palan, "Tax Havens and the Commercialization of State Sovereignty," *International Organizations* 56, no. 1 (Winter 2002): 161–162.
37. Ibid., 161.
38. Ibid., 152.
39. Marc Lopatin, "Tax Avoiders Rob Wealth of Nations." *The Observer*, November 17, 2002, http://observer.guardian.co.uk/business/story/0,6903,841410,00.html. Also, interview by the author with a former Jersey government official, London, England, not for attribution.
40. Mark P. Hampton and John Christensen, "Offshore Pariahs? Small Island Economies, Tax Havens, and the Re-configuration of Global Finance," *World Development* 30, no. 9 (2002): 1667.
41. Palan, "Tax Havens and the Commercialization of State Sovereignty," 158.
42. A thorough review of the offshore phenomenon is contained in Jack A. Blum, "Offshore Money" in *Transnational Crime in the Americas: An Inter-American Dialogue Book*, ed. Tom Farer (New York: Routledge, 1999), 57–84.

43. Two "name and shame" efforts bear mentioning. In 2000, the Financial Action Task Force named 15 "Non-Cooperative Countries and Territories," cited for failure to adopt FATF recommendations. Additions to and removals from the list followed in subsequent years. Also in 2000 the OECD named 35 jurisdictions with harmful tax practices in a "List of Uncooperative Tax Havens." Thereafter, most of the named jurisdictions gave commitment letters promising to clean up their respective money-laundering and tax regimes. Both the FATF and OECD initiatives largely faded after the World Bank and IMF sought a more "cooperative" approach to problem jurisdictions, beginning in 2003. The current position of western governments stresses information sharing in money-laundering and tax evasion cases, while basic haven and secrecy structures are allowed to continue.
44. Interview by the author with a French banker, Paris, France, not for attribution.
45. *Holman v Johnson*, 98 Eng. Rep. 1120, 1121 (K.B. 1775).
46. William S. Dodge, "Breaking the Public Law Taboo," *Harvard International Law Journal* 43 (Winter 2002): 161, 220, 219, asks the question, "Why do courts refuse to enforce foreign public law when they routinely enforce foreign private law?" He concludes that "governments would be better off if they could cooperate by enforcing each other's public laws," and adds, "If one can justify courts maintaining the public law taboo at all, it is only as a strategy for achieving more effective cooperation through international agreements."
47. U.S. General Accounting Office, *International Taxation: Problems Persist in Determining Tax Effects of Intercompany Prices*, report to the ranking minority member, Committee on Foreign Relations, U.S. Senate (GAO/GGD-92-89), June 1992, 20.
48. U.S. General Accounting Office, *Tax Administration: Foreign- and U.S.-Controlled Corporations That Did Not Pay U.S. Income Taxes, 1989–95,* report to the Honorable Byron L. Dorgan, U.S. Senate (GAO/GGD-99-39), March 1999, 4.
49. U.S. General Accounting Office, *Tax Administration: Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations, 1996–2000*, report to congressional requesters (GAO-04-358), February 2004, 29.
50. Ibid.

51. In 1988 in the Anti-Drug Abuse Act, Congress added §1346 to Title 18 in order to broaden the interpretation of a scheme: "For the purposes of this chapter, the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services."
52. U.S. Customs Service, *Customs Value*, Washington, D.C., December 1999, 2–3.
53. *United States v Haim*, 218 F. Supp. 922 (S.S.N.Y., 1963) [9][10] states the following: "The purpose of the general false statement statute, 18 U.S.C. §1001, has been broadly defined to include all 'false and fraudulent statements or representations where these were knowingly and willingly used in documents or affidavits' in any matter within the jurisdiction of any department or agency of the United States."
54. A further statute bears mentioning—26 U.S.C. §7201, commonly referred to as the tax evasion statute. Abusive transfer pricing that reduces taxes payable in the United States could conceivably be prosecuted under §7201 if it was fraudulent and constituted criminal tax evasion as opposed to permissible tax avoidance, but the burden of proof would be difficult and the Internal Revenue Service has not demonstrated much interest in moving in this direction.
55. Robert J. Leo, "Impact of the Asian Crisis on Transnational Legal Practice: A Primer on Pricing Issues for Counsel to Importers and Exporters," *International Law Practicum* (Autumn 1999).
56. *United States v Boots*, 80 F.3d 580 (1st Cir. 1996).
57. *United States v Trapilo*, 130 F.3d 547 (2nd Cir. 1997).
58. *United States v Pasquantino*, 336 F.3d 321 (4th Cir. 2003).
59. Bradley R. Wilson, "Subtle Indiscretions? International Smuggling, Federal Criminal Law, and the Revenue Rule," *Cornell Law Review* 89, no. 1 (November 2003): 253, 260.
60. Interview by the author with a Treasury Department official, Washington, D.C., not for attribution.
61. Another approach to curtailing transfer pricing, taken by the OECD, the United States, and many other major countries, falls under the rubric of "advance pricing agreements" (APA). In order to escape arbitrary assessments of taxes, which can be done legally by taxing authorities in many countries, corporations are encouraged to bring their transfer pricing methodologies to tax authorities for review. Upon approval under APA programs, tax authorities forego the threat

of arbitrary assessments while the agreements are in force and followed. The program has not been particularly successful. In the United States, for example, with more than 60,000 multinational corporations in operation and the APA program in existence since 1991, only 492 APA agreements had been executed by 2003. Furthermore, the APA program reportedly is tainted by scandal, with many APA officials leaving government to enter the private sector, then negotiating highly favorable APA agreements with their former colleagues.

62. Interview by the author with a Treasury Department official, Washington, D.C., not for attribution.
63. Interview by the author with a Treasury Department official, Washington, D.C., not for attribution.
64. Interview by the author with a U.S. banker, in flight across the United States, not for attribution.
65. Lawrence Malkin and Yuval Elizur, "Terrorism's Money Trail," *World Policy Journal* 19, no. 1 (Spring 2002): 67. I have shared views with Lawrence Malkin. The United States has been running a current account deficit consistently since 1982, with expenditures for imports exceeding revenues from exports. U.S. current account deficits constitute the largest item on the demand side for dirty money.
66. Karen Tandy, Administrator, Drug Enforcement Administration, U.S. Senate Caucus on International Narcotics Control hearing on "Money Laundering: Current Status of Our Efforts to Coordinate and Combat Money Laundering and Terrorist Financing," March 4, 2004.

