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Financial Crime and Corruption

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I. Slush Funds

According to David McClintick ("Swordfish: A True Story of Ambition, Savagery, and Betrayal"), in the late 1980's, the FBI and DEA set up dummy corporations to deal in drugs. They funneled into these corporate fronts money from drug-related asset seizures.

The idea was to infiltrate global crime networks but a lot of the money in "Operation Swordfish" may have ended up in the wrong pockets. Government agents and sheriffs got mysteriously and filthily rich and the whole sorry affair was wound down. The GAO reported more than \$3.6 billion missing. This bit of history gave rise to at least one blockbuster with Oscar-winner Halle Berry.

Alas, slush funds are much less glamorous in reality. They usually involve grubby politicians, pawky bankers, and philistine businessmen - rather than glamorous hackers and James Bondian secret agents.

The Kazakh prime minister, Imanghaliy Tasmaghambetov, freely admitted on April 4, 2002 to his country's rubber-stamp parliament the existence of a \$1 billion slush fund. The money was apparently skimmed off the proceeds of the opaque sale of the Tengiz oilfield.

Remitting it to Kazakhstan - he expostulated with a poker face - would have fostered inflation. So, the country's president, Nazarbaev, kept the funds abroad "for use in the event of either an economic crisis or a threat to Kazakhstan's security".

The money was used to pay off pension arrears in 1997 and to offset the pernicious effects of the 1998 devaluation of the Russian ruble. What was left was duly transferred to the \$1.5 billion National Fund, the PM insisted. Alas, the original money in the Fund came entirely from another sale of oil assets to Chevron, thus casting in doubt the official version.

The National Fund was, indeed, augmented by a transfer or two from the slush fund - but at least one of these transfers occurred only 11 days after the damning revelations. Moreover, despite incontrovertible evidence to the contrary, the unfazed premier denied that his president possesses multi-million dollar bank accounts abroad.

He later rescinded this last bit of disinformation. The president, he said, has no bank accounts abroad but will promptly return all the money in these non-existent accounts to Kazakhstan. These vehemently denied accounts, he speculated, were set up by the president's adversaries "for the purpose of compromising his name".

On April 15, 2002 even the docile opposition had enough of this fuzzy logic. They established a People Oil's Fund to monitor, henceforth, the regime's financial shenanigans.

By their calculations less than 7 percent of the income from the sale of hydrocarbon fuels (c. \$4-5 billion annually) make it to the national budget.

Slush funds infect every corner of the globe, not only the more obscure and venal ones. Every secret service - from the Mossad to the CIA - operates outside the stated state budget. Slush funds are used to launder money, shower cronies with patronage, and bribe decision makers. In some countries, setting them up is a criminal offense, as per the 1990 Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime. Other jurisdictions are more forgiving.

The Catholic Bishops Conference of Papua New Guinea and the Solomon Islands issued a press release November 2001 in which it welcomed the government's plans to abolish slush funds. They described the poisonous effect of this practice: "With a few notable exceptions, the practice of directing funds through politicians to district projects has been disastrous. It has created an atmosphere in which corruption is thought to have flourished. It has reduced the responsibility of public servants, without reducing their numbers or costs. It has been used to confuse people into believing public funds are the 'property' of individual members rather than the property of the people, honestly and fairly administered by the servants of the people.

The concept of 'slush-funds' has resulted in well- documented inefficiencies and failures. There were even accusations made that funds were withheld from certain members as a way of forcing them into submission. It seems that the era of the 'slush funds' has been a shameful period."

But even in the most orderly and lawful administration, funds are liable to be mislaid. "The Economist" reported recently about a \$10 billion class-action suit filed by native-Americans against the US government. The funds, supposed to be managed in trust since 1880 on behalf of half a million beneficiaries, were "either lost or stolen" according to officials.

Rob Gordon, the Director of the National Wilderness Institute accused "The US Interior Department (of) looting the special funds that were established to pay for wildlife conservation and squandering the money instead on questionable administrative expenses, slush funds and employee moving expenses".

Charles Griffin, the Deputy Director of the Heritage Foundation's Government Integrity Project, charges: "The federal budget provides numerous slush funds that can be used to subsidize the lobbying and political activities of special-interest groups".

On his list of "Top Ten Federal Programs That Actively Subsidize Politics and Lobbying" are: AmeriCorps, Senior Community Service Employment Program, Legal Services Corporation, Title X Family Planning, National Endowment for the Humanities, Market Promotion Program, Senior Environmental Employment Program, Superfund Worker Training, HHS Discretionary Aging Projects, Telecomm. & Info. Infrastructure Assistance.

These federal funds alone total \$1.8 billion. "Next" and "China Times" - later joined by "The Washington Post" - accused the former Taiwanese president, Lee Teng-hui, of forming a \$100 million overseas slush fund intended to finance the gathering of information, influence-peddling, and propaganda operations. Taiwan footed the bills trips by Congressional aides and funded academic research and think tank conferences.

High ranking Japanese officials, among others, may have received payments through this stealthy venue.

Lee is alleged to have drawn \$100,000 from the secret account in February 1999. The money was used to pay for the studies of a former Japanese Vice-Defense Minister Masahiro Akiyama's at Harvard.

Ryutaro Hashimoto, the former Japanese prime minister, was implicated as a beneficiary of the fund. So were the prestigious lobbying firm, Cassidy and Associates and assorted assistant secretaries in the Bush administration.

Carl Ford, Jr., currently assistant secretary of state for intelligence and research, worked for Cassidy during the relevant period and often visited Taiwan. James Kelly, assistant secretary of state for East Asian and Pacific Affairs enjoyed the Taiwanese largesse as well. Both are in charge of crafting America's policy on Taiwan.

John Bolton, erstwhile undersecretary of state for arms control and international security, admitted, during his confirmation hearings, to having received \$30,000 to cover the costs of writing 3 research papers.

The Taiwanese government has yet to deny the news stories.

A Japanese foreign ministry official used slush fund money to finance the extra-marital activities of himself and many of his colleagues - often in posh hotel suites.

But this was no exception. According to Asahi Shimbun, more than half of the 60 divisions of the ministry maintained similar funds. The police and the ministry are investigating. One arrest has been made. The ministry's accounting division has discovered these corrupt practices twenty years before but kept mum.

Even low-level prefectural bureaucrats and teachers in Japan build up slush funds by faking business trips or padding invoices and receipts. Japanese citizens' groups conservatively estimated that \$20 million in travel and entertainment expenses in the prefectures in 1994 were faked, a practice known as "kara shutcho" (i.e., empty business trip).

Officials of the Hokkaido Board of Education admitted to the existence of a 100 million yen secret fund. In a resulting probe, 200 out of 286 schools were found to maintain their own slush funds. Some of the money was used to support friendly politicians.

But slush funds are not a sovereign prerogative.

Multinationals, banks, corporation, religious organizations, political parties, and even NGO's salt away some of their revenues and profits in undisclosed accounts, usually in off-shore havens.

Secret election campaign slush funds are a fixture in American politics. A 5-year old bill requires disclosure of donors to such funds but the House is busy loosening its provisions. "The Economist" listed in 2002 the tsunami of scandals that engulfs Germany, both its major political parties, many of the Lander and numerous highly placed and mid-level bureaucrats. Secret, mainly party, funds seem to be involved in the majority of these lurid affairs.

Italian firms made donations to political parties through slush funds, though corporate donations - providing they are transparent - are perfectly legal in Italy. Both the right and, to a lesser extent, the left in France are said to have managed enormous political slush funds.

President Chirac is accused of having abused for his personal pleasure, one such municipal fund in Paris, when he was its mayor. But the funds were mostly used to provide party activists with mock jobs. Corporations paid kickbacks to obtain public works or local building permits. Ostensibly, they were paying for sham "consultancy services".

The epidemic hasn't skipped even staid Ottawa. Its Chief Electoral Officer told Sun Media in September 2001 that he is "concerned" about millions stashed away by Liberal candidates. Sundry ministers who coveted the prime minister's job, have raised funds covertly and probably illegally.

On April 11, 2002 UPI reported that Spain's second- largest bank, Banco Bilbao Vizcaya Argentaria (BBVA), held nearly \$200 million hidden in secret offshore accounts, "which were allegedly used to manipulate politicians, pay off the 'revolutionary tax' to ETA - the Basque terrorist organization - and open the door for business deals, according to news reports".

The money may have gone to luminaries such as Venezuela's Hugo Chavez, Peru's Alberto Fujomori and Vladimiro Montesinos. The bank's board members received fat, tax-free, "pensions" from the illegal accounts opened in 1987 - a total of more than \$20 million.

Latin American drug money launderers - from Puerto Rico to Colombia - may have worked through these funds and the bank's clandestine entities in the Cayman Islands and Jersey. The current Spanish Secretary of State for the Treasury has been the bank's tax advisor between 1992-7.

The "Financial Times" reported in June 2000 that, in anticipation of new international measures to curb corruption, "leading European arms manufacturers" resorted to the creation of off-shore slush funds. The money is intended to bribe foreign officials to win tenders and contracts.

Kim Woo-chung, Daewoo's former chairman, is at the center of a massive scandal involving dozens of his company's executive, some of whom ended up in prison.

He stands accused of diverting a whopping \$20 billion to an overseas slush fund.

A mind boggling \$10 billion were alleged to have been used to bribe Korean government officials and politicians.

But his conduct and even the scale of the fraud he perpetrated may have been typical to Korea's post-war

incestuous relationship between politics and business.

In his paper "The Role of Slush Funds in the Preparation of Corruption Mechanisms", reprinted by Transparency International, Gherardo Colombo defines corporate slush funds thus: "Slush funds are obtained from a joint stock company's finances, carefully managed so that the amounts involved do not appear on the balance sheet. They do not necessarily have to consist of money, but can also take the form of stocks and shares or other economically valuable goods (works of art, jewels, yachts, etc.) It is enough that they can be used without any particular difficulty or that they can be transferred to a third party.

If a fund is in the form of money, it is not even necessary to refer to it outside the company accounts, since it can appear in them in disguised form (the 'accruals and deferrals' heads are often resorted to for the purpose of hiding slush money). In light of this, it is not always correct to regard it as a reserve fund that is not accounted for in the books. Deception, trickery or forgery of various kinds are often resorted to for the purpose of setting up a slush fund".

He mentions padded invoices, sham contracts, fictitious loans, interest accruing on holding accounts, back to back transactions with related entities (Enron) - all used to funnel money to the slush funds. Such funds are often set up to cover for illicit and illegal self-enrichment, embezzlement, or tax evasion.

Less known is the role of these furtive vehicles in financing unfair competitive practices, such as dumping.

Clients, suppliers, and partners receive hidden rebates and subsidies that much increase the - unreported - real cost of production.

BBVA's payments to ETA may have been a typical payment of protection fees. Both terrorists and organized crime put slush funds to bad use. They get paid from such funds - and maintain their own. Ransom payments to kidnappers often flow through these channels.

But slush funds are overwhelmingly used to bribe corrupt politicians. The fight against corruption has been titled against the recipients of illicit corporate largesse. But to succeed, well-meaning international bodies, such as the OECD's FATF, must attack with equal zeal those who bribe. Every corrupt transaction is between a venal politician and an avaricious businessman. Pursuing the one while ignoring the other is self-defeating.

Note - The Psychology of Corruption Most politicians bend the laws of the land and steal money or solicit bribes because they need the funds to support networks of patronage. Others do it in order to reward their nearest and dearest or to maintain a lavish lifestyle when their political lives are over.

But these mundane reasons fail to explain why some officeholders go on a rampage and binge on endless quantities of lucre. All rationales crumble in the face of a Mobutu Sese Seko or a Saddam Hussein or a Ferdinand Marcos who absconded with billions of US dollars from the coffers of Zaire, Iraq, and the Philippines, respectively.

These inconceivable dollops of hard cash and valuables often remain stashed and untouched, moldering in bank accounts and safes in Western banks. They serve no purpose, either political or economic. But they do fulfill a psychological need. These hoards are not the megalomaniacal equivalents of savings accounts. Rather they are of the nature of compulsive collections.

Erstwhile president of Sierra Leone, Momoh, amassed hundreds of video players and other consumer goods in vast rooms in his mansion. As electricity supply was intermittent at best, his was a curious choice. He used to sit among these relics of his cupidity, fondling and counting them insatiably.

While Momoh relished things with shiny buttons, people like Sese Seko, Hussein, and Marcos drooled over money.

The ever-heightening mountains of greenbacks in their vaults soothed them, filled them with confidence, regulated their sense of self-worth, and served as a love substitute. The balances in their bulging bank accounts were of no practical import or intent. They merely catered to their psychopathology.

These politicians were not only crooks but also kleptomaniacs. They could no more stop thieving than Hitler could stop murdering. Venality was an integral part of their psychological makeup.

Kleptomania is about acting out. It is a compensatory act.

Politics is a drab, uninspiring, unintelligent, and, often humiliating business. It is also risky and rather arbitrary. It involves enormous stress and unceasing conflict.

Politicians with mental health disorders (for instance, narcissists or psychopaths) react by decompensation. They rob the state and coerce businessmen to grease their palms because it makes them feel better, it helps them to repress their mounting fears and frustrations, and to restore their psychodynamic equilibrium. These politicians and bureaucrats "let off steam" by looting.

Kleptomaniacs fail to resist or control the impulse to steal, even if they have no use for the booty. According to the Diagnostic and Statistical Manual IV-TR (2000), the bible of psychiatry, kleptomaniacs feel "pleasure, gratification, or relief when committing the theft." The good book proceeds to say that " ... (T)he individual may hoard the stolen objects ...".

As most kleptomaniac politicians are also psychopaths, they rarely feel remorse or fear the consequences of their misdeeds. But this only makes them more culpable and dangerous.

II. Corruption and Transparency

I. The Facts Just days before a much-awaited donor conference, the influential International Crisis Group (ICG) recommended to place all funds pledged to Macedonia under the oversight of a "corruption advisor" appointed by the European Commission. The donors ignored this and other recommendations. To appease the critics, the affable Attorney General of Macedonia charged a former Minister of Defense with abuse of duty for allegedly having channeled millions of DM to his relatives during the recent civil war. Macedonia has belatedly passed an anti- money laundering law recently - but failed, yet again, to adopt strict anti-corruption legislation.

In Albania, the Chairman of the Albanian Socialist Party, Fatos Nano, was accused by Albanian media of laundering \$1 billion through the Albanian government.

Pavel Borodin, the former chief of Kremlin Property, decided not appeal his money laundering conviction in a Swiss court. The Slovak daily "Sme" described in scathing detail the newly acquired wealth and lavish lifestyles of formerly impoverished HZDS politicians.

Some of them now reside in refurbished castles. Others have swimming pools replete with wine bars.

Pavlo Lazarenko, a former Ukrainian prime minister, is detained in San Francisco on money laundering charges.

His defense team accuses the US authorities of "selective prosecution".

They are quoted by Radio Free Europe as saying: "The impetus for this prosecution comes from allegations made by the Kuchma regime, which itself is corrupt and dedicated to using undemocratic and repressive methods to stifle political opposition ... (other Ukrainian officials) including Kuchma himself and his closest associates, have committed conduct similar to that with which Lazarenko is charged but have not been prosecuted by the U.S. government".

The UNDP estimated, in 1997, that, even in rich, industrialized, countries, 15% of all firms had to pay bribes. The figure rises to 40% in Asia and 60% in Russia.

Corruption is rife and all pervasive, though many allegations are nothing but political mud-slinging.

Luckily, in countries like Macedonia, it is confined to its rapacious elites: its politicians, managers, university professors, medical doctors, judges, journalists, and top bureaucrats. The police and customs are hopelessly compromised. Yet, one rarely comes across graft and venality in daily life. There are no false detentions (as in Russia), spurious traffic tickets (as in Latin America), or widespread stealthy payments for public goods and services (as in Africa).

It is widely accepted that corruption retards growth by deterring foreign investment and encouraging brain drain.

It leads to the misallocation of economic resources and distorts competition. It depletes the affected country's endowments - both natural and acquired. It demolishes the tenuous trust between citizen and state. It casts civil and government institutions in doubt, tarnishes the entire political class, and, thus, endangers the democratic system and the rule of law, property rights included.

This is why both governments and business show a growing commitment to tackling it. According to Transparency International's "Global Corruption Report 2001", corruption has been successfully contained in private banking and the diamond trade, for instance.

Hence also the involvement of the World Bank and the IMF in fighting corruption. Both institutions are increasingly concerned with poverty reduction through economic growth and development. The World Bank estimates that corruption reduces the growth rate of an affected country by 0.5 to 1 percent annually. Graft amounts to an increase in the marginal tax rate and has pernicious effects on inward investment as well.

The World Bank has appointed last year a Director of Institutional Integrity - a new department that combines the Anti-Corruption and Fraud Investigations Unit and the Office of Business Ethics and Integrity. The Bank helps countries to fight corruption by providing them with technical assistance, educational programs, and lending.

Anti-corruption projects are an integral part of every Country Assistance Strategy (CAS). The Bank also supports international efforts to reduce corruption by sponsoring conferences and the exchange of information.

It collaborates closely with Transparency International, for instance.

At the request of member-governments (such as Bosnia- Herzegovina and Romania) it has prepared detailed country corruption surveys covering both the public and the private sectors. Together with the EBRD, it publishes a corruption survey of 3000 firms in 22 transition countries (BEEPS - Business Environment and Enterprise Performance Survey). It has even set up a multilingual hotline for whistleblowers.

The IMF made corruption an integral part of its country evaluation process. It suspended arrangements with endemically corrupt recipients of IMF financing. Since 1997, it has introduced policies regarding misreporting, abuse of IMF funds, monitoring the use of debt relief for poverty reduction, data dissemination, legal and judicial reform, fiscal and monetary transparency, and even internal governance (e.g., financial disclosure by staff members).

Yet, no one seems to agree on a universal definition of corruption. What amounts to venality in one culture (Sweden) is considered no more than hospitality, or an expression of gratitude, in another (France, or Italy).

Corruption is discussed freely and forgivingly in one place - but concealed shamefully in another. Corruption, like other crimes, is probably seriously under-reported and under-penalized.

Moreover, bribing officials is often the unstated policy of multinationals, foreign investors, and expatriates. Many of them believe that it is inevitable if one is to expedite matters or secure a beneficial outcome. Rich world governments turn a blind eye, even where laws against such practices are extant and strict.

In his address to the Inter-American Development Bank on March 14, President Bush promised to "reward nations that root out corruption" within the framework of the Millennium Challenge Account initiative. The USA has pioneered global anti-corruption campaigns and is a signatory to the 1996 IAS Inter-American Convention against Corruption, the Council of Europe's Criminal Law Convention on Corruption, and the OECD's 1997 anti-bribery convention. The USA has had a comprehensive "Foreign Corrupt Practices Act" since 1977.

The Act applies to all American firms, to all firms - including foreign ones - traded in an American stock exchange, and to bribery on American territory by foreign and American firms alike. It outlaws the payment of bribes to foreign officials, political parties, party officials, and political candidates in foreign countries. A similar law has now been adopted by Britain.

Yet, "The Economist" reports that the American SEC has brought only three cases against listed companies until 1997. The US Department of Justice brought another 30 cases. Britain has persecuted successfully only one of its officials for overseas bribery since 1889. In the Netherlands bribery is tax deductible. Transparency International now publishes a name and shame Bribery Payers Index to complement its 91-country strong Corruption Perceptions Index.

Many rich world corporations and wealthy individuals make use of off-shore havens or "special purpose entities" to launder money, make illicit payments, avoid or evade taxes, and conceal assets or liabilities. According to Swiss authorities, more than \$40 billion are held by Russians in its banking system alone. The figure may be 5 to 10 times higher in the tax havens of the United Kingdom.

In a survey it conducted last month of 82 companies in which it invests, "Friends, Ivory, and Sime" found that only a quarter had clear anti-corruption management and accountability systems in place.

Tellingly only 35 countries signed the 1997 OECD "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions" - including four non-OECD members: Chile, Argentina, Bulgaria, and Brazil. The convention has been in force since February 1999 and is only one of many OECD anti-corruption drives, among which are SIGMA (Support for Improvement in Governance and Management in Central and Eastern European countries), ACN (Anti-Corruption Network for Transition Economies in Europe), and FATF (the Financial Action Task Force on Money Laundering).

Moreover, The moral authority of those who preach against corruption in poor countries - the officials of the IMF, the World Bank, the EU, the OECD - is strained by their ostentatious lifestyle, conspicuous consumption, and "pragmatic" morality.

II. What to Do? What is Being Done? Two years ago, I proposed a taxonomy of corruption, venality, and graft. I suggested this cumulative definition: a. The withholding of a service, information, or goods that, by law, and by right, should have been provided or divulged. b. The provision of a service, information, or goods that, by law, and by right, should not have been provided or divulged. c. That the withholding or the provision of said service, information, or goods are in the power of the withholder or the provider to withhold or to provide AND That the withholding or the provision of said service, information, or goods constitute an integral and substantial part of the authority or the function of the withholder or the provider. d. That the service, information, or goods that are provided or divulged are provided or divulged against a benefit or the promise of a benefit from the recipient and as a result of the receipt of this specific benefit or the promise to receive such benefit. e. That the service, information, or goods that are withheld are withheld because no benefit was provided or promised by the recipient.

There is also what the World Bank calls "State Capture" defined thus: "The actions of individuals, groups, or firms, both in the public and private sectors, to influence the formation of laws, regulations, decrees, and other government policies to their own advantage as a result of the illicit and non-transparent provision of private benefits to public officials".

We can classify corrupt and venal behaviors according to their outcomes: a. Income Supplement - Corrupt actions whose sole outcome is the supplementing of the income of the provider without affecting the "real world" in any manner. b. Acceleration or Facilitation Fees - Corrupt practices whose sole outcome is to accelerate or facilitate decision making, the provision of goods and services or the divulging of information. c. Decision Altering (State Capture) Fees - Bribes and promises of bribes which alter decisions or affect them, or which affect the formation of policies, laws, regulations, or decrees beneficial to the bribing entity or person. d. Information Altering Fees - Backhanders and bribes that subvert the flow of true and complete information within a society or an economic unit (for instance, by selling professional diplomas, certificates, or permits). e. Reallocation Fees - Benefits paid (mainly to politicians and political decision makers) in order to affect the allocation of economic resources and material wealth or the rights thereto. Concessions, licenses, permits, assets privatized, tenders awarded are all subject to reallocation fees.

To eradicate corruption, one must tackle both giver and taker.

History shows that all effective programs shared these common elements: a. The persecution of corrupt, high-profile, public figures, multinationals, and institutions (domestic and foreign). This demonstrates that no

one is above the law and that crime does not pay. b. The conditioning of international aid, credits, and investments on a monitored reduction in corruption levels. The structural roots of corruption should be tackled rather than merely its symptoms. c. The institution of incentives to avoid corruption, such as a higher pay, the fostering of civic pride, "good behavior" bonuses, alternative income and pension plans, and so on. d. In many new countries (in Asia, Africa, and Eastern Europe) the very concepts of "private" versus "public" property are fuzzy and impermissible behaviors are not clearly demarcated. Massive investments in education of the public and of state officials are required. e. Liberalization and deregulation of the economy.

Abolition of red tape, licensing, protectionism, capital controls, monopolies, discretionary, non-public, procurement. Greater access to information and a public debate intended to foster a "stakeholder society". f. Strengthening of institutions: the police, the customs, the courts, the government, its agencies, the tax authorities - under time limited foreign management and supervision.

Awareness to corruption and graft is growing - though it mostly results in lip service. The Global Coalition for Africa adopted anti-corruption guidelines in 1999. The otherwise opaque Asia Pacific Economic Cooperation (APEC) forum is now championing transparency and good governance. The UN is promoting its pet convention against corruption.

The G-8 asked its Lyon Group of senior experts on transnational crime to recommend ways to fight corruption related to large money flows and money laundering. The USA and the Netherlands hosted global forums on corruption - as will South Korea next year. The OSCE is rumored to respond with its own initiative, in collaboration with the US Congressional Helsinki Commission.

The south-eastern Europe Stability Pact sports its own Stability Pact Anti-corruption Initiative (SPAI). It held its first conference in September 2001 in Croatia. More than 1200 delegates participated in the 10th International Anti-Corruption Conference in Prague last year. The conference was attended by the Czech prime minister, the Mexican president, and the head of the Interpol.

The most potent remedy against corruption is sunshine - free, accessible, and available information disseminated and probed by an active opposition, uncompromised press, and assertive civic organizations and NGO's. In the absence of these, the fight against official avarice and criminality is doomed to failure. With them, it stands a chance.

Corruption can never be entirely eliminated - but it can be restrained and its effects confined. The cooperation of good people with trustworthy institutions is indispensable.

Corruption can be defeated only from the inside, though with plenty of outside help. It is a process of self-redemption and self-transformation. It is the real transition.

III. Asset Confiscation and Asset Forfeiture The abuse of asset confiscation and forfeiture statutes by governments, law enforcement agencies, and political appointees and cronies throughout the world is well-documented. In many developing countries and countries in transition, assets confiscated from real and alleged criminals and tax evaders are sold in fake auctions to party hacks, cronies, police officers, tax inspectors, and relatives of prominent politicians at bargain basement prices.

That the assets of suspects in grave crimes and corruption should be frozen or "disrupted" until they are convicted or exonerated by the courts - having exhausted their appeals - is understandable and in accordance with the Vienna Convention. But there is no justification for the seizure and sale of property otherwise.

In Switzerland, financial institutions are obliged to automatically freeze suspect transactions for a period of five days, subject to the review of an investigative judge.

In France, the Financial Intelligence Unit can freeze funds involved in a reported suspicious transaction by administrative fiat. In both jurisdictions, the fast track freezing of assets has proven to be a more than adequate measure to cope with organized crime and venality.

The presumption of innocence must fully apply and due process upheld to prevent self-enrichment and corrupt dealings with confiscated property, including the unethical and unseemly use of the proceeds from the sale of forfeited assets to close gaping holes in strained state and municipal budgets.

In the United States, according to The Civil Asset Forfeiture Reform Act of 2000 (HR 1658), the assets of suspects under investigation and of criminals convicted of a variety of more than 400 minor and major offenses (from soliciting a prostitute to gambling and from narcotics charges to corruption and tax evasion) are often confiscated and forfeited ("in personam, or value-based confiscation").

Technically and theoretically, assets can be impounded or forfeited and disposed of even in hitherto minor Federal civil offenses (mistakes in fulfilling Medicare or tax return forms) The UK's Assets Recovery Agency (ARA) that is in charge of enforcing the Proceeds of Crime Act 2002, had this chilling statement to make on May 24, 2007: "We are pursuing the assets of those involved in a wide range of crime including drug dealing, people trafficking, fraud, extortion, smuggling, control of prostitution, counterfeiting, benefit fraud, tax evasion and environmental crimes such as illegal dumping of waste and illegal fishing." (!) Drug dealing and illegal fishing in the same sentence.

The British firm Bentley-Jennison, who provide Forensic Accounting Services, add: "In some cases the defendants will even have their assets seized at the start of an investigation, before any charges have been considered. In many cases the authorities will assume that all of the assets held by the defendant are illegally obtained as he has a "criminal lifestyle". It is then down to the defendant to prove otherwise. If the defendant is judged to have a criminal lifestyle then it will be assumed that physical assets, such as properties and motor vehicles, have been acquired through the use of criminal funds and it will be necessary to present evidence to contradict this.