PART II Inequality: The Gap Matters

1. David S. Landes, *The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor* (New York: W.W. Norton, 1998), xx.
2. Lant Pritchett, "Forget Convergence: Divergence Past, Present, and Future," *Finance & Development*, June 1996, 40.
3. Interview by the author with a senior official, Board of Governors of the Federal Reserve System, Washington, D.C. The interview was on the record but I have chosen to avoid identifying the interviewee.

CHAPTER 5 The Global Divide

1. Plato, *Laws*, Book V.
2. Angus Maddison published highly original work in *Dynamic Forces in Capitalist Development: A Long-Run Comparative View* (New York: Oxford University Press, 1991). Drawing on Maddison's data, François Bourguignon and Christian Morrisson published "Inequality Among World Citizens: 1820–1992," *American Economic Review* 92, no. 4 (September 2002): 727–744. Data are presented in constant PPP 1990 dollars.
3. Not all elements of GDP are necessarily reflected in personal incomes. For example, foreign direct investment and some portions of government spending may not show up in income levels derived from household surveys. Thus, personal incomes tend to appear lower in data developed from household surveys as compared to data from shares of GDP.
4. Our inequality calculations use the following data from the World Bank's *World Development Indicators 2004:* GDP (at both PPP and market exchange rates), population, and income shares for each quintile. Only countries that report both GDP and population are included in our data. For those countries without income share data, we use 1990s regional estimated income share, as described in Deininger and Squire (1996). We divided each country in our data set into five quintiles of equal population and assigned the appropriate GDP share. We then ranked these country quintiles from poorest to richest based on per capita income and created global quintiles of very nearly equal population. Using this data set, we calculated our estimates of inequality, such as the ratio of the richest global quintile to the poorest quintile and the per capita income ranges for each global quintile. All original income inequality calculations were done by Jennifer Nordin.
5. These calculations are similar to those described in the previous note. It may be useful to note here the inherent limitations of our (and many other) inequality calculations. Breaking each country into its income share quintiles refines the analysis from the earlier UN inequality estimate that assumed all people within a given country had the same per capita income. This gets us part of the way to the ideal way to count the poor: Analyze all 6 billion people individually, clearly an unworkable

plan. An even more refined analysis would use deciles or centiles. Some data are not available for every country and every year, such as the income share data. We use the highly regarded Deininger and Squire (1996) regional data where needed, an acceptable substitution because neighboring countries tend to share key characteristics. Finally, it is well known that income surveys do not capture the full extent of wealth held by the world's richest people. If anything, this point underscores that the true global disparity is even greater than what we have calculated.

6. *Economist*, "Food for Thought," May 29, 2004, 72.
7. International Monetary Fund, "A Review of PPP-Adjusted GDP Estimation and its Potential Use for the Fund's Operational Purposes," IMF working paper no. WP/95/18 prepared by Nancy Wagner, February 1995, iii.
8. The poverty head counts are, respectively, by: (1) Xavier Sala-i-Martin, "The Disturbing 'Rise' of Global Income Inequality," Columbia University Department of Economics discussion paper #0102-44 (April 2002): 19; (2) Surjit S. Bhalla, *Imagine There's No Country: Poverty, Inequality, and Growth in the Era of Globalization* (Washington, D.C.: Institute for International Economics, 2002), 8; (3) *World Development Report 2000/2001* (New York: Oxford University Press for the World Bank, 2001), 3; (4) Sanjay Reddy and Thomas Pogge, "How *Not* to Count the Poor, Version 4.5," (New York: Columbia University, March 26, 2003), 30, who estimate poverty head counts at higher than 30 percent of world population.
9. Department for Work & Pensions (UK), *Households Below Average Income Statistical Report*, March 30, 2004, www.dwp.gov.uk/asd/hbai/hbai2003/contents.asp. The median income is based on the benchmark of a couple with no children, before housing costs.
10. *Human Development Report 2004* (New York: United Nations Development Programme, 2004), 141–142.
11. Ambuj D. Sagam and Adil Najam, "Shaping Human Development: Which Way Next?" *Third World Quarterly* 20, no. 4 (August 1, 1999), 743.
12. Aristotle, *The Nichomachean Ethics*, Book 1, Chapter VI.
13. Amartya Sen, *Development as Freedom* (New York: Anchor Books, 1999), 75.

14. Ibid., 87.
15. Council of the European Union, "Joint Report by the Commission and the Council on Social Inclusion," 7101/04, March 5, 2004, 8.
16. Xavier Sala-i-Martin, "The World Distribution of Income (Estimated from Individual Country Distributions)," Columbia University Department of Economics discussion paper #0102-58, April 2002, 29.
17. Bhalla, *Imagine There's No Country,* 2.
18. Joseph E. Stiglitz, *Globalization and Its Discontents* (New York: W.W. Norton, 2002), 5.
19. Sala-i-Martin, "The Disturbing 'Rise' of Global Income Inequality," 38.
20. Reddy and Pogge, "How *Not* to Count the Poor," 32.
21. Shaohua Chen and Martin Ravallion, "How Did the World's Poorest Fare in the 1990s?" World Bank working paper no. 2409, August 2000, 1.
22. Jan Knippers Black, *Inequity in the Global Village: Recycled Rhetoric and Disposable People* (West Hartford, CT: Kumarian Press, 1999), 13.
23. Robert J. Barro, "The U.N. is Dead Wrong on Poverty and Inequality," *BusinessWeek*, May 6, 2002, 24.
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CHAPTER 6 "I Don't Understand" and "Don't Tell Anyone"

1. This myth takes on a further dimension. Many analysts think that trade data between exporting and importing countries can be analyzed to calculate total mispricing. For example, if exports of, say, bicycles from country A to country B are recorded at $20 million, and imports of bicycles by country B from country A are recorded (without transportation costs or customs duties) at $30 million, then there is $10 million mispricing somewhere. As an IMF economist stated, "Macroeconomic estimates of misinvoicing can be made by comparing domestic trade data with partner-country data from the IMF's Direction

of Trade database. . . ." (Peter J. Quirk, "Money Laundering Muddying the Macroeconomy," *Finance & Development*, March 1997, www.worldbank.org/fandd/english/0397/articles/0110397.htm). This statement is incorrect. Differences in domestic trade data and partner-country trade data only reveal reinvoicing, that is, that part of price manipulation that occurs when a transaction is reinvoiced through a third party, as explained in the Dirty-Money User Manual. It does not reveal that part of price manipulation that occurs within the same invoice that goes straight from exporter to importer. That part is hidden from view and is not shown by cross-country trade data comparisons.