The defendant's bank accounts will also be scanned for evidence of spending and any expenditure on unidentified assets (and in some cases identified assets) is also likely to be included as alleged criminal benefit.

This often leads to the inclusion of sums from legitimate sources and double counting both of which need to be eliminated".

Under the influence of the post-September 11 United States and the FATF (Financial Action Task Force on Money Laundering), Canada, Australia, the United Kingdom, Greece, South Korea, and Russia have similar asset recovery and money laundering laws in place.

International treaties (for instance, the 1959 European Convention on Mutual Legal Assistance in Criminal Matters, the 1990 Convention of the Council of Europe on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (ETS 141), and The U.N.

Convention against Corruption 2003- UNCAC) and European Union Directives (e.g., 2001/97/EC) allow the seizure and confiscation of the assets and "unexplained wealth" of criminals and suspects globally, even if their alleged or proven crime does not constitute an offense where they own property or have bank accounts.

This abrogation of the principle of dual criminality sometimes leads to serious violations of human and civil rights. Hitler could have used it to ask the United Kingdom's Assets Recovery Agency (ARA) to confiscate the property of refugee Jews who committed "crimes" by infringing on the infamous Nuremberg race laws.

Only offshore tax havens, such as Andorra, Antigua, Aruba, the British Virgin Islands, Guernsey, Monaco, the Netherlands Antilles, Samoa, St. Vincent, the US Virgin Islands, and Vanuatu still resist the pressure to join in the efforts to trace and seize suspects' assets and bank accounts in the absence of a conviction or even charges.

Even worse, unlike in other criminal proceedings, the burden of proof is on the defendant who has to demonstrate that the source of the funds used to purchase the confiscated or forfeited assets is legal. When the defendant fails to furnish such evidence conclusively and convincingly, or if he has left the United States or had died, the assets are sold at an auction and the proceeds usually revert to various law enforcement agencies, to the government's budget, or to good social causes and programs. This is the case in many countries, including United Kingdom, United States, Germany, France, Hong Kong, Italy, Denmark, Belgium, Austria, Greece, Ireland, New Zealand, Singapore and Switzerland.

According to a brief written by Jack Smith, Mark Pieth, and Guillermo Jorge at the Basel Institute on Governance, International Centre for Asset Recovery: "Article 54(1)(c) of the UNCAC recommends that states parties establish non-criminal systems of confiscation, which have several advantages for recovery actions: the standard of evidence is lower ("preponderance of the evidence" rather than "beyond a reasonable doubt"); they are not subject to some of the more restrictive traditional safeguards of international cooperation such as the offense for which the defendant is accused has to be a crime in the receiving state (dual criminality); and it opens more formal avenues for negotiation and settlements. This is already the practice in some jurisdictions such as the US, Ireland, the UK, Italy, Colombia, Slovenia, and South Africa, as well as some Australian and Canadian States".

In most countries, including the United Kingdom, the United States, Austria, Germany, Indonesia, Macedonia, and Ireland, assets can be impounded, confiscated, frozen, forfeited, and even sold prior to and without any criminal conviction.

In Australia, Austria, Ireland, Hong-Kong, New Zealand, Singapore, United Kingdom, South Africa, United States and the Netherlands alleged and suspected criminals, their family members, friends, employees, and partners can be stripped of their assets even for crimes they have committed in other countries and even if they have merely made use of revenues obtained from illicit activities (this is called "in rem, or property-based confiscation"). This often gives rise to cases of double jeopardy.

Typically, the defendant is notified of the impending forfeiture or confiscation of his or her assets and has recourse to a hearing within the relevant law enforcement agency and also to the courts. If he or she can prove "substantial harm" to life and business, the property may be released to be used, though ownership is rarely restored.

When the process of asset confiscation or asset forfeiture is initiated, banking secrecy is automatically lifted and the government indemnifies the banks for any damage they may suffer for disclosing confidential information about their clients' accounts.

In many countries from South Korea to Greece, lawyer- client privilege is largely waived. The same requirements of monitoring of clients' activities and reporting to the authorities apply to credit and financial institutions, venture capital firms, tax advisers, accountants, and notaries.

Elsewhere, there are some other worrying developments: In Bulgaria, the assets of tax evaders have recently begun to be confiscated and turned over to the National Revenue Agency and the State Receivables Collection Agency.

Property is confiscated even when the tax assessment is disputed in the courts. The Agency cannot, however, confiscate single-dwelling houses, bank accounts up to 250 leva of one member of the family, salary or pension up to 250 leva a month, social care, and alimony, support money or allowances.

Venezuela has recently reformed its Organic Tax Code to allow for: " (P)re-judgment enforcement measures (to) include closure of premises for up to ten days and confiscation of merchandise. These measures will be applied in addition to the attachment or sequestration of personal property and the prohibition against

alienation or encumbrance of realty. During closure of premises, the employer must continue to pay workers, thereby avoiding an appeal for constitutional protection".

Finally, in many states in the United States, "community responsibility" statutes require of owners of legal businesses to "abate crime" by openly fighting it themselves. If they fail to tackle the criminals in their neighborhood, the police can seize and sell their property, including their apartments and cars. The proceeds from such sales accrue to the local municipality.

In New-York City, the police confiscated a restaurant because one of its regular patrons was an alleged drug dealer. In Alabama, police seized the home of a senior citizen because her yard was used, without her consent, for drug dealing. In Maryland, the police confiscated a family's home and converted it into a retreat for its officers, having mailed one of the occupants a package of marijuana.

III. Money Laundering in A Changed World

If you shop with a major bank, chances are that all the transactions in your account are scrutinized by AML (Anti Money Laundering) software. Billions of dollars are being invested in these applications. They are supposed to track suspicious transfers, deposits, and withdrawals based on overall statistical patterns. Bank directors, exposed, under the Patriot Act, to personal liability for money laundering in their establishments, swear by it as a legal shield and the holy grail of the on-going war against financial crime and the finances of terrorism.

Quoted in Wired.com, Neil Katkov of Celent Communications, pegs future investments in compliance-related activities and products by American banks alone at close to \$15 billion in the next 3 years (2005-2008). The United State's Treasury Department's Financial Crimes Enforcement Network (finCEN) received c. 15 million reports in each of the years 2003 and 2004.

But this is a drop in the seething ocean of illicit financial transactions, sometimes egged on and abetted even by the very Western governments ostensibly dead set against them.

Israel has always turned a blind eye to the origin of funds deposited by Jews from South Africa to Russia. In Britain it is perfectly legal to hide the true ownership of a company. Underpaid Asian bank clerks on immigrant work permits in the Gulf states rarely require identity documents from the mysterious and well-connected owners of multi-million dollar deposits.

Hawaladars continue plying their paperless and trust-based trade - the transfer of billions of US dollars around the world. American and Swiss banks collaborate with dubious correspondent banks in off shore centres.

Multinationals shift money through tax free territories in what is euphemistically known as "tax planning". Internet gambling outfits and casinos serve as fronts for narco- dollars. British Bureaux de Change launder up to 2.6 billion British pounds annually.

The 500 Euro note makes it much easier to smuggle cash out of Europe. A French parliamentary committee accused the City of London of being a money laundering haven in a 400 page report. Intelligence services cover the tracks of covert operations by opening accounts in obscure tax havens, from Cyprus to Nauru. Money laundering, its venues and techniques, are an integral part of the economic fabric of the world. Business as usual? Not really. In retrospect, as far as money laundering goes, September 11 may be perceived as a watershed as important as the precipitous collapse of communism in 1989. Both events have forever altered the patterns of the global flows of illicit capital.

What is Money Laundering? Strictly speaking, money laundering is the age-old process of disguising the illegal origin and criminal nature of funds (obtained in sanctions-busting arms sales, smuggling, trafficking in humans, organized crime, drug trafficking, prostitution rings, embezzlement, insider trading, bribery, and computer fraud) by moving them untraceably and investing them in legitimate businesses, securities, or bank deposits. But this narrow definition masks the fact that the bulk of money laundered is the result of tax evasion, tax avoidance, and outright tax fraud, such as the "VAT carousel scheme" in the EU (moving goods among businesses in various jurisdictions to capitalize on differences in VAT rates). Tax-related laundering nets between 10-20 billion US dollars annually from France and Russia alone. The confluence of criminal and tax averse funds in money laundering networks serves to obscure the sources of both.

The Scale of the Problem According to a 1996 IMF estimate, money laundered annually amounts to 2-5% of world GDP (between 800 billion and 2 trillion US dollars in today's terms). The lower figure is considerably larger than an average European economy, such as Spain's.

The System It is important to realize that money laundering takes place within the banking system. Big amounts of cash are spread among numerous accounts (sometimes in free economic zones, financial off shore centers, and tax havens), converted to bearer financial instruments (money orders, bonds), or placed with trusts and charities. The money is then transferred to other locations, sometimes as bogus payments for "goods and services" against fake or inflated invoices issued by holding companies owned by lawyers or accountants on behalf of unnamed beneficiaries. The transferred funds are re-assembled in their destination and often "shipped" back to the point of origin under a new identity. The laundered funds are then invested in the legitimate economy. It is a simple procedure - yet an effective one. It results in either no paper trail - or too much of it. The accounts are invariably liquidated and all traces erased.

Why is It a Problem? Criminal and tax evading funds are idle and non-productive. Their injection, however surreptitiously, into the economy transforms them into a productive (and cheap) source of capital. Why is this negative? Because it corrupts government officials, banks and their officers, contaminates legal sectors of the economy, crowds out legitimate and foreign capital, makes money supply unpredictable and uncontrollable, and increases cross-border capital movements, thereby enhancing the volatility of exchange rates.

A multilateral, co-ordinated, effort (exchange of information, uniform laws, extra-territorial legal powers) is required to counter the international dimensions of money laundering. Many countries opt in because money laundering has also become a domestic political and economic concern. The United Nations, the Bank for International Settlements, the OECD's FATF (Financial Action Task Force), the EU, the Council of Europe, the Organisation of American States, all published anti-money laundering standards. Regional groupings were formed (or are being established) in the Caribbean, Asia, Europe, southern Africa, western Africa, and Latin America.

Money Laundering in the Wake of the September 11 Attacks Regulation The least important trend is the tightening of financial regulations and the establishment or enhancement of compulsory (as opposed to industry or voluntary) regulatory and enforcement agencies.

New legislation in the US which amounts to extending the powers of the CIA domestically and of the DOJ extra-territorially, was rather xenophobically described by a DOJ official, Michael Chertoff, as intended to "make sure the American banking system does not become a haven for foreign corrupt leaders or other kinds of foreign organized criminals".

Privacy and bank secrecy laws have been watered down.

Collaboration with off shore "shell" banks has been banned. Business with clients of correspondent banks was curtailed. Banks were effectively transformed into law enforcement agencies, responsible to verify both the identities of their (foreign) clients and the source and origin of their funds. Cash transactions were partly criminalized. And the securities and currency trading industry, insurance companies, and money transfer services are subjected to growing scrutiny as a conduit for "dirty cash".

Still, such legislation is highly ineffective. The American Bankers' Association puts the cost of compliance with the laxer anti-money-laundering laws in force in 1998 at 10 billion US dollars - or more than 10 million US dollars per obtained conviction. Even when the system does work, critical alerts drown in the torrent of reports mandated by the regulations. One bank actually reported a suspicious transaction in the account of one of the September 11 hijackers - only to be ignored.

The Treasury Department established Operation Green Quest, an investigative team charged with monitoring charities, NGO's, credit card fraud, cash smuggling, counterfeiting, and the Hawala networks. This is not without precedent. Previous teams tackled drug money, the biggest money laundering venue ever, BCCI (Bank of Credit and Commerce International), and ... Al Capone.

The more veteran, New-York based, El-Dorado anti money laundering Task Force (established in 1992) will lend a hand and share information.

More than 150 countries promised to co-operate with the US in its fight against the financing of terrorism - 81 of which (including the Bahamas, Argentina, Kuwait, Indonesia, Pakistan, Switzerland, and the EU) actually froze assets of suspicious individuals, suspected charities, and dubious firms, or passed new anti money laundering laws and stricter regulations (the Philippines, the UK, Germany).

A EU directive now forces lawyers to disclose incriminating information about their clients' money laundering activities. Pakistan initiated a "loyalty scheme", awarding expatriates who prefer official bank channels to the much maligned (but cheaper and more efficient) Hawala, with extra baggage allowance and special treatment in airports.

The magnitude of this international collaboration is unprecedented. But this burst of solidarity may yet fade.

China, for instance, refuses to chime in. As a result, the statement issued by APEC in November 2001 on measures to stem the finances of terrorism was lukewarm at best. And, protestations of close collaboration to the contrary, Saudi Arabia has done nothing to combat money laundering "Islamic charities" (of which it is proud) on its territory.

Still, a universal code is emerging, based on the work of the OECD's FATF (Financial Action Task Force) since 1989 (its famous "40 recommendations") and on the relevant UN conventions. All countries are expected by the West, on pain of possible sanctions, to adopt a uniform legal platform (including reporting on suspicious transactions and freezing assets) and to apply it to all types of financial intermediaries, not only to banks. This is likely to result in...

The Decline of off Shore Financial Centres and Tax Havens By far the most important outcome of this new-fangled juridical homogeneity is the acceleration of the decline of off shore financial and banking centres and tax havens.

The distinction between off-shore and on-shore will vanish. Of the FATF's "name and shame" blacklist of 19 "black holes" (poorly regulated territories, including Israel, Indonesia, and Russia) - 11 have substantially revamped their banking laws and financial regulators.

Coupled with the tightening of US, UK, and EU laws and the wider interpretation of money laundering to include political corruption, bribery, and embezzlement - this would make life a lot more difficult for venal politicians and major tax evaders. The likes of Sani Abacha (late President of Nigeria), Ferdinand Marcos

(late President of the Philippines), Vladimiro Montesinos (former, now standing trial, chief of the intelligence services of Peru), or Raul Salinas (the brother of Mexico's President) - would have found it impossible to loot their countries to the same disgraceful extent in today's financial environment. And Osama bin Laden would not have been able to wire funds to US accounts from the Sudanese Al Shamal Bank, the "correspondent" of 33 American banks.

Quo Vadis, Money Laundering? Crime is resilient and fast adapting to new realities.

Organized crime is in the process of establishing an alternative banking system, only tangentially connected to the West's, in the fringes, and by proxy. This is done by purchasing defunct banks or banking licences in territories with lax regulation, cash economies, corrupt politicians, no tax collection, but reasonable infrastructure.

The countries of Eastern Europe - Yugoslavia (Montenegro and Serbia), Macedonia, Ukraine, Moldova, Belarus, Albania, to mention a few - are natural targets. In some cases, organized crime is so all-pervasive and local politicians so corrupt that the distinction between criminal and politician is spurious.

Gradually, money laundering rings move their operations to these new, accommodating territories. The laundered funds are used to purchase assets in intentionally botched privatizations, real estate, existing businesses, and to finance trading operations. The wasteland that is Eastern Europe craves private capital and no questions are asked by investor and recipient alike.

The next frontier is cyberspace. Internet banking, Internet gambling, day trading, foreign exchange cyber transactions, e-cash, e-commerce, fictitious invoicing of the launderer's genuine credit cards - hold the promise of the future. Impossible to track and monitor, ex-territorial, totally digital, amenable to identity theft and fake identities - this is the ideal vehicle for money launderers.

This nascent platform is way too small to accommodate the enormous amounts of cash laundered daily - but in ten years time, it may. The problem is likely to be exacerbated by the introduction of smart cards, electronic purses, and payment-enabled mobile phones.

In its "Report on Money Laundering Typologies" (February 2001) the FATF was able to document concrete and suspected abuses of online banking, Internet casinos, and web-based financial services. It is difficult to identify a customer and to get to know it in cyberspace, was the alarming conclusion. It is equally complicated to establish jurisdiction.

Many capable professionals - stockbrokers, lawyers, accountants, traders, insurance brokers, real estate agents, sellers of high value items such as gold, diamonds, and art - are employed or co-opted by money laundering operations. Money launderers are likely to make increased use of global, around the clock, trading in foreign currencies and derivatives. These provide instantaneous transfer of funds and no audit trail.

The underlying securities involved are susceptible to market manipulation and fraud. Complex insurance policies (with the "wrong" beneficiaries), and the securitization of receivables, leasing contracts, mortgages, and low grade bonds are already used in money laundering schemes. In general, money laundering goes well with risk arbitraging financial instruments.

Trust-based, globe-spanning, money transfer systems based on authentication codes and generations of commercial relationships cemented in honour and blood - are another wave of the future. The Hawala and Chinese networks in Asia, the Black Market Peso Exchange (BMPE) in Latin America, other evolving courier systems in Eastern Europe (mainly in Russia, Ukraine, and Albania) and in Western Europe (mainly in France and Spain).

In conjunction with encrypted e-mail and web anonymizers, these networks are virtually impenetrable.

As emigration increases, diasporas established, and transport and telecommunications become ubiquitous, "ethnic banking" along the tradition of the Lombards and the Jews in medieval Europe may become the preferred venue of money laundering. September 11 may have retarded world civilization in more than one way.

IV. Hawala, or The Bank that Never Was

I. OVERVIEW In the wake of the September 11 terrorist attacks on the USA, attention was drawn to the age-old, secretive, and globe-spanning banking system developed in Asia and known as "Hawala" (to change, in Arabic). It is based on a short term, discountable, negotiable, promissory note (or bill of exchange) called "Hundi". While not limited to Moslems, it has come to be identified with "Islamic Banking".

Islamic Law (Sharia'a) regulates commerce and finance in the Fiqh Al Mua'malat, (transactions amongst people).

Modern Islamic banks are overseen by the Shari'a Supervisory Board of Islamic Banks and Institutions ("The Shari'a Committee").

The Shi'a "Islamic Laws according to the Fatawa of Ayatullah al Uzama Syed Ali al-Husaini Seestani" has this to say about Hawala banking: "2298. If a debtor directs his creditor to collect his debt from the third person, and the creditor accepts the arrangement, the third person will, on completion of all the conditions to

be explained later, become the debtor.

Thereafter, the creditor cannot demand his debt from the first debtor".

The prophet Muhammad (a cross border trader of goods and commodities by profession) encouraged the free movement of goods and the development of markets.

Numerous Moslem scholars railed against hoarding and harmful speculation (market cornering and manipulation known as "Gharar"). Moslems were the first to use promissory notes and assignment, or transfer of debts via bills of exchange ("Hawala"). Among modern banking instruments, only floating and, therefore, uncertain, interest payments ("Riba" and "Jahala"), futures contracts, and forfeiting are frowned upon. But agile Moslem traders easily and often circumvent these religious restrictions by creating "synthetic Murabaha (contracts)" identical to Western forward and futures contracts. Actually, the only allowed transfer or trading of debts (as distinct from the underlying commodities or goods) is under the Hawala. "Hawala" consists of transferring money (usually across borders and in order to avoid taxes or the need to bribe officials) without physical or electronic transfer of funds.

Money changers ("Hawaladar") receive cash in one country, no questions asked. Correspondent hawaladars in another country dispense an identical amount (minus minimal fees and commissions) to a recipient or, less often, to a bank account. E-mail, or letter ("Hundi") carrying couriers are used to convey the necessary information (the amount of money, the date it has to be paid on) between Hawaladars. The sender provides the recipient with code words (or numbers, for instance the serial numbers of currency notes), a digital encrypted message, or agreed signals (like handshakes), to be used to retrieve the money. Big Hawaladars use a chain of middlemen in cities around the globe.

But most Hawaladars are small businesses. Their Hawala activity is a sideline or moonlighting operation. "Chits" (verbal agreements) substitute for certain written records.

In bigger operations there are human "memorizers" who serve as arbiters in case of dispute. The Hawala system requires unbounded trust. Hawaladars are often members of the same family, village, clan, or ethnic group. It is a system older than the West. The ancient Chinese had their own "Hawala" - "fei qian" (or "flying money"). Arab traders used it to avoid being robbed on the Silk Road.

Cheating is punished by effective ex-communication and "loss of honour" - the equivalent of an economic death sentence. Physical violence is rarer but not unheard of.

Violence sometimes also erupts between money recipients and robbers who are after the huge quantities of physical cash sloshing about the system. But these, too, are rare events, as rare as bank robberies. One result of this effective social regulation is that commodity traders in Asia shift hundreds of millions of US dollars per trade based solely on trust and the verbal commitment of their counterparts.

Hawala arrangements are used to avoid customs duties, consumption taxes, and other trade-related levies.

Suppliers provide importers with lower prices on their invoices, and get paid the difference via Hawala.

Legitimate transactions and tax evasion constitute the bulk of Hawala operations. Modern Hawala networks emerged in the 1960's and 1970's to circumvent official bans on gold imports in Southeast Asia and to facilitate the transfer of hard earned wages of expatriates to their families ("home remittances") and their conversion at rates more favourable (often double) than the government's. Hawala provides a cheap (it costs c. 1% of the amount transferred), efficient, and frictionless alternative to morbid and corrupt domestic financial institutions. It is Western Union without the hi-tech gear and the exorbitant transfer fees.

Unfortunately, these networks have been hijacked and compromised by drug traffickers (mainly in Afghanistan and Pakistan), corrupt officials, secret services, money launderers, organized crime, and terrorists. Pakistani Hawala networks alone move up to 5 billion US dollars annually according to estimates by Pakistan's Minister of Finance, Shaukat Aziz. In 1999, Institutional Investor Magazine identified 1100 money brokers in Pakistan and transactions that ran as high as 10 million US dollars apiece. As opposed to stereotypes, most Hawala networks are not controlled by Arabs, but by Indian and Pakistani expatriates and immigrants in the Gulf. The Hawala network in India has been brutally and ruthlessly demolished by Indira Gandhi (during the emergency regime imposed in 1975), but Indian nationals still play a big part in international Hawala networks. Similar networks in Sri Lanka, the Philippines, and Bangladesh have also been eradicated.

The OECD's Financial Action Task Force (FATF) says that: "Hawala remains a significant method for large numbers of businesses of all sizes and individuals to repatriate funds and purchase gold.... It is favoured because it usually costs less than moving funds through the banking system, it operates 24 hours per day and every day of the year, it is virtually completely reliable, and there is minimal paperwork required." (Organisation for Economic Co-Operation and Development (OECD), "Report on Money Laundering Typologies 1999-2000," Financial Action Task Force, FATF-XI, February 3, 2000, at http://www.oecd.org/fatf/pdf/TY2000_en.pdf) Hawala networks closely feed into Islamic banks throughout the world and to commodity trading in South Asia. There are more than 200 Islamic banks in the USA alone and many thousands in Europe, North and South Africa, Saudi Arabia, the Gulf states (especially in the free zone of Dubai and in Bahrain), Pakistan, Malaysia, Indonesia, and other South East Asian countries. By the end of 1998, the overt (read: tip of the iceberg) liabilities of these financial institutions amounted to 148 billion US dollars. They dabbled in equipment leasing, real estate leasing and development, corporate equity, and trade/structured trade and commodities financing (usually in consortia called "Mudaraba").

While previously confined to the Arab peninsula and to south and east Asia, this mode of traditional banking became truly international in the 1970's, following the unprecedented flow of wealth to many Moslem nations due to the oil shocks and the emergence of the Asian tigers. Islamic banks joined forces with corporations,

multinationals, and banks in the West to finance oil exploration and drilling, mining, and agribusiness. Many leading law firms in the West (such as Norton Rose, Freshfields, Clyde and Co. and Clifford Chance) have "Islamic Finance" teams which are familiar with Islam-compatible commercial contracts.

II. HAWALA AND TERRORISM Recent anti-terrorist legislation in the US and the UK allows government agencies to regularly supervise and inspect businesses that are suspected of being a front for the "Hawala" banking system, makes it a crime to smuggle more than \$10,000 in cash across USA borders, and empowers the Treasury secretary (and its Financial Crimes Enforcement Network - FinCEN) to tighten record-keeping and reporting rules for banks and financial institutions based in the USA. A new inter-agency Foreign Terrorist Asset Tracking Center (FTAT) was set up. A 1993 moribund proposed law requiring US-based Halawadar to register and to report suspicious transactions may be revived. These relatively radical measures reflect the belief that the al-Qaida network of Osama bin Laden uses the Hawala system to raise and move funds across national borders. A Hawaladar in Pakistan (Dihab Shill) was identified as the financier in the attacks on the American embassies in Kenya and Tanzania in 1998.

But the USA is not the only country to face terrorism financed by Hawala networks.

In mid-2001, the Delhi police, the Indian government's Enforcement Directorate (ED), and the Military Intelligence (MI) arrested six Jammu Kashmir Islamic Front (JKIF) terrorists. The arrests led to the exposure of an enormous web of Hawala institutions in Delhi, aided and abetted, some say, by the ISI (Inter Services Intelligence, Pakistan's security services). The Hawala network was used to funnel money to terrorist groups in the disputed Kashmir Valley.

Luckily, the common perception that Hawala financing is paperless is wrong. The transfer of information regarding the funds often leaves digital (though heavily encrypted) trails. Couriers and "contract memorizers", gold dealers, commodity merchants, transporters, and moneylenders can be apprehended and interrogated. Written, physical, letters are still the favourite mode of communication among small and medium Hawaladars, who also invariably resort to extremely detailed single entry bookkeeping. And the sudden appearance and disappearance of funds in bank accounts still have to be explained. Moreover, the sheer scale of the amounts involved entails the collaboration of off shore banks and more established financial institutions in the West. Such flows of funds affect the local money markets in Asia and are instantaneously reflected in interest rates charged to frequent borrowers, such as wholesalers. Spending and consumption patterns change discernibly after such influxes. Most of the money ends up in prime world banks behind flimsy business facades. Hackers in Germany claimed (without providing proof) to have infiltrated Hawala-related bank accounts.

The problem is that banks and financial institutions - and not only in dodgy offshore havens ("black holes" in the lingo) - clam up and refuse to divulge information about their clients. Banking is largely a matter of fragile trust between bank and customer and tight secrecy. Bankers are reluctant to undermine either. Banks use mainframe computers which can rarely be hacked through cyberspace and can be compromised only physically in close co-operation with insiders. The shadier the bank - the more formidable its digital defenses. The use of numbered accounts (outlawed in Austria, for instance, only recently) and pseudonyms (still possible in Lichtenstein) complicates matters. Bin Laden's accounts are unlikely to bear his name. He has collaborators.

Hawala networks are often used to launder money, or to evade taxes. Even when employed for legitimate purposes, to diversify the risk involved in the transfer of large sums, Hawaladars apply techniques borrowed from money laundering. Deposits are fragmented and wired to hundreds of banks the world over ("starburst").

Sometimes, the money ends up in the account of origin ("boomerang").

Hence the focus on payment clearing and settlement systems. Most countries have only one such system, the repository of data regarding all banking (and most non-banking) transactions in the country. Yet, even this is a partial solution. Most national systems maintain records for 6-12 months, private settlement and clearing systems for even less.