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7. Published data on flight capital are sparse and incomplete. None of what is available shows very much, if any, of the invisible portion of flight capital that is absent from national accounts. Nevertheless, using data from the IMF and the World Bank, the linkage between capital flight and poverty can be demonstrated for Latin America and Sub-Saharan Africa, two areas for which data are reasonably usable. Jennifer Nordin has plotted capital flight data against poverty data for these two regions, which show a positive correlation. These data are in no way definitive, and leave ample room for further research. We would be pleased to share these data with economic scholars. More accurate correlations of capital flight and poverty depend on the development of better estimates of illegal financial flows from developing and transitional economies.

   Another method for estimating flight capital takes the black market exchange rate premium as a proxy for flight capital. Data on black market premiums are available for 1993–1995 from *World Currency Yearbook, 27th edition, 1990–93*, ed. Philip P. Cowitt (Brooklyn, NY: Currency Data & Intelligence, Inc., 1996).

The Bank for International Settlements compiles "External Loans and Deposits of Reporting Banks vis-à-vis Individual Countries (Non-Bank Private Sector)," which is available at www.bis.org. This is a modification to earlier figures on "Cross-Border Bank Deposits of Non-Banks." The current data set covers overseas deposits of private noncitizens. The data are not particularly useful in analyzing flight capital because they cover only bank deposits at a reporting date, not the flow of money into and out of bank accounts outside the account holder's country of residence. Thus it represents only a fraction of accumulated flight capital lodged abroad.

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15. The Bank for International Settlements in Basel, Switzerland, recommends that commercial banks have a ratio of capital to loans of not more than 1 to 12.5, producing a capital adequacy ratio of 8 percent. See "International Convergence of Capital Measurement and Capital Standards—A Revised Framework, June 2004—Part 2," www.bis.org/publ/bcbs107b.pdf.

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4. Ibid.
5. Ibid.
6. Smith, *The Theory of Moral Sentiments*, part I, sec. I, ch. 1, paragraph 1.
7. Smith, *The Theory of Moral Sentiments*, part I, sec. I, ch. 1, paragraph 2. *Note:* This passage is the first of several quotations of Adam Smith and Jeremy Bentham in which I take minor liberties with their own texts, either with punctuation, spelling, or the elimination of some words or phrases. This is done to modernize or shorten the text and in no case is intended to alter the meaning.
8. Smith, *The Theory of Moral Sentiments*, part III, ch. 1, paragraph 6.
9. Smith offers ample detail on this point: "We can never survey our own sentiments and motives, we can never form any judgment concerning them, unless we remove ourselves, as it were, from our own natural station, and endeavour to view them as at a certain distance from us. But we can do this in no other way than by endeavouring to view them with the eyes of other people, or as other people are likely to view them. . . . We endeavour to examine our own conduct as we imagine any other fair and impartial spectator would examine it." *Theory of Moral Sentiments*, part III, ch. 1, paragraph 2.
10. See, for example, D.D. Raphael, ed., *British Moralists 1650–1800* (Oxford, England: Clarendon Press, 1969).
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13. Smith, *The Theory of Moral Sentiments*, part III, ch. 3, paragraph 4.
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INDEX

Abacha, Mariam, 62
Abacha, Mohammed and Ibrahim, 62–63
Abacha, Sani, 60–62, 63, 64, 66, 208
ABB Ltd., 65
Accra, Ghana, 2
Act utilitarianism, 322
Aditjondro, George, 70, 73–74
Advance-fee fraud, 64–65
Aeroflot, 155–156
Afghanistan, 88, 90, 92–94, 104, 123, 124, 203
Africa, 1–7, 247. *See also specific countries*
Åland Islands, 36
Alderney, *see* Channel Islands
Alienation, 266–267
Algeria, 169, 232
Allahar, Anton, 337
Al Qaeda, 93, 120, 123–127, 183, 184, 185
Al Taqwa Trade, Property and Industry Company Limited, 124–126
American Bankers Association, 178, 179
Amin, Galal, 244
Anarchy, State, and Utopia (Nozick), 364
Andorra, 36
Angola, 51, 65, 139, 141, 167, 204, 232
Anguilla, 36
Annunzio-Wylie Anti–Money Laundering Act, 175
Anticorruption efforts, 249–252, 346
Antigua and Barbuda, 36
Anti–money laundering
  Bank of America, 159
  Canadian statute, 343
  Difference in predicate crimes, 186–189
  Drugs and, 89, 91, 182
  Efforts, laws, legislation, 163, 173–174, 175, 177, 186–190, 338, 343–344
  IMF/World Bank and, 253
  Patriot Act, 177, 178–182
  Riggs Bank, 54, 57
  Terrorists' money and, 183
Argentina, 28–29, 243
Arms trafficking, 97–98, 111, 167
Aruba, 36
Asian values, 312–313
Assets, offshore, 163–165
Asset stripping, 145–146, 156, 157, 160
Atkinson, Charles Milner, 311
Aufhauser, David, 183, 185, 379
Austin, John, 304, 307
Australia, 7, 62, 73, 76, 90, 110, 118, 314, 316
Austria, 36, 62, 74, 104, 112, 128, 192

Babangida, Ibrahim, 51
Backman, Michael, 72, 73
Bagnasco, Adolfo, 27

Bahamas, 36, 73, 125, 192
Bahrain, 36
Baker, J. Egan, 294, 295
Baker, James Wimberly, 294, 295–297
Baker Hughes, 65
Banco Nación, 27
Banco Noroeste S.A., 65
Bank of America, 333, 334, 336
Bank of China, 146–147, 148, 149, 150
Bank of Credit and Commerce International (BCCI), 54, 60, 87
Bank of New York, 158, 159
Banks:
  Abacha and, 62
  conveying overseas, 43
  debt of poor countries and, 256–257
  in Japan, 116–117
  proceeds of bribery, corruption, and, 53–54
  in Russia, 153–154
  secrecy and, 191–194
  shell type, 179, 347
  terrorist attacks and, 178–180
  See also specific banks
Bank Secrecy Act (BSA), 174
Barbados, 36
Beccairia, Cesare, 302
Belarus, 97, 105, 168, 204
Belgium, 36, 90, 138, 140, 141, 142, 168, 263
Belize, 36
Bell Helicopter, 42–43
Bentham, Jeremy:
  career of, 300–301
  Constitutional Code for the Use of All Nations and All Governments Professing Liberal Opinions, 306
  early life of, 300
  jurisprudence and, 301
  on natural rights, 305
  on pauper management, 305–306
  philosophy of, 16, 280
  prison design and, 306
  University College London and, 311
  utilitarianism and, 302–305
Berezovsky, Boris, 155–156, 159
Berlin, Peter, 158–159
Berlin Wall, 13
Bermuda, 36, 73, 136, 192
Bhalla, Surjit, 228–229, 230
Bhutto, Benazir, 52, 77–82
Bin Laden, Osama, 123–124, 184
Bin Sultan, Bandar, 56
Birdsall, Nancy, 274
Black Market Peso Exchange system, 41
Blackstone, William, *Commentaries on the Laws of England*, 301
Blinder, Alan, 320
Blood From Stones: The Secret Financial Network of Terror (Farah), 127
Blum, Jack, 162
Blumenthal, Erwin, 140
Bolivia, 89, 98
Bongo, Omar, 52
Bout, Victor, 127, 142
Brandt, Richard, 321–322
Brazil, 39, 51, 65, 104, 118, 122, 168, 169, 170, 212, 241–242
Bribery, 50–51, 53
British Virgin Islands, 36, 73, 79, 83, 130, 142, 145
Brookings Institution, 7, 378, 379, 380
Bubble economy of Japan, 116–118
Burkina Faso, 3, 215
Burma, 73, 90, 92, 105, 118, 120
Business schools, 366

Cali cartel, 94–95
Cambridge University, 315
Camdessus, Michel, 158, 162
Campione d'Italia, 36, 125, 126

Canada, 84, 128, 141, 143, 148, 149, 199, 200, 263, 343
Capital inflows, 236–237
Capital outflows, 236
Caux Round Table, 365
Cayman Islands, 36, 44, 65, 73, 98, 99, 145, 147, 191, 192, 194
Center for International Policy, 377, 379
Central Intelligence Agency (CIA), 96, 98, 104, 138, 139, 184
Challenge:
  to philosophers, 330–331
  to western business and banking communities, 205–206
  to World Bank, 275–277
Channel Islands, 36, 62, 83, 128, 142, 157, 192, 347; Alderney, 36; Guernsey, 36; Jersey, 36, 83, 157, 192; Sark, 36
Chaudan, William, 66
Chavez, Demetrio Limonier, 97
Chernomyrdin, Viktor, 156
Chile, 54–55, 248
China, 13, 45, 90, 104, 113, 114, 115, 143–151, 168, 204, 212, 229, 230, 246, 265, 269, 313
China's Pitfall (He), 150–151
Chou, John, 146–147
Chubais, Anatoly, 154–155
Citibank, 99, 149, 179, 180, 353
Citibank Private Bank, 44–45, 62–63
Citibank Switzerland, 79–80
Citigroup, 178
Club convergence, 268, 271
Cohen, Stephen, *Failed Crusade: America and the Tragedy of Post-Communist Russia*, 159
Collor de Mello, Fernando, 51
Colombia, 39, 41, 42–43, 88, 89, 92, 93, 94–96, 97, 98, 104, 118, 120, 203, 233, 237, 306
Coltan, 142, 324
Commentaries on the Laws of England (Blackstone), 301
A Comment on the Commentaries (Bentham), 301
Commercial component of dirty money:
  China and, 143–151
  Congo, 138–143
  drugs and, 89–92
  overview of, 23–24, 133–138
  Russia and, 151–160
  See also Tax evasion
Conable, Barber, 249
Concentration accounts, 44
Conditional convergence, 271
Confucianism, 312–313
Congo, 138–143, 232, 233, 237, 324
Consequentialism, 302
Constitutional Code for the Use of All Nations and All Governments Professing Liberal Opinions (Bentham), 306
Continuum threatening capitalism, 16, 337, 338–341
Conventional wisdom, myths as:
  "errors and omissions," 241–242
  hoarding money abroad or in-country not different, 244
  illegal overseas deposits as rational reactions, 242–244
  legal and illegal transfers abroad indistinguishable, 244–245
  transfers abroad return to stabilized state, 245–246
Convergence hypothesis, 267–272
Cook Islands, 36, 73
Cornia, Giovanni, 234
Corporate social responsibility movement, 365
Corporations and antisecrecy efforts, 347

Corrupt component of dirty money:
amount of as percentage of GDP, 168–169
Indonesia and, 68–76
Nigeria and, 57–68
overview of, 23, 49–54
Pakistan and, 76–87
poverty and, 251
Riggs National Bank and, 54–57
World Bank and, 249–252
Corruption, definition of, 49–50
Costa Rica, 36
Côte d'Ivoire, 52, 140, 168
Counterfeiting, 112, 120–122, 166
Countertrade deals, 32
Crawley, Tom, 294–295
Credit cards, 46
Credit Suisse, 62, 63, 74
Criminal component of dirty money:
amount of as percentage of GDP, 166–168
government sponsors or endorsers of, 104–105
groups and, 105, 106–109
international crime and, 100–105, 106–109
North Korea and, 105, 110–113
overview of, 23, 88–89
terrorism and, 118–123
Critique of the Doctrine of Inalienable, Natural Rights (Bentham), 305
Cuba, 13, 88, 119, 120, 132
Culture, philosophy as becoming, 312–313
Currency and monetary instruments reports (CMIRs), 174
Currency transaction reports (CTRs), 174
Customs declarations, 31, 198
Cyprus, 28, 36, 39, 128, 152
Czech Republic, 90, 355
Damage claims, 32
Deaton, Angus, 228
Debt of poor countries:
approach to resolving, 353–354
balancing responsibility and, 354–358
offset of, 359–360
overview of, 254–257
weighing claims and, 358–359
Defraigne, Pierre, 12
Delegitimizing dirty money, 342–345
Democracy, 372–373
Demos, John and Rafael, 5
De Soto, Hernando, 14, 18
Diamonds, 30, 127, 139
Dirty money:
approach to stories of, 48–49
assessment of amount of, 162–169
cost-benefit analysis of, 202–206
definition of, 23, 163
delegitimizing, 342–345
faking transactions and, 38–41
fictitious pricing and, 25–33
forms of, 23–24
foundations and, 37–38
gimmicks and, 41–46
as increasing, 182–183
justification for facilitating inflow of, 201–202
laundered money compared to, 163
offshore dummy companies and, 35–37
price of dealing with, 47
procedures for moving, 24–25
pursuit of, 190–191
reinvoicing companies and, 33–35
trusts and, 37
See also Anti–money laundering efforts; Commercial component of dirty money; Corrupt