Yet, the crux of the problem is not the Hawala or the Hawaladars. The corrupt and inept governments of Asia are to blame for not regulating their banking systems, for over-regulating everything else, for not fostering competition, for throwing public money at bad debts and at worse borrowers, for over-taxing, for robbing people of their life savings through capital controls, for tearing at the delicate fabric of trust between customer and bank (Pakistan, for instance, froze all foreign exchange accounts two years ago). Perhaps if Asia had reasonably expedient, reasonably priced, reasonably regulated, user-friendly banks - Osama bin Laden would have found it impossible to finance his mischief so invisibly.

V. Straf - Corruption in Central and Eastern Europe

The three policemen barked "straf", "straf" in unison. It was a Russianized version of the German word for "fine" and a euphemism for bribe. I and my fiancé were stranded in an empty ally at the heart of Moscow, physically encircled by these young bullies, an ominous propinquity. They held my passport ransom and began to drag me to a police station nearby. We paid.

To do the fashionable thing and to hold the moral high ground is rare. Yet, denouncing corruption and fighting it satisfies both conditions. Such hectoring is usually the preserve of well-heeled bureaucrats, driving

utility vehicles and banging away at wireless laptops. The General Manager of the IMF makes 400,000 US dollars a year, tax-free, and perks. This is the equivalent of 2,300 (!) monthly salaries of a civil servant in Macedonia - or 7,000 monthly salaries of a teacher or a doctor in Yugoslavia, Moldova, Belarus, or Albania. He flies only first class and each one of his air tickets is worth the bi-annual income of a Macedonian factory worker. His shareholders - among them poor and developing countries - are forced to cough up these exorbitant fees and to finance the luxurious lifestyle of the likes of Kohler and Wolfensohn. And then they are made to listen to the IMF lecture them on belt tightening and how uncompetitive their economies are due to their expensive labour force.

To me, such a double standard is the epitome of corruption. Organizations such as the IMF and World Bank will never be possessed of a shred of moral authority in these parts of the world unless and until they forgo their conspicuous consumption.

Yet, corruption is not a monolithic practice. Nor are its outcomes universally deplorable or damaging. One would do best to adopt a utilitarian and discerning approach to it.

The advent of moral relativism has taught us that "right" and "wrong" are flexible, context dependent and culture-sensitive yardsticks.

What amounts to venality in one culture (Slovenia) is considered no more than gregariousness or hospitality in another (Macedonia).

Moreover, corruption is often "imported" by multinationals, foreign investors, and expats. It is introduced by them to all levels of governments, often in order to expedite matters or secure a beneficial outcome.

To eradicate corruption, one must tackle both giver and taker.

Thus, we are better off asking "cui bono" than "is it the right thing to do". Phenomenologically, "corruption" is a common - and misleading - label for a group of behaviours. One of the following criteria must apply: (a) The withholding of a service, information, or goods that, by law, and by right, should have been provided or divulged.

To have a phone installed in Russia one must openly bribe the installer (according to a rather rigid tariff). In many of the former republics of Yugoslavia, it is impossible to obtain statistics or other data (the salaries of senior public officeholders, for instance) without resorting to kickbacks. (b) The provision of a service, information, or goods that, by law, and by right, should not have been provided or divulged.

Tenders in the Czech Republic are often won through bribery. The botched privatizations all over the former Eastern Bloc constitute a massive transfer of wealth to select members of a nomenklatura. Licences and concessions are often granted in Bulgaria and the rest of the Balkan as means of securing political allegiance or paying off old political "debts". (c) That the withholding or the provision of said service, information, or goods are in the power of the withholder or the provider to withhold or to provide AND That the withholding or the provision of said service, information, or goods constitute an integral and substantial part of the authority or the function of the withholder or the provider.

The post-communist countries in transition are a dichotomous lot. On the one hand, they are intensely and stiflingly bureaucratic. On the other hand, none of the institutions functions properly or lawfully. While these countries are LEGALISTIC - they are never LAWFUL.

This fuzziness allows officials in all ranks to usurp authority, to trade favours, to forge illegal consensus and to dodge criticism and accountability. There is a direct line between lack of transparency and venality. Eran Fraenkel of Search for Common Ground in Macedonia has coined the phrase "ambient corruption" to capture this complex of features. (d) That the service, information, or goods that are provided or divulged are provided or divulged against a benefit or the promise of a benefit from the recipient and as a result of the receipt of this specific benefit or the promise to receive such benefit.

It is wrong to assume that corruption is necessarily, or even mostly, monetary or pecuniary. Corruption is built on mutual expectations. The reasonable expectation of a future benefit is, in itself, a benefit. Access, influence peddling, property rights, exclusivity, licences, permits, a job, a recommendation - all constitute benefits. (e) That the service, information, or goods that are withheld are withheld because no benefit was provided or promised by the recipient.

Even then, in CEE, we can distinguish between a few types of corrupt and venal behaviours in accordance with their OUTCOMES (utilities): (1) Income Supplement Corrupt actions whose sole outcome is the supplementing of the income of the provider without affecting the "real world" in any manner.

Though the perception of corruption itself is a negative outcome - it is so only when corruption does not constitute an acceptable and normative part of the playing field. When corruption becomes institutionalised - it also becomes predictable and is easily and seamlessly incorporated into decision making processes of all economic players and moral agents. They develop "by-passes" and "techniques" which allow them to restore an efficient market equilibrium. In a way, all-pervasive corruption is transparent and, thus, a form of taxation.

This is the most common form of corruption exercised by low and mid-ranking civil servants, party hacks and municipal politicians throughout the CEE.

More than avarice, the motivating force here is sheer survival. The acts of corruption are repetitive, structured and in strict accordance with an un-written tariff and code of conduct. (2) Acceleration Fees Corrupt practices whose sole outcome is to ACCELERATE decision making, the provision of goods and services or the divulging of information. None of the outcomes or the utility functions are altered. Only the speed of the economic dynamics is altered. This kind of corruption is actually economically BENEFICIAL. It is

a limited transfer of wealth (or tax) which increases efficiency. This is not to say that bureaucracies and venal officialdoms, over-regulation and intrusive political involvement in the workings of the marketplace are good (efficient) things. They are not. But if the choice is between a slow, obstructive and passive-aggressive civil service and a more forthcoming and accommodating one (the result of bribery) - the latter is preferable.

Acceleration fees are collected mostly by mid-ranking bureaucrats and middle rung decision makers in both the political echelons and the civil service. (3) Decision Altering Fees This is where the line is crossed from the point of view of aggregate utility. When bribes and promises of bribes actually alter outcomes in the real world - a less than optimal allocation of resources and distribution of means of production is obtained. The result is a fall in the general level of production. The many is hurt by the few. The economy is skewed and economic outcomes are distorted.

This kind of corruption should be uprooted on utilitarian grounds as well as on moral ones. (4) Subversive Outcomes Some corrupt collusions lead to the subversion of the flow of information within a society or an economic unit.

Wrong information often leads to disastrous outcomes.

Consider a medical doctor or an civil engineer who bribed their way into obtaining a professional diploma.

Human lives are at stake. The wrong information, in this case is the professional validity of the diplomas granted and the scholarship (knowledge) that such certificates stand for. But the outcomes are lost lives. This kind of corruption, of course, is by far the most damaging.

Unfortunately, it is widespread in CEE. It is proof of the collapse of the social treaty, of social solidarity and of the fraying of the social fabric.

No Western country accepts CEE diplomas without further accreditation, studies and examinations. Many "medical doctors" and "engineers" who emigrated to Israel from Russia and the former republics of the USSR - were suspiciously deficient professionally. Israel was forced to re-educate them prior to granting them a licence to practice locally. (5) Reallocation Fees Benefits paid (mainly to politicians and political decision makers) in order to affect the allocation of economic resources and material wealth or the rights thereto.

Concessions, licences, permits, assets privatised, tenders awarded are all subject to reallocation fees. Here the damage is materially enormous (and visible) but, because it is widespread, it is "diluted" in individual terms. Still, it is often irreversible (like when a sold asset is purposefully under-valued) and pernicious. a factory sold to avaricious and criminally minded managers is likely to collapse and leave its workers unemployed.

Corruption pervades daily life even in the prim and often hectoring countries of the West. It is a win-win game (as far as Game Theory goes) - hence its attraction. We are all corrupt to varying degrees. But it is wrong and wasteful - really, counterproductive - to fight corruption in CEE in a wide front and indiscriminately. It is the kind of corruption whose evil outcomes outweigh its benefits that should be fought. This fine (and blurred) distinction is too often lost on decision makers and law enforcement agencies in both East and West.

ERADICATING CORRUPTION An effective program to eradicate corruption must include the following elements: 1. Egregiously corrupt, high-profile, public figures, multinationals, and institutions (domestic and foreign) must be singled out for harsh (legal) treatment and thus demonstrate that no one is above the law and that crime does not pay. 2. All international aid, credits, and investments must be conditioned upon a clear, performance-based, plan to reduce corruption levels and intensity.

Such a plan should be monitored and revised as needed. Corruption retards development and produces instability by undermining the credentials of democracy, state institutions, and the political class. Reduced corruption is, therefore, a major target of economic and institutional developmental. 3. Corruption cannot be reduced only by punitive measures. A system of incentives to avoid corruption must be established. Such incentives should include a higher pay, the fostering of civic pride, educational campaigns, "good behaviour" bonuses, alternative income and pension plans, and so on. 4. Opportunities to be corrupt should be minimized by liberalizing and deregulating the economy. Red tape should be minimized, licensing abolished, international trade freed, capital controls eliminated, competition introduced, monopolies broken, transparent public tendering be made mandatory, freedom of information enshrined, the media should be directly supported by the international community, and so on. Deregulation should be a developmental target integral to every program of international aid, investment, or credit provision. 5. Corruption is a symptom of systemic institutional failure. Corruption guarantees efficiency and favourable outcomes. The strengthening of institutions is of critical importance. The police, the customs, the courts, the government, its agencies, the tax authorities, the state owned media - all must be subjected to a massive overhaul. Such a process may require foreign management and supervision for a limited period of time. It most probably would entail the replacement of most of the current - irredeemably corrupt - personnel. It would need to be open to public scrutiny. 6. Corruption is a symptom of an all-pervasive sense of helplessness. The citizen (or investor, or firm) feels dwarfed by the overwhelming and capricious powers of the state. It is through corruption and venality that the balance is restored. To minimize this imbalance, potential participants in corrupt dealings must be made to feel that they are real and effective stakeholders in their societies. A process of public debate coupled with transparency and the establishment of just distributive mechanisms will go a long way towards rendering corruption obsolete.

VI. The Kleptocracies of the East

The process of transition from communism to capitalism was largely hijacked either by outright criminals in budding outfits of organized crime - or by pernicious and all-pervasive kleptocracies: politicians and political parties bent on looting the state and suppressing the opposition, sometimes fatally.

In the past 16 years, industrial production in the economies in transition tumbled in real terms by more than 60 percent. The monthly salary in the poorer bits equals the daily wage of a skilled German industrial worker, or one seventh the European Union's average.

Gross domestic product per capita is less than one third the EU's. Infrastructure, internal and export markets, state institutions - all crumbled with dizzying speed.

In some countries - not the least Russia - privatization amounted to a mass transfer of assets to cronies and insiders, often well-connected members of the communist nomenclature: managers, members of the security services and other penumbral figures. Laws were passed and institutions tweaked to reflect the special interests of these groupings. "Classical" forms of crime flourished throughout the benighted region. Prostitution, gambling, drugs, smuggling, kidnapping, organ trafficking and other varieties of delinquency yielded to their perpetrators billions of dollars annually. In the impoverished economies of the east, these fantastic revenues - laundered through off shore accounts - were leveraged by criminals to garner political favors, to buy into legitimate businesses and to infiltrate civil society.

None of this is new to Western publics. Rogues and "robber barons" have always doubled as entrepreneurs.

The oil, gaming and railways industries in America, for instance, owe their existence to dubious personas and questionable practices. Well into the 17th century, the British sovereign maintained a monopoly on chartering businesses and awarded the coveted licenses to loyal servants and obsequious sycophants.

Still, the ubiquity of crime in east Europe and its reach are unprecedented in European annals. In the void-like interregnum between centrally planned and free market economies only criminals, politicians, managers, and employees of the security services were positioned to benefit from the upheaval.

At the outset of transition, the underworld constituted an embryonic private sector, replete with international networks of contacts, cross-border experience, capital agglomeration and wealth formation, sources of venture (risk) capital, an entrepreneurial spirit, and a diversified portfolio of investments and revenue generating assets.

Criminals were used to private sector practices: price signals, competition, joint venturing, and third party dispute settlement.

Crime - alone among all economic activities in communist societies - obeyed the laws of the free market. Criminals had to be entrepreneurial and profitable to survive. Their instincts sharpened by - often lethal - competition, they were never corrupted by central planning.

Deprived of access to state largesse, criminals invested their own capital in efficiently-run small to medium size enterprises. Attuned to the needs and wishes of their customers, criminals engaged in primitive forms of market research, through neighborhood and grassroots "pollsters" and "activists". They responded with agility and in real time to changes in the patterns of supply and demand by altering their product mix and their pricing.

They have always been pioneers of bleeding-edge technologies.

Criminals are effective organizers and managers. They excel at enforcing workplace discipline with irresistible incentives and irreversible disincentives, at setting targets and at networking. The superior felonious echelons are upwardly mobile and have a clear career path. Every management fad - from territorially exclusive franchises to "stock" options - has been invented by criminals long before they triumphed in the boardroom.

In east Europe, criminals on all levels, from the organized to the petty, often substituted for the dysfunctional, or ideologically hidebound organs of the state. Consider the dispensation of justice. The criminal code of conduct and court system replaced the compromised and lethargic official judiciary. Debt collectors and enforcers stood in for venal and incompetent police forces.

Crime is a growth industry and sustains hordes of professionals: accountants and lawyers, forgers and cross border guides, weapons experts and bankers, mechanics and hit-men. Expertise, know-how and acumen, amassed over centuries of practice, are taught in the criminal universities known as penitentiaries: roads less traveled, countries more lenient, passports to be bought, sold, or forged, how-to manuals, goods and services on offer and demand.