component of dirty money; Criminal component of dirty money
Disparities, *see* Income disparities
Disutility, 281, 327–329
Divergence in per capita incomes, 269–270
Documents, false, submission of, 198–201
Dollar, David, 231–232
Domar, Evsey, 268
Dominica, 36
Dos Santos, Jose Eduardo, 51
Dougherty, Peter, 16
Drugs:
  Afghanistan and, 92–94
  Colombia and, 94–96
  dirty money and, 203
  Japanese yakuza and, 115–116
  money involved in, 166
  Nigeria and, 60
  North Korea and, 110–111
  Peru and, 96–100
  trafficking in, 89–92
Dubai, 36, 62, 79–80, 82, 84, 87
Dubro, Alec, 114
Dummy entities, 33–38, 190
  Chinese businesspeople and, 145
  9/11, 369
  Tanaka and, 115
  Tax evasion and, 243, 339
Dutch, *see* Netherlands, the
Dworkin, Ronald, 366

Easterly, William, *The Elusive Quest for Growth*, 232–233
Economic growth and poverty, 230–232
Economics, as field, 320–321
Economic Sentiments: Adam Smith, Condorcet, and the Enlightenment (Rothschild), 291
Economist (journal), 215, 340
Ecuador, 133
Edgeworth, F.Y., 317
Edwards, Lucy, 158–159
Egypt, 32, 110, 111, 125, 128, 129, 141, 168, 192, 204, 245, 357
Eigen, Peter, 249–250
Electronic banking, 46
Elliott, Amy, 44–45
The Elusive Quest for Growth (Easterly), 232–233
Ends, as justifying means, 309, 310
England, *see* United Kingdom
Enlightenment, 286, 290
Enron, 65, 193, 347
Environmental issues, 265
Equatorial Guinea, 54–56
Ernst & Young, *Transfer Pricing Global Reference Guide*, 30
"Errors and omissions," 241–242
Escobar, Pablo, 94
Etete, Daniel, 66
Ethics departments, 366
Europe, 23, 34, 87, 88, 96, 112, 128, 136, 140, 143, 152–153, 168, 189, 190, 194, 201–202, 237, 365
European Commission, 12
European Union, 53, 104, 225, 243, 357
Ewing, A.C., 329
Exports:
  data on, 236
  imports and, 348
  inequality and, 232–233
  nonremittance of proceeds from, 160
  overpricing of, 29
  promotion of, 351–352
  underpricing of, 152–153

Failed Crusade: America and the Tragedy of Post-Communist Russia (Cohen), 159

Failed states, 203
Faking transactions, 38–41, 171–172
False documents, submission of, 198–201
Farah, Douglas, *Blood From Stones: The Secret Financial Network of Terror*, 127
Fear and change, 368–369
Federal Bureau of Investigation (FBI) and terrorist financing, 184
Federal Reserve Bank of New York, 126, 128
Federal Reserve Board, 175, 193, 209
Federal Reserve System, 132
Felony offenses, 31, 198–199, 349
Fimaco, 157–158
Financial Action Task Force (FATF), 175–177, 253
Financial reports, signing of, 350
Fitzgerald, Peter, 105, 110–111
Flee clauses, 37
Fleming, Bob, 2
Foley, Caroline, 320
Ford, Henry, 264
Foreign aid, 246–249, 260–261, 352
Foreign Corrupt Practices Act, 53, 59–60, 115
Foreign direct investment, 145, 245–246, 352
Foundations:
  in Indonesia, 69, 70, 71
  offshore, 37–38
  in Pakistan, 85, 86
4-1-9 schemes, 64–65
A Fragment on Government (Bentham), 301
France, 21, 52, 62, 66, 68, 104, 128, 140, 152, 168, 169, 263, 290, 301, 307
Freeland, Chrystia, *Sale of the Century: Russia's Wild Ride from Communism to Capitalism*, 155
Free-market system:
  beyond U.S. borders, 13–14
  giving others stake in, 369
  legality of, 8
  loophole in, 190–191
  philosophy underpinning, 280–281
  problems with, 12
  reform of, 9
  within United States, 12–13
Free shares, 73–74, 75–76
Free trade zones, 136
Friedman, Milton, 327
Friedman, Thomas, 264, 337
Fujimori, Alberto, 97, 98, 99

Gabon, 52
Gall, Norman, 15
Gazprom, 156–157
GDP, *see* Gross domestic product (GDP)
Gell-Mann, Murray, 337–338
Genetic diseases, 265–266
Germany, 62, 104, 128, 152, 168, 169, 191, 231, 263
Gibraltar, 36, 66
Gini coefficient, 222, 223–224
Global financial system, cleaning up, 351–353
Globalization and poverty, 232–233, 239, 264
Global Wealth report (Boston Consulting Group), 164, 165
Gold in Pakistan, 79–80
Gorbachev, Mikhail, 153
Grassley, Charles, 177, 178, 179
Gray, John, 18
Great Britain, *see* United Kingdom
Grenada, 36

Gross domestic product (GDP):
corruption money as percentage of, 168–169
criminal money as percentage of, 166–168
income as per capita shares of, 212
measurement of, 237–239
as measure of progress, 221
as national utility calculation, 321
total, and shares of richest and poorest, 218–220
Growth theory, 268
Guernsey, *see* Channel Islands

Halliburton, 65–67
Haq, Mahbub Ul, 225
Harmattan season, 4
Harrod, Roy, 268
Harvard Business School, 1, 336, 378
Harvard University, 77, 321
Hawala system, 45–46
He Qinglian, *China's Pitfall*, 150–151
Himmat, Ali Ghaleb, 125, 126
Himmelfarb, Gertrude, 306
HIV/AIDS crisis, 51, 265
Hong Kong, 36, 39, 62, 73, 111, 116, 145, 146–147, 148–150, 169
Houphouët-Boigny, Felix, 52
Huber, Ahmed, 125, 126
Humanity, sense of, and change, 369–371
Human trafficking, 100, 103–104, 116, 166
Hume, David, 285, 302
Hungary, 36
Hussein, Saddam, 125, 127–133
Hutcheson, Francis, 283
Hyde, Henry, 92
Hyperinflation, 248