Profit margins in crime are outlandish and lead to feverish wealth accumulation. The banking system is used both to stash the proceeds and to launder them. Tax havens, off shore financial institutions and money couriers - all form part of a global web. Thus cleansed and rendered untraceable, the money is invested in legitimate activities.

In some countries - especially on the drug path, or on the trail of white slavery - crime is a major engine of economic growth.

As opposed to the visible sectors of the east's demonetized economies, criminal enterprises never run out of liquidity and thus are always keen to invest. Moreover, crime is international and cosmopolitan. It is accustomed to sophisticated export-import transactions.

Many criminals - as opposed to the vast majority of their countrymen - are polyglottal, well-traveled, aware of world prices, the international financial system and demand and supply in various markets. They are experienced negotiators. In short: criminals are well- heeled international businessmen, well-connected both abroad and with the various indigenous elites.

The Wild East in Europe is often compared to the Wild West in America a century or so ago. The Russian oligarchs, goes the soothing analogy, are local versions of Morgan, Rockefeller, Pullman and Vanderbilt. But this affinity is spurious. The United States always had a civic culture with civic values and an aspiration to, ultimately, create a harmonious and benevolent civic society.

Criminality was regarded as a shameful stepping stone on the way to an orderly community of learned, civilized, law-abiding citizens.

This cannot be said about Russia, for instance. The criminal there is, if anything, admired and emulated. Even the language of legal business in countries in transition is suffused with underworld parlance. There is no - and never was - a civic tradition in the countries of eastern Europe, a Bill of Rights, a veritable Constitution, a modicum of self rule, a true abolition of classes and nomenclatures. These territories are accustomed to being governed by paranoiac and murderous tyrants akin to the current crop of delinquents. That some criminals are members of the new political, financial and industrial elites (and vice versa) - tends to support this long-rooted association.

In all the countries of the region, politicians and managers abuse the state and its simulacrum institutions in close symbiosis with felons. Patronage and sinecures extend to collaborating lawbreakers. Veritable villains gain access to state owned assets and resources in a cycle of money laundering. Law enforcement agencies and the courts are "encouraged" to turn a blind eye, or even to help criminals eliminate internal and external competition in their turf.

Criminals, in return, serve as the "long and anonymous arm" of politicians, obtaining for them illicit goods, or providing "black" services. Corruption often flows through criminal channels or via the mediation and conduit of delinquents. Within the shared sphere of the informal economy, assets are shifted among these economic players. Both players oppose attempts at reform and transparency and encourage - even engender - nationalism and racism, paranoid and grievances to recruit foot soldiers.

Fortunately, there is the irrepressible urge to become legitimate. Politicians, who grope for a new ideological cover for their opportunism, partner with legitimacy- seeking, established crime lords. Both groups benefit from a swelling economic pie. They fight against other, less successful, criminals, who wish to persist in their old ways and, thus, hamper economic growth. The battle is never won but at least it succeeds to firmly drive crime where it belongs: underground.

VII. FIMACO - Russia's Missing Billions

Russia's Audit Chamber - with the help of the Swiss authorities and their host of dedicated investigators - may be about to solve a long standing mystery. An announcement by the Prosecutor's General Office is said to be imminent. The highest echelons of the Yeltsin entourage - perhaps even Yeltsin himself - may be implicated - or exonerated. A Russian team has been spending the better part of the last two months poring over documents and interviewing witnesses in Switzerland, France, Italy, and other European countries.

About \$4.8 billion of IMF funds are alleged to have gone amiss during the implosion of the Russian financial markets in August 1998. They were supposed to prop up the banking system (especially SBS-Agro) and the ailing and sharply devalued ruble. Instead, they ended up in the bank accounts of obscure corporations - and, then, incredibly, vanished into thin air.

The person in charge of the funds in 1998 was none other than Mikhail Kasyanov, Russia's current Prime Minister - at the time, Deputy Minister of Finance for External Debt.

His signature on all foreign exchange transactions - even those handled by the central bank - was mandatory. In July 2000, he was flatly accused by the Italian daily, La Repubblica, of authorizing the diversion of the disputed funds.

Following public charges made by US Treasury Secretary Robert Rubin as early as March 1999, both Russian and American media delved deeply over the years into the affair. Communist Duma Deputy Viktor Ilyukhin jumped on the bandwagon citing an obscure "trustworthy foreign source" to substantiate his indictment of Kremlin cronies and oligarchs contained in an open letter to the Prosecutor General, Yuri Skuratov.

The money trail from the Federal Reserve Bank of New York to Swiss and German subsidiaries of the Russian central Bank was comprehensively reconstructed. Still, the former Chairman of the central bank, Sergei Dubinin, called Ilyukhin's allegations and the ensuing Swiss investigations - "a black PR campaign ... a lie".

Others pointed to an outlandish coincidence: the ruble collapsed twice in Russia's post-Communist annals. Once, in 1994, when Dubinin was Minister of Finance and was forced to resign. The second time was in 1998, when Dubinin was governor of the central bank and was, again, ousted.

Dubinin himself seems to be unable to make up his mind.

In one interview he says that IMF funds were used to prop up the ruble - in others, that they went into "the national pot" (i.e., the Ministry of Finance, to cover a budgetary shortfall).

The Chairman of the Federation Council at the time, Yegor Stroev, appointed an investigative committee in 1999. Its report remains classified but Stroev confirmed that IMF funds were embezzled in the wake of the 1998 forced devaluation of the ruble.

This conclusion was weakly disowned by Eleonora Mitrofanova, an auditor within the Duma's Audit Chamber who said that they discovered nothing "strictly illegal" - though, incongruously, she accused the central bank of suppressing the Chamber's damning report. The Chairman of the Chamber of Accounts, Khachim Karmokov, quoted by PwC, said that "the audits performed by the Chamber revealed no serious procedural breaches in the bank's performance".

But Nikolai Gonchar, a Duma Deputy and member of its Budget Committee, came close to branding both as liars when he said that he read a copy of the Audit Chamber report and that it found that central bank funds were siphoned off to commercial accounts in foreign banks.

The Moscow Times cited a second Audit Chamber report which revealed that the central bank was simultaneously selling dollars for rubles and extending ruble loans to a few well-connected commercial banks, thus subsidizing their dollar purchases. The central bank went as far as printing rubles to fuel this lucrative arbitrage. The dollars came from IMF disbursements.

Radio Free Europe/Radio Liberty, based on its own sources and an article in the Russian weekly "Novaya Gazeta", claims that half the money was almost instantly diverted to shell companies in Sydney and London. The other half was mostly transferred to the Bank of New York and to Credit Suisse.

Why were additional IMF funds transferred to a chaotic Russia, despite warnings by many and a testimony by a Russian official that previous tranches were squandered? Moreover, why was the money sent to the Central Bank, then embroiled in a growing scandal over the manipulation of treasury bills, known as GKO's and other debt instruments, the OFZ's - and not to the Ministry of Finance, the beneficiary of all prior transfers? The central bank did act as MinFin's agent - but circumstances were unusual, to say the least.

There isn't enough to connect the IMF funds with the money laundering affair that engulfed the Bank of New York a year later to the day, in August 1999 - though several of the personalities straddled the divide between the bank and its clients. Swiss efforts to establish a firm linkage failed as did their attempt to implicate several banks in the Italian canton of Ticino. The Swiss - in collaboration with half a dozen national investigation bureaus, including the FBI - were more successful in Italy proper, where they were able to apprehend a few dozen suspects in an elaborate undercover operation.

FIMACO's name emerged rather early in the swirl of rumors and denials. At the IMF's behest, PricewaterhouseCoopers (PwC) was commissioned by Russia's central bank to investigate the relationship between the Russian central bank and its Channel Islands offshoot, Financial Management Company Limited, immediately when the accusations surfaced.

Skuratov unearthed \$50 billion in transfers of the nation's hard currency reserves from the central bank to FIMACO, which was majority-owned by Eurobank, the central bank's Paris-based daughter company. According to PwC, Eurobank was 23 percent owned by "Russian companies and private individuals".

Dubinin and his successor, Gerashchenko, admit that FIMACO was used to conceal Russia's assets from its unrelenting creditors, notably the Geneva-based Mr.

Nessim Gaon, whose companies sued Russia for \$600 million. Gaon succeeded to freeze Russian accounts in Switzerland and Luxemburg in 1993. PwC alerted the IMF to this pernicious practice, but to no avail.

Moreover, FIMACO paid exorbitant management fees to self-liquidating entities, used funds to fuel the speculative GKO market, disbursed non-reported profits from its activities, through "trust companies", to Russian subjects, such as schools, hospitals, and charities - and, in general, transformed itself into a mammoth slush fund and source of patronage. Russia admitted to lying to the IMF in 1996.

It misstated its reserves by \$1 billion.

Some of the money probably financed the fantastic salaries of Dubinin and his senior functionaries. He earned \$240,000 in 1997 - when the average annual salary in Russia was less than \$2000 and when Alan Greenspan, Chairman of the Federal Reserve of the USA, earned barely half as much.

Former Minister of Finance, Boris Fedorov, asked the governor of the central bank and the prime minister in 1993 to disclose how were the country's foreign exchange reserves being invested. He was told to mind his own business. To Radio Free Europe/Radio Liberty he said, six years later, that various central bank schemes were set up to "allow friends to earn handsome profits ... They allowed friends to make profits because when companies are created without any risk, and billions of dollars are transferred, somebody takes a (quite big) commission ... a minimum of tens of millions of dollars. The question is: Who received these commissions? Was this money repatriated to the country in the form of dividends?" Dubinin's vehement denials of FIMACO's involvement in the GKO market are disingenuous. Close to half of all foreign investment in the money-spinning market for Russian domestic bonds were placed through FIMACO's nominal parent company, Eurobank and, possibly, through its subsidiary, co-owned with FIMACO, Eurofinance Bank.

Nor is Dubinin more credible when he denies that profits and commissions were accrued in FIMACO and then drained off. FIMACO's investment management agreement with Eurobank, signed in 1993, entitled it to 0.06 percent of the managed funds per quarter.

Even accepting the central banker's ludicrous insistence that the balance never exceeded \$1.4 billion -

FIMACO would have earned \$3.5 million per annum from management fees alone - investment profits and brokerage fees notwithstanding. Even Eurobank's president at the time, Andrei Movchan, conceded that FIMACO earned \$1.7 million in management fees.

The IMF insisted that the PwC reports exonerated all the participants. It is, therefore, surprising and alarming to find that the online copies of these documents, previously made available on the IMF's Web site, were "Removed September 30, 1999 at the request of PricewaterhouseCoopers".

The cover of the main report carried a disclaimer that it was based on procedures dictated by the central bank and "...consequently, we (PwC) make no representation regarding the sufficiency of the procedures described below ... The report is based solely on financial and other information provided by, and discussions with, the persons set out in the report. The accuracy and completeness of the information on which the report is based is the sole responsibility of those persons. ...

PricewaterhouseCoopers have not carried out any verification work which may be construed to represent audit procedures ... We have not been provided access to Ost West Handelsbank (the recipient of a large part of the \$4.8 IMF tranche)".

The scandal may have hastened the untimely departure of the IMF's Managing Director at the time, Michel Camdessus, though this was never officially acknowledged. The US Congress was reluctant to augment the Fund's resources in view of its controversial handling of the Asian and Russian crises and contagion.

This reluctance persisted well into the new millennium. A congressional delegation, headed by James Leach (R, Iowa), Chairman of the Banking and Financial Services Committee, visited Russia in April 2000, accompanied by the FBI, to investigate the persistent contentions about the misappropriation of IMF funds.

Camdessus himself went out of his way to defend his record and reacted in an unprecedented manner to the allegations. In a letter to Le Mond, dated August 18, 1999 - and still posted on the IMF's Web site, three years later - he wrote, inadvertently admitting to serious mismanagement: "I wish to express my indignation at the false statements, allegations, and insinuations contained in the articles and editorial commentary appearing in Le Monde on August 6, 8, and 9 on the content of the PricewaterhouseCoopers (PWC) audit report relating to the operations of the Central Bank of Russia and its subsidiary, FIMACO.

Your readers will be shocked to learn that the report in question, requested and made public at the initiative of the IMF ... (concludes that) no misuse of funds has been proven, and the report does not criticize the IMF's behavior ... I would also point out that your representation of the IMF's knowledge and actions is misleading. We did know that part of the reserves of the Central Bank of Russia was held in foreign subsidiaries, which is not an illegal practice; however, we did not learn of FIMACO's activities until this year —because the audit reports for 1993 and 1994 were not provided to us by the Central Bank of Russia.

The IMF, when apprised of the possible range of FIMACO activities, informed the Russian authorities that it would not resume lending to Russia until a report on these activities was available for review by the IMF and corrective actions had been agreed as needed ... I would add that what the IMF objected to in FIMACO's operations extends well beyond the misrepresentation of Russia's international reserves in mid-1996 and includes several other instances where transactions through it had resulted in a misleading representation of the reserves and of monetary and exchange policies. These include loans to Russian commercial banks and investments in the GKO market".

No one accepted - or accepts - the IMF's convoluted post- facto "clarifications" at face value. Nor was Dubinin's tortured sophistry - IMF funds cease to be IMF funds when they are transferred from the Ministry of Finance to the central bank - countenanced.

Even the compromised office of the Russian Prosecutor- General urged Russian officials, as late as July 2000, to re-open the investigation regarding the diversion of the funds. The IMF dismissed this sudden burst of rectitude as the rehashing of old stories. But Western officials - interviews by Radio Free Europe/Radio Liberty - begged to differ.