IBM, 27–28
Illegal migration, 100, 103–104
IMF, *see* International Monetary Fund (IMF)
Imports, 235–236, 348. *See also* Exports
Income disparities, global, 210–217, 218, 219–220, 262–263, 271–272
India, 29, 45, 77, 79, 110, 114, 134, 168, 169, 230, 265
Indonesia, 38, 65, 68–76, 110, 116, 168, 204, 231, 233
Inequality:
capitalism and, 209, 351–353
conflicting views of, 228–230, 234–235
globalization and, 232–233, 239
lawlessness and, 15–16
monetary measures of, 222–224
nonmonetary measures of, 224–226
as unsustainable, 262–267
Infectious Greed (Partnoy), 13
An Inquiry into the Nature and Causes of the Wealth of Nations (Smith), 283, 286–290, 297
Intellectual gap, 258–261
International business corporations (IBCs), 35–37
International crime, 100–105
International Monetary Fund (IMF):
dirty money and, 252–253
HIPC Initiative, 255–256
on purchasing power parity (PPP), 216
Russia and, 157, 158, 160
Interpol, 21, 99, 166, 167
An Introduction to the Principles of Morals and Legislation (Bentham), 302, 303–304
Investment funds, offshore, 193

Iraq, 105, 119, 127–133, 167, 168, 203, 233
Ireland, 36
Isle of Man, 36, 128
Itera, 156–157
Ittefaq Industries, 82
Ivory Coast, *see* Côte d'Ivoire

Japan, 43, 66, 98, 99, 104, 105, 110, 111, 113–118, 120, 128, 137, 168, 203, 217, 263, 269, 271, 312, 365
Japanese yakuza, 113–118
Jersey, *see* Channel Islands
Jevons, William Stanley, 314–315
J.I.M. Transport, 333–336
John Holt Trading Company, 11–12
Jordan, 97, 98, 128, 129, 130
JP Morgan Chase, 178
Jubilee 2000, 354–355
Justice:
  capitalism and, 361–367
  as growth strategy, 372
  prioritization of, 375
  utilitarianism and, 323–325

Kabila, Laurent, 141
Kadannikov, Vladimir, 155
Kaiping case, 148–149
Kano, Nigeria, 5
Kaplan, David, 114
Kareri, Simon, 56
Kari, Alhaji Inuwa, 336
Karzai, Hamid, 93
Kearney, A.T., 233
Kellogg Brown and Root, 66
Kenya, 26, 51, 124, 168, 245
Kerry, John, 177, 179
Keynes, John Maynard, 268, 320
Khan, A.Q., 87
Kickbacks, 133–134, 169–170
Kim Dok Hong, 112–113
Kim Jong Il, 105, 110, 112
Kodama, Yoshio, 114–115
Kraay, Aart, 231–232
Kuttner, Robert, 137–138
Kuwait, 129
Kuznets, Simon, 216, 231
Kwitny, Jonathan, 139, 141

Labuan, 36
Lagos, Nigeria, 6–7
"La Mina" transactions, 39–40
Lam Yiu Chung, 149–150
Laundered money, definition of, 163. *See also* Anti–money laundering efforts
The Law of Peoples (Rawls), 363–364
Leaving money in poor countries, 257–258, 259
Lebanon, 36
Leo, Robert, 199
Letters of credit, 43, 160
Levin, Carl, 177, 178, 179
Liberia, 36, 60, 105, 120, 127, 130, 203, 233
Libya, 87, 105, 111, 119, 122, 132
Liechtenstein, 36, 38, 62
Li Fuxiang, 147–148
Liu, Sherry, 146–147
Lockheed Aircraft, 115
London Club, 255, 359
Long-Term Capital Management, 193
Lorenz curve, 222–223
Lucas, Robert, 268
Luxembourg, 27, 36, 56, 62, 63, 98, 128, 212

Macau, 36, 148
Madeira, 36, 66
Mail fraud, 197, 200
Malaysia, 36, 52, 73, 74, 104, 116, 196, 199, 312

Maldives, the, 36
Malik, Rehman, 83–84
Malta, 36
Manu, Alhaji Baba, 336
Manufactured goods and inequality, 233
Mao Tse-tung, 313
Marginal revolution, 314
Marianas, the, 36
Markets, expanding, 264–265
Marshall, Alfred, 316–317
Marshall Islands, 36
Martinez, Eduardo, 39
Marxism, 313, 328, 329
Massachusetts Institute of Technology, 321
Massieu, Ruiz, 45
Mauritius, 36
Maximizing philosophy, *see* Utilitarianism
Mayer-Foulkes, David, 271
McCulloch, Ramsey, 304
McKee, Lyman, 2
McNamara, Robert, 247, 251
Measure for Measure (Shakespeare), 217
Medellín cartel, 39–40, 94
Melilla, 36
Menger, Carl, 298
The Methods of Ethics (Sidgwick), 315, 316
Mexico, 44–45, 88, 90, 98, 105, 110, 168, 233, 245–246, 264
Milanovic, Branko, 230
Mill, James, 304–305
Mill, John Stuart, 305, 307–308
Mispricing, 25–28, 31–32, 169–170, 348–351
Mobutu Sese Seko, 138–141
Moi, Daniel arap, 51–52
Monaco, 36, 66
Money Laundering Control Act, 175
Montesinos, Vladimiro, 96–99
Montserrat, 36
Morality and utility, 328–329
Moral Sense doctrine, 283
Morris, Roger, 139
Motivation for cross-border dirty-money flows, 243–244
Mugabe, Robert, 52
Mules, 42
Musharraf, Pervez, 84–86, 87

Nada, Youssef Mustafa, 125, 126
Napoleonic Code, 301
Nauru, 36
Netherlands, the, *including references to* Dutch, 66, 68, 74, 87, 90, 104, 130, 169, 263
Netherlands Antilles, 36, 128, 157
Nevis, 36
New Growth Theory, 268
New Zealand, 8, 73, 90
The Nicomachean Ethics, 225
Nigeria, 1–2, 5, 6, 7, 11, 41, 51, 57–68, 167, 168, 170, 203, 204, 207–208, 245, 246, 253, 333–336, 353–354
Niger Republic, 5
9/11 Commission Report, 127
Niue, 36
Nordin, Jennifer, 234
North Korea, 13, 87, 88, 90, 104, 105–113, 115, 119, 166, 203
Nozick, Robert, 364
Nuclear weapons, 87, 111
Nyerere, Julius, 251

Obasanjo, Olusegun, 65, 380
Obiang, Teodoro, 55–56
Offshore assets, 163–164
Offshore banking, 193
Oil-for-Food program (United Nations), 129–131

Oil sales, unrecorded, 167
Operation Green Ice, 95
Operation Green Quest, 184
Operation Polar Cap, 40
Overpricing of exports, 29
Oxford (University), 77, 282, 300, 316, 317, 361

Pakistan, 15, 18, 45–46, 76–87, 88, 93, 104, 111, 123, 168, 203, 233
Panama, 36, 38, 73, 98, 105, 128
Paraguay, 51, 123
Paris Club, 255, 356–357, 359
Park, Gil-Sung, 16
Partnoy, Frank, *Infectious Greed*, 13
Patriot Act, 177–182
Pauper Management Improved (Bentham), 305–306
Pei, Minxin, 143
Personal investment corporations (PICs), 35–37
Peru, 89, 96–100, 105
Philippines, the, 61, 73, 104, 116, 120, 204, 215, 255, 264
Philosophical Radicals, 304–305
Philosophy:
  as becoming culture, 312–313
  distortion of, 16
  public policy and, 17
  teaching of, 366–367
  See also Bentham, Jeremy; Rawls, John; Nozik, Robert; Pogge, Thomas; Smith, Adam; Utilitarianism
Pigou, Arthur Cecil, 318
Pinochet, Augusto, 54–55
Place, Francis, 304
Plamenatz, John, 327
Plato, 210
Pogge, Thomas, 228, 364–365, 366
Poland, 79, 90, 104, 168, 245
Politically exposed persons, 346
Population, global, 265
Po Sang Bank, 149–151
Poverty:
  conflicting views of, 226–228, 234–235
  corruption and, 251
  dirty money and, 204–205, 240–241
  economic growth and, 230–232
  globalization and, 232–233, 239, 264
  monetary measures of, 221–222
  nonmonetary measures of, 224–226
  Smith on, 16
  terrorism and, 233–234, 266–267
Poverty gaps, 221, 272–275
Poverty line, 221
Preston, Louis, 250
Pribbeno, Bill, 2
Pricing:
  fictitious, 25–33, 134–135, 194–197
  honesty in, 348–351
  reinvoicing companies and, 33–35
  underpricing, 28–29, 152–153
  See also Transfer pricing; Mispricing
Pricing declaration, 350
Priestley, Joseph, 302
Principles of Economics (Marshall), 316, 317
Pritchett, Lant, 270
Product quality, falsifying, 39
Purchasing power parity (PPP) figures, 213–214, 215–217, 228

Qaddafi, Muammar, 119–120
Quintile canyon, 210–217, 218, 219–220

Racketeer Influenced and Corrupt Organizations (RICO) Act, 174
Rawls, John, *A Theory of Justice*, 297–298, 361–364

Razzak Yaqub, Abdul, 79, 80
Real estate swaps, 43
Realizing Rawls (Pogge), 364–365
Reddy, Sanjay, 228
Reed, John, 45
Reinvoicing companies, 33–35
Reisman, David, 360
Relative poverty, 222
Renewal of capitalism, 368–375
Rescheduling of debt, 255–256
Revenue rule, 194–195, 199–200
Revolutionary Armed Forces of
Colombia (FARC), 97
Ricardo, David, 304
Rich, Marc, 61
Riggs National Bank, 54–57
Riley, Bill, 333
The Roaring Nineties: A New History of the World's Most Prosperous Decade (Stiglitz), 291–292
Rockefeller Brothers Fund, 2
Rodriguez Orejuela, Gilberto and
Miguel, 94, 95
Romer, Paul, 268
Rostow, W.W., 246
Rothschild, Emma, *Economic Sentiments: Adam Smith, Condorcet, and the Enlightenment*, 291
Round tripping, 145
Rubin, Robert, 158
Rule utilitarianism, 322, 323
Russia, 28, 34, 43, 104, 111, 118, 130, 151–160, 167, 168, 183, 204, 227, 245, 248, 313
Russian Central Bank, 153–154, 157–158

Sachs, Jeffrey, 269, 354
Saint Kitts, 36
Saint Lucia, 36
Saint Pierre et Miquelon, 36
Saint Vincent and the Grenadines, 36
Sala-i-Martin, Xavier, 226–227
Sale of the Century: Russia's Wild Ride from Communism to Capitalism (Freeland), 155
Salinas, Raul, 44–45
São Tomé and Principe, 36
Sark, *see* Channel Islands
Saudi Arabia, 56, 65, 85, 87, 123, 124, 126, 167, 168, 251
Scheme to defraud, 197
Schlegelmilch, Jens, 79–80
Scott, Henry, 283
Secrecy:
- dummy companies and, 35
- falsifying prices and, 32–33
- as motivation for cross-border dirty-money flows, 243
- trusts and, 37

Secrecy jurisdictions, 36, 191–194, 346–347
Selective sacrifice, 302–303, 310
Self-interest, 293–294, 371–372
Sen, Amartya, 225, 239
September 11, 2001 (9/11), 14, 88, 126, 177, 178, 183, 203
Serrano, Rosso Jose, 95–96
Services:
- billing for, 40
- mispricing of, 26–28, 31–32

Seychelles, the, 36
Share swaps, 43
Sharif, Nawaz, 52, 82–85
Shaw, William, 323–324
Shell banks, 179, 347
Shihata, Ibrahim, 250
Shinto, 312
Shutt, Harry, 15
Sidgwick, Henry, 315–316
Sierra Leone, 120, 127, 203, 212, 221
Singapore, 36, 52, 62, 73, 74, 147, 312