Yuri Skuratov, the former Prosecutor-General, ousted for undue diligence, wrote in a book he published two years ago, that only c. \$500 million of the \$4.8 were ever used to stabilize the ruble. Even George Bush Jr., when still a presidential candidate accused Russia's former Prime Minister Viktor Chernomyrdin of complicity in embezzling IMF funds. Chernomyrdin threatened to sue.

The rot may run even deeper. The Geneva daily "Le Temps", which has been following the affair relentlessly, accused, two years ago, Roman Abramovich, a Yeltsin- era oligarch and a member of the board of directors of Sibneft, of colluding with Runicom, Sibneft's trading arm, to misappropriate IMF funds. Swiss prosecutors raided Runicom's offices just one day after Russian Tax Police raided Sibneft's Moscow headquarters.

Absconding with IMF funds seemed to have been a pattern of behavior during Yeltsin's venal regime. The columnist Bradley Cook recounts how Aldrich Ames, the mole within the CIA, "was told by his Russian control officer during their last meeting, in November 1993, that the \$130,000 in fresh \$100 bills that he was being bribed with had come directly from IMF loans." Venyamin Sokolov, who headed the Audit Chamber prior to Sergei Stepashin, informed the US Senate of \$2 billion that evaporated from the coffers of the central bank in 1995.

Even the IMF reluctantly admits: "Capital transferred abroad from Russia may represent such legal activities as exports, or illegal sources. But it is impossible to determine whether specific capital flows from Russia-legal or illegal-come from a particular inflow, such as IMF loans or export earnings. To put the scale of IMF lending to Russia into perspective, Russia's exports of goods and services averaged about \$80 billion a year in recent years, which is over 25 times the average annual disbursement from the IMF since 1992".

DISCLAIMER Sam Vaknin served in various senior capacities in Mr.

Gaon's firms and advises governments in their negotiations with the IMF.

VIII. The Enrons of the East

Hermitage Capital Management, an international investment firm owned by HSBC London, is suing PwC (PricewaterhouseCoopers), the biggest among the big four accounting firms (Andersen, the fifth, is being cannibalized by its competitors).

Hermitage also demands to have PwC's license suspended in Russia. All this fuss over allegedly shoddy audits of Gazprom, the Russian energy behemoth with over \$20 billion in annual sales and the world's largest reserves of natural gas. Hermitage runs a \$600 million Russia fund which is invested in the shares of the allegedly misaudited giant.

The accusations are serious. According to infuriated Hermitage, PwC falsified and distorted the 2000-1 audits by misrepresenting the sale of Gazprom's subsidiary, Purgaz, to Itera, a conveniently obscure entity. Other loss spinning transactions were also creatively tackled.

Stoitransgaz - partly owned by former Gazprom managers and their relatives - landed more than \$1 billion in lucrative Gazprom contracts.

These shenanigans resulted in billions of dollars of losses and a depressed share price. AFP quotes William Browder, Hermitage's disgruntled CEO, as saying: "This is Russia's Enron". PwC threatened to counter-sue Hermitage over its "completely unfounded" allegations.

But Browder's charges are supported by Boris Fyodorov, a former Russian minister of finance and a current Gazprom independent director. Fyodorov manages his own investment boutique, United Financial Group.

Browder is a former Solomon Brothers investment banker. Other investment banks and brokerage firms - foreign and Russian - are supportive of his allegations.

They won't and can't be fobbed.

Fyodorov speculates that PwC turned a blind eye to many of Gazprom's shadier deals in order to keep the account.

Gazprom shareholders will decide in June whether to retain it as an auditor or not. Browder is initiating a class action lawsuit in New York of Gazprom ADR holders against PwC.

Even Russia's president concurs. A year ago, he muttered ominously about "enormous amounts of misspent money (in Gazprom)". He replaced Rem Vyakhirev, the oligarch that ran Gazprom, with his own protégé. Russia owns 38 percent of the company.

Gazprom is just the latest in an inordinately long stream of companies with dubious methods. Avto VAZ bled itself white - under PwC's nose - shipping cars to dealers, without guarantees or advance payments. The penumbral dealers then vanished without a trace. Avto VAZ wrote off more than \$1 billion in "uncollected bills" by late 1995. PwC did make a mild comment in the 1997 audit.

But the first real warning appeared only three years later in the audit for the year 2000.

Andrei Sharonov, deputy minister in the federal Ministry of Economics said, in an interview he granted "Business Week" last February: "Auditors have been working on behalf of management rather than shareholders." In a series of outlandish ads, published in Russian business dailies in late February, senior partners in the PwC Moscow office made this incredible statement: "(Audit) does not represent a review of each transaction, or a qualitative assessment of a company's performance".

The New York Times quotes a former employee of Ernst&Young in Moscow as saying: "A big client is god.

You do what they want and tell you to do. You can play straight-laced and try to be upright and protect your reputation with minor clients, but you can't do it with the big guys. If you lose that account, no matter how justified you are, that's the end of a career".

PwC should know. When it mentioned suspicious heavily discounted sales of oil to Rosneft in a 1998 audit report, its client, Purneftegaz, replaced it with Arthur Andersen.

The dubious deals dutifully vanished from the audit reports, though they continue apace. Andersen claims such transactions do not require disclosure under Russian law.

How times change! Throughout the 1990's, Russia and its nascent private sector were subjected to self-righteous harangues from visiting Big Five accountants. The hectoring targeted the lack of good governance among Russia's corporations and public administration alike.

Hordes of pampered speakers and consultants espoused transparent accounting, minority shareholders' rights, management accessibility and accountability and other noble goals.

That was before Enron. The tables have turned. The Big Five - from disintegrating Andersen to KPMG - are being chastised and fined for negligent practices, flagrant conflicts of interests, misrepresentation,

questionable ethics and worse. Their worldwide clout, moral authority, and professional standing have been considerably dented.

America's GAAP (Generally Accepted Accounting Practices) - once considered the undisputable benchmark of rectitude and disclosure - are now thought in need of urgent revision. The American issuer of accounting standards - FASB (Financial Accounting Standards Board) - is widely perceived to be an incestuous arrangement between the clubby members of a rapacious and unscrupulous profession. Many American scholars even suggest to adopt the hitherto much-derided alternative - the International Accounting Standards (IAS) recently implemented through much of central and eastern Europe.

Russia's Federal Commission for the Securities Market (FCSM) convened a conclave of Western and domestic auditing firms. The theme was how to spot and neutralize bad auditors. With barely concealed and gleeful schadenfreude, the Russians said that the Enron scandal undermined their confidence in Western accountants and the GAAP.

The Institute of Corporate Law and Corporate Governance (ICLG), having studied the statements of a few major Russian firms, concluded that there are indications of financial problems, "not mentioned by (mostly Western) auditors". They may have a point. Most of the banks that collapsed ignominiously in 1998 received glowing audits signed by Western auditors, often one of the Big Five.

The Russian Investor Protection Association (IPA) and Institute of Professional Auditors (IPAR) embarked on a survey of Russian investors, enterprises, auditors, and state officials - and what they think about the quality of the audit services they are getting.

Many Russian managers - as avaricious and venal as ever - now can justify hiring malleable and puny local auditors instead of big international or domestic ones.

Surgutneftegaz - with \$2 billion net profit last year and on-going dispute with its shareholders about dividends - wants to sack "Rosexperitza", a respectable Russian accountancy, and hire "Aval", a little known accounting outfit. Aval does not even make it to the list of 200 largest accounting firms in Russia, according to Renaissance Capital, an investment bank.

Other Russian managers are genuinely alarmed by the vertiginous decline in the reputation of the global accounting firms and by the inherent conflict of interest between consulting and audit jobs performed by the same entity. Sviazinvest, a holding and telecom company, hired Accenture on top of - some say instead of - Andersen Consulting.

A decade of achievements in fostering transparency, better corporate governance, and more realistic accounting in central and eastern Europe - may well evaporate in the wake of Enron and other scandals. The forces of reaction and corruption in these nether lands - greedy managers, venal bureaucrats, and anti-reformists - all seized the opportunity to reverse what was hitherto considered an irreversible trend towards Western standards. This, in turn, is likely to deter investors and retard the progress towards a more efficient market economy.

The Big Six accounting firms were among the first to establish a presence in Russia. Together with major league consultancies, such as Baker-McKinsey, they coached Russian entrepreneurs and managers in the ways of the West. They introduced investors to Russia when it was still considered a frontier land. They promoted Russian enterprises abroad and nursed the first, precarious, joint ventures between paranoid Russians and disdainful Westerners.

Companies like Ernst&Young are at the forefront of the fight to include independent directors in the boards of Russian firms, invariably stuffed with relatives and cronies. Together with IPA, Ernst&Young recently established the National Association of Independent Directors (NAID). It is intended to "assist Russian companies to increase their efficiency through introduction of best independent directors' practices".

But even these - often missionary - pioneers were blinded by the spoils of a "free for all", "winner takes all", and "might is right" environment. They geared the accounts of their clients - by minimizing their profits - towards tax avoidance and the abolition of dividends. Quoting unnamed former employees of the audit firms, "The New York Times" described how "... the auditors often chose to play by Russian rules, and in doing so sacrificed the transparency that investors were counting on them to ensure".

IX. The Typology of Financial Scandals

I. Overview The recent implosion of the global equity markets - from Hong Kong to New York - engendered yet another round of the semipternal debate: should central banks contemplate abrupt adjustments in the prices of assets - such as stocks or real estate - as they do changes in the consumer price indices? Are asset bubbles indeed inflationary and their bursting deflationary? Central bankers counter that it is hard to tell a bubble until it bursts and that market intervention bring about that which it is intended to prevent. There is insufficient historical data, they reprimand errant scholars who insist otherwise. This is disingenuous. Ponzi and pyramid schemes have been a fixture of Western civilization at least since the middle Renaissance.

Assets tend to accumulate in "asset stocks". Residences built in the 19th century still serve their purpose today.

The quantity of new assets created at any given period is, inevitably, negligible compared to the stock of

the same class of assets accumulated over decades and, sometimes, centuries. This is why the prices of assets are not anchored - they are only loosely connected to their production costs or even to their replacement value.

Asset bubbles are not the exclusive domain of stock exchanges and shares. "Real" assets include land and the property built on it, machinery, and other tangibles. "Financial" assets include anything that stores value and can serve as means of exchange - from cash to securities.

Even tulip bulbs will do.

In 1634, in what later came to be known as "tulipmania", tulip bulbs were traded in a special marketplace in Amsterdam, the scene of a rabid speculative frenzy. Some rare black tulip bulbs changed hands for the price of a big mansion house. For four feverish years it seemed like the craze would last forever. But the bubble burst in 1637. In a matter of a few days, the price of tulip bulbs was slashed by 96%! Uniquely, tulipmania was not an organized scam with an identifiable group of movers and shakers, which controlled and directed it. Nor has anyone made explicit promises to investors regarding guaranteed future profits.

The hysteria was evenly distributed and fed on itself.

Subsequent investment fiddles were different, though.

Modern dodges entangle a large number of victims. Their size and all-pervasiveness sometimes threaten the national economy and the very fabric of society and incur grave political and social costs.

There are two types of bubbles.

Asset bubbles of the first type are run or fanned by financial intermediaries such as banks or brokerage houses. They consist of "pumping" the price of an asset or an asset class.

The assets concerned can be shares, currencies, other securities and financial instruments - or even savings accounts. To promise unearthly yields on one's savings is to artificially inflate the "price", or the "value" of one's savings account.

More than one fifth of the population of 1983 Israel were involved in a banking scandal of Albanian proportions. It was a classic pyramid scheme. All the banks, bar one, promised to gullible investors ever increasing returns on the banks' own publicly-traded shares.

These explicit and incredible promises were included in prospectuses of the banks' public offerings and won the implicit acquiescence and collaboration of successive Israeli governments. The banks used deposits, their capital, retained earnings and funds illegally borrowed through shady offshore subsidiaries to try to keep their impossible and unhealthy promises. Everyone knew what was going on and everyone was involved. It lasted 7 years. The prices of some shares increased by 1-2 percent daily.

On October 6, 1983, the entire banking sector of Israel crumbled. Faced with ominously mounting civil unrest, the government was forced to compensate shareholders. It offered them an elaborate share buyback plan over 9 years. The cost of this plan was pegged at \$6 billion - almost 15 percent of Israel's annual GDP. The indirect damage remains unknown.

Avaricious and susceptible investors are lured into investment swindles by the promise of impossibly high profits or interest payments.

The organizers use the money entrusted to them by new investors to pay off the old ones and thus establish a credible reputation. Charles Ponzi perpetrated many such schemes in 1919-1925 in Boston and later the Florida real estate market in the USA. Hence a "Ponzi scheme".

In Macedonia, a savings bank named TAT collapsed in 1997, erasing the economy of an entire major city, Bitola.

After much wrangling and recriminations - many politicians seem to have benefited from the scam - the government, faced with elections in September, has recently decided, in defiance of IMF diktats, to offer meager compensation to the afflicted savers. TAT was only one of a few similar cases. Similar scandals took place in Russia and Bulgaria in the 1990's .

One third of the impoverished population of Albania was cast into destitution by the collapse of a series of nation-wide leveraged investment plans in 1997. Inept political and financial crisis management led Albania to the verge of disintegration and a civil war. Rioters invaded police stations and army barracks and expropriated hundreds of thousands of weapons.

Islam forbids its adherents to charge interest on money lent - as does Judaism. To circumvent this onerous decree, entrepreneurs and religious figures in Egypt and in Pakistan established "Islamic banks". These institutions pay no interest on deposits, nor do they demand interest from borrowers. Instead, depositors are made partners in the banks' - largely fictitious - profits. Clients are charged for - no less fictitious - losses. A few Islamic banks were in the habit of offering vertiginously high "profits". They went the way of other, less pious, pyramid schemes.

They melted down and dragged economies and political establishments with them.