Singer, Peter, 325
Small, Richard, 179
Smith, Adam:
  career of, 282–283
  Das Adam Smith Problem, 293–294, 297
  distortion of philosophy of, 298–299, 340
  early life of, 282
  An Inquiry into the Nature and Causes of the Wealth of Nations, 283, 286–290, 297
  "invisible hand" and, 290–293
  on poverty, 16
  The Theory of Moral Sentiments, 283–286, 291, 292, 293, 297–298
Smuggling:
  of arms, 97–98, 111, 167
  of drugs, 89–92
  of goods, 167–168
  of humans, 100, 103–104, 116, 166
Smurfing, 42
Snelgrave, William, 371
Social exclusion, 225
Socialism, failure of, 13, 373–374
Société Générale de Surveillance (SGS), 78, 79, 82
Soghanalian, Sarkis, 97
Solow, Robert, 268
South Africa, 30, 36, 65, 90, 127, 168, 212, 355
South Korea, 71, 104, 110, 116, 118, 168, 169, 248, 312
Stanley, Albert, 66
State Administration of Foreign Exchange (China), 147–148
Stiglitz, Joseph, 58, 258–259, 291–292
Stolen goods, cross-border trafficking in, 167
Strained states, 204
Stroessner, Alfredo, 51
Structural adjustment programs of World Bank, 247
Sudan, 73, 105, 119, 120, 123, 124
Sudan Interior Mission (SIM) hospital, 4–5
Suharto, Tommy, 70–72
Suharto, Tutut, 70
Suharto and family, 68–76
Sukarno, 68–69
Suspicious activity reports (SARs), 175
Switzerland, 36, 44, 62, 63, 66, 74, 80, 104, 125, 128, 152, 168, 264
Sympathy, 284–285, 293, 294

Taiwan, 111, 115, 116, 169, 248, 312
Taliban, 92, 93, 124, 126, 185
Tanzania, 251
Tanaka, Kakuei, 115
Tanzania, 251
Tanzi, Vito, 135
Tax confidentiality, 347–348
Tax evasion:
  collusion in, 137–138
  fake transactions and, 171–172
  flow of proceeds from, 99–100, 189
  forms of, 135–136
  mispricing and, 169–170
  revenue rule and, 194–195, 199–200
  transfer pricing and, 170–171, 195–197
Tax havens, 36, 191–194, 346–347
Terrorism:
  alienation and, 266–267
  crime and, 118–123
  dirty money and, 203
  financing of, 183–185
  Iraq and, 127–133
  poverty and, 233–234
  See also Al Qaeda

Tesler, Jeffrey, 66
Thailand, 90, 104, 116, 233, 312
A Theory of Justice (Rawls), 297–298, 361–364
The Theory of Moral Sentiments (Smith), 283–286, 291, 292, 293, 297–298
The Theory of Political Economy (Jevons), 314
Third World debt crisis, 247
Timber trade, illegal, 167
Tipping point
  for the United States, 374
  for the World Bank, 374
  students, 375
Tonga, 36
Townsend, Bruce, 112
Transactions, faking, 38–41, 171–172
Transfer pricing, 30–31, 136–137, 170–171, 195–197
Transparency International, 58, 250
Tri-border region, 122, 166
Trusts, offshore, 37
Turkey, 88, 124, 130, 168, 246
Turks and Caicos Islands, 36

UBS, 132
Ukraine, 104, 168, 204
Underpricing, 28–29, 152–153
United Kingdom, *including references to* England and Great Britain, 12, 33, 60, 62, 63, 95, 128, 147, 152, 168, 169, 192, 194, 222, 231, 263, 290, 301, 302, 305, 306, 314, 316, 320
United Nations:
  Global Compact, 365
  Human Development Index, 225
  International Comparison Program, 216, 230
  Monitoring Group, 184, 185
  Oil-for-Food program, 129–131
  quintile ranking, 211
  report on Congo by, 141–143
  System of National Accounts, 216
United States, tipping point for, 374
University College London, 311
University of New Hampshire, 1
Unlawful activities, differences between onshore and offshore, 186–189
Uruguay, 27, 36, 40, 99
U.S. Customs Service, 184, 198–199, 348
U.S. Drug Enforcement Administration, 40, 95, 98, 203
U.S. Treasury Department:
  Financial Crimes Enforcement Network, 175
  Foreign Terrorist Asset Tracking Center, 183–184
  interviews with officials, 173, 200, 201
  Office of the Comptroller of the Currency, 57
Utilitarianism:
  capitalism and, 310, 311, 319, 329, 340–341
  history and overview of, 302–305, 307–311
  Jevons and, 314–315
  justice and, 323–325
  Marshall and, 316–317
  misapplication of, 325–326
  Pigou and, 318
  problems with, 309–310, 325–327
  Sidgwick and, 315–316
  transformation of, from philosophy into science, 317–318
  in twentieth century, 319–323
  in twenty-first century, 327–329

Utility
  Bentham and, 302–303, 304, 305, 310, 311
  difficulty in calculating, 320–321, 325–326
  Edgeworth and, 317
  embedded in economics, 317–318, 319
  Hume and, 302
  Jevons and, 314–315
  justice and, 323–324, 365, 367, 372
  Marshall, 316–317, 318
  Mill and, 308
  Pigou and, 318
  Rawls and, 362–363
  twentieth-century, 319–321

Vanuatu, 36, 73
Venezuela, 98, 110, 130, 168, 170, 204, 232, 304
Vivas, Raul, 39–40
Vojta, George, 365

Wahhabism, 124
Walzer, Michael, 366
Wang Xuebing, 146, 147
Warke, Tom, 317–318, 321
Warner, Andrew, 269
Waziri, Alhaji Jalo Ibrahim Mohammed, 333, 334, 336
Wealth of Nations, see *An Inquiry into the Nature and Causes of the Wealth of Nations* (Smith)
Western Samoa, 36
Westminster Review (journal), 304–305
Williams, Bernard, 331
Wire fraud, 197–198, 200
Wire transfer redirection, 43–44
Witoelar, Wimar, 76
Wolfensohn, James, 250
World Bank:
  anticorruption efforts of, 249–252, 346
  challenge to, 276
  Congo and, 140
  dirty money and, 252–254, 274
  end game of, 247–248
  focus of, 241
  HIPC Initiative, 255–256
  Indonesia and, 72
  intellectual and character gaps in, 258–261
  McNamara and, 247
  reconstitution of, 360–361
  shortcomings of, 275–277, 370
  structural adjustment programs of, 247
  tipping point for, 374–375
World Trade Organization, 200, 349
World Wealth Report, 163, 164

Xu Chaofan, 148–149
Xu Guojun, 148

Yamaguchi-gumi, 115
Yaqub, Muhammad, 18
Yayasans, 69, 70, 71
Yeltsin, Boris, 153
Yu Zhendong, 148

Zaire, *see* Congo
Zardari, Asif Ali, 78–80, 81–82
Zen Buddhism, 312
Zhu Xiaohua, 147–148
Zimbabwe, 52, 120, 141–142, 203