By definition, pyramid schemes are doomed to failure.

The number of new "investors" - and the new money they make available to the pyramid's organizers - is limited.

When the funds run out and the old investors can no longer be paid, panic ensues. In a classic "run on the

bank", everyone attempts to draw his money simultaneously. Even healthy banks - a distant relative of pyramid schemes - cannot cope with such stampedes.

Some of the money is invested long-term, or lent. Few financial institutions keep more than 10 percent of their deposits in liquid on-call reserves.

Studies repeatedly demonstrated that investors in pyramid schemes realize their dubious nature and stand forewarned by the collapse of other contemporaneous scams. But they are swayed by recurrent promises that they could draw their money at will ("liquidity") and, in the meantime, receive alluring returns on it ("capital gains", "interest payments", "profits").

People know that they are likelier to lose all or part of their money as time passes. But they convince themselves that they can outwit the organizers of the pyramid, that their withdrawals of profits or interest payments prior to the inevitable collapse will more than amply compensate them for the loss of their money. Many believe that they will succeed to accurately time the extraction of their original investment based on - mostly useless and superstitious - "warning signs".

While the speculative rash lasts, a host of pundits, analysts, and scholars aim to justify it. The "new economy" is exempt from "old rules and archaic modes of thinking". Productivity has surged and established a steeper, but sustainable, trend line. Information technology is as revolutionary as electricity. No, more than electricity. Stock valuations are reasonable. The Dow is on its way to 33,000. People want to believe these "objective, disinterested analyses" from "experts".

Investments by households are only one of the engines of this first kind of asset bubbles. A lot of the money that pours into pyramid schemes and stock exchange booms is laundered, the fruits of illicit pursuits. The laundering of tax-evaded money or the proceeds of criminal activities, mainly drugs, is effected through regular banking channels. The money changes ownership a few times to obscure its trail and the identities of the true owners.

Many offshore banks manage shady investment ploys.

They maintain two sets of books. The "public" or "cooked" set is made available to the authorities - the tax administration, bank supervision, deposit insurance, law enforcement agencies, and securities and exchange commission. The true record is kept in the second, inaccessible, set of files.

This second set of accounts reflects reality: who deposited how much, when and subject to which conditions - and who borrowed what, when and subject to what terms.

These arrangements are so stealthy and convoluted that sometimes even the shareholders of the bank lose track of its activities and misapprehend its real situation.

Unscrupulous management and staff sometimes take advantage of the situation. Embezzlement, abuse of authority, mysterious trades, misuse of funds are more widespread than acknowledged.

The thunderous disintegration of the Bank for Credit and Commerce International (BCCI) in London in 1991 revealed that, for the better part of a decade, the executives and employees of this penumbral institution were busy stealing and misappropriating \$10 billion. The Bank of England's supervision department failed to spot the rot on time. Depositors were - partially - compensated by the main shareholder of the bank, an Arab sheikh. The story repeated itself with Nick Leeson and his unauthorized disastrous trades which brought down the venerable and veteran Barings Bank in 1995.

The combination of black money, shoddy financial controls, shady bank accounts and shredded documents renders a true account of the cash flows and damages in such cases all but impossible. There is no telling what were the contributions of drug barons, American off-shore corporations, or European and Japanese tax-evaders - channeled precisely through such institutions - to the stratospheric rise in Wall-Street in the last few years.

But there is another - potentially the most pernicious - type of asset bubble. When financial institutions lend to the unworthy but the politically well-connected, to cronies, and family members of influential politicians - they often end up fostering a bubble. South Korean chaebols, Japanese keiretsu, as well as American conglomerates frequently used these cheap funds to prop up their stock or to invest in real estate, driving prices up in both markets artificially.

Moreover, despite decades of bitter experiences - from Mexico in 1982 to Asia in 1997 and Russia in 1998 - financial institutions still bow to fads and fashions. They act herd-like in conformity with "lending trends". They shift assets to garner the highest yields in the shortest possible period of time. In this respect, they are not very different from investors in pyramid investment schemes.

II. Case Study - The Savings and Loans Associations Bailout Also published by United Press International (UPI) Asset bubbles - in the stock exchange, in the real estate or the commodity markets - invariably burst and often lead to banking crises. One such calamity struck the USA in 1986-1989. It is instructive to study the decisive reaction of the administration and Congress alike. They tackled both the ensuing liquidity crunch and the structural flaws exposed by the crisis with tenacity and skill. Compare this to the lackluster and hesitant tentativeness of the current lot. True, the crisis - the result of a speculative bubble - concerned the banking and real estate markets rather than the capital markets. But the similarities are there.

The savings and loans association, or the thrift, was a strange banking hybrid, very much akin to the building society in Britain. It was allowed to take in deposits but was really merely a mortgage bank. The Depository Institutions Deregulation and Monetary Control Act of 1980 forced S&L's to achieve interest parity with commercial banks, thus eliminating the interest ceiling on deposits which they enjoyed hitherto.

But it still allowed them only very limited entry into commercial and consumer lending and trust services.

Thus, these institutions were heavily exposed to the vicissitudes of the residential real estate markets in their respective regions. Every normal cyclical slump in property values or regional economic shock - e.g., a plunge in commodity prices - affected them disproportionately.

Interest rate volatility created a mismatch between the assets of these associations and their liabilities. The negative spread between their cost of funds and the yield of their assets - eroded their operating margins. The 1982 Garn-St. Germain Depository Institutions Act encouraged thrifts to convert from mutual - i.e., depositor-owned - associations to stock companies, allowing them to tap the capital markets in order to enhance their faltering net worth.

But this was too little and too late. The S&L's were rendered unable to further support the price of real estate by rolling over old credits, refinancing residential equity, and underwriting development projects. Endemic corruption and mismanagement exacerbated the ruin. The bubble burst.

Hundreds of thousands of depositors scrambled to withdraw their funds and hundreds of savings and loans association (out of a total of more than 3,000) became insolvent instantly, unable to pay their depositors. They were besieged by angry - at times, violent - clients who lost their life savings.

The illiquidity spread like fire. As institutions closed their gates, one by one, they left in their wake major financial upheavals, wrecked businesses and homeowners, and devastated communities. At one point, the contagion threatened the stability of the entire banking system.

The Federal Savings and Loans Insurance Corporation (FSLIC) - which insured the deposits in the savings and loans associations - was no longer able to meet the claims and, effectively, went bankrupt. Though the obligations of the FSLIC were never guaranteed by the Treasury, it was widely perceived to be an arm of the federal government.

The public was shocked. The crisis acquired a political dimension.

A hasty \$300 billion bailout package was arranged to inject liquidity into the shriveling system through a special agency, the FHFB. The supervision of the banks was subtracted from the Federal Reserve. The role of the the Federal Deposit Insurance Corporation (FDIC) was greatly expanded.

Prior to 1989, savings and loans were insured by the now- defunct FSLIC. The FDIC insured only banks. Congress had to eliminate FSLIC and place the insurance of thrifts under FDIC. The FDIC kept the Bank Insurance Fund (BIF) separate from the Savings Associations Insurance Fund (SAIF), to confine the ripple effect of the meltdown.

The FDIC is designed to be independent. Its money comes from premiums and earnings of the two insurance funds, not from Congressional appropriations. Its board of directors has full authority to run the agency.

The board obeys the law, not political masters. The FDIC has a preemptive role. It regulates banks and savings and loans with the aim of avoiding insurance claims by depositors.

When an institution becomes unsound, the FDIC can either shore it up with loans or take it over. If it does the latter, it can run it and then sell it as a going concern, or close it, pay off the depositors and try to collect the loans.

At times, the FDIC ends up owning collateral and trying to sell it.

Another outcome of the scandal was the Resolution Trust Corporation (RTC). Many savings and loans were treated as "special risk" and placed under the jurisdiction of the RTC until August 1992. The RTC operated and sold these institutions - or paid off the depositors and closed them. A new government corporation (Resolution Fund Corporation, RefCorp) issued federally guaranteed bailout bonds whose proceeds were used to finance the RTC until 1996.

The Office of Thrift Supervision (OTS) was also established in 1989 to replace the dismantled Federal Home Loan Board (FHLB) in supervising savings and loans. OTS is a unit within the Treasury Department, but law and custom make it practically an independent agency.

The Federal Housing Finance Board (FHFB) regulates the savings establishments for liquidity. It provides lines of credit from twelve regional Federal Home Loan Banks (FHLB). Those banks and the thrifts make up the Federal Home Loan Bank System (FHLBS). FHFB gets its funds from the System and is independent of supervision by the executive branch.

Thus a clear, streamlined, and powerful regulatory mechanism was put in place. Banks and savings and loans abused the confusing overlaps in authority and regulation among numerous government agencies. Not one regulator possessed a full and truthful picture. Following the reforms, it all became clearer: insurance was the FDIC's job, the OTS provided supervision, and liquidity was monitored and imparted by the FHLB.

Healthy thrifts were coaxed and cajoled to purchase less sturdy ones. This weakened their balance sheets considerably and the government reneged on its promises to allow them to amortize the goodwill element of the purchase over 40 years. Still, there were 2,898 thrifts in 1989. Six years later, their number shrank to 1,612 and it stands now at less than 1,000. The consolidated institutions are bigger, stronger, and better capitalized.

Later on, Congress demanded that thrifts obtain a bank charter by 1998. This was not too onerous for most of them. At the height of the crisis the ratio of their combined equity to their combined assets was less than 1%. But in 1994 it reached almost 10% and remained there ever since.

This remarkable turnaround was the result of serendipity as much as careful planning. Interest rate spreads became highly positive. In a classic arbitrage, savings and loans paid low interest on deposits and invested the money in high yielding government and corporate bonds. The prolonged equity bull market allowed thrifts to float new stock at exorbitant prices.

As the juridical relics of the Great Depression - chiefly amongst them, the Glass-Steagall Act - were repealed, banks were liberated to enter new markets, offer new financial instruments, and spread throughout the USA.

Product and geographical diversification led to enhanced financial health.

But the very fact that S&L's were poised to exploit these opportunities is a tribute to politicians and regulators alike - though except for setting the general tone of urgency and resolution, the relative absence of political intervention in the handling of the crisis is notable. It was managed by the autonomous, able, utterly professional, largely a- political Federal Reserve. The political class provided the professionals with the tools they needed to do the job.

This mode of collaboration may well be the most important lesson of this crisis.

III. Case Study - Wall Street, October 1929 Also published by United Press International (UPI) Claud Cockburn, writing for the "Times of London" from New-York, described the irrational exuberance that gripped the nation just prior to the Great Depression.

As Europe wallowed in post-war malaise, America seemed to have discovered a new economy, the secret of uninterrupted growth and prosperity, the fount of transforming technology: "The atmosphere of the great boom was savagely exciting, but there were times when a person with my European background felt alarmingly lonely. He would have liked to believe, as these people believed, in the eternal upswing of the big bull market or else to meet just one person with whom he might discuss some general doubts without being regarded as an imbecile or a person of deliberately evil intent-some kind of anarchist, perhaps".

The greatest analysts with the most impeccable credentials and track records failed to predict the forthcoming crash and the unprecedented economic depression that followed it. Irving Fisher, a preeminent economist, who, according to his biographer-son, Irving Norton Fisher, lost the equivalent of \$140 million in today's money in the crash, made a series of soothing predictions. On October 22 he uttered these avuncular statements: "Quotations have not caught up with real values as yet ... (There is) no cause for a slump ... The market has not been inflated but merely readjusted..".

Even as the market convulsed on Black Thursday, October 24, 1929 and on Black Tuesday, October 29 - the New York Times wrote: "Rally at close cheers brokers, bankers optimistic".

In an editorial on October 26, it blasted rabid speculators and compliant analysts: ``We shall hear considerably less in the future of those newly invented conceptions of finance which revised the principles of political economy with a view solely to fitting the stock market's vagaries." But it ended thus: "(The Federal Reserve has) insured the soundness of the business situation when the speculative markets went on the rocks." Compare this to Alan Greenspan Congressional testimony this summer: "While bubbles that burst are scarcely benign, the consequences need not be catastrophic for the economy ... (The Depression was brought on by) ensuing failures of policy".

Investors, their equity leveraged with bank and broker loans, crowded into stocks of exciting "new technologies", such as the radio and mass electrification. The bull market - especially in issues of public utilities - was fueled by "mergers, new groupings, combinations and good earnings" and by corporate purchasing for "employee stock funds".

Cautionary voices - such as Paul Warburg, the influential banker, Roger Babson, the "Prophet of Loss" and Alexander Noyes, the eternal Cassandra from the New York Times - were derided. The number of brokerage accounts doubled between March 1927 and March 1929.

When the market corrected by 8 percent between March 18-27 - following a Fed induced credit crunch and a series of mysterious closed-door sessions of the Fed's board - bankers rushed in. The New York Times reported: ``Responsible bankers agree that stocks should now be supported, having reached a level that makes them attractive." By August, the market was up 35 percent on its March lows. But it reached a peak on September 3 and it was downhill since then.

On October 19, five days before "Black Thursday", Business Week published this sanguine prognosis: "Now, of course, the crucial weaknesses of such periods — price inflation, heavy inventories, over-extension of commercial credit — are totally absent. The security market seems to be suffering only an attack of stock indigestion... There is additional reassurance in the fact that, should business show any further signs of fatigue, the banking system is in a good position now to administer any needed credit tonic from its excellent Reserve supply".

The crash unfolded gradually. Black Thursday actually ended with an inspiring rally. Friday and Saturday - trading ceased only on Sundays - witnessed an upswing followed by mild profit taking. The market dropped 12.8 percent on Monday, with Winston Churchill watching from the visitors' gallery - incurring a loss of \$10-14 billion.

The Wall Street Journal warned naive investors: "Many are looking for technical corrective reactions from time to time, but do not expect these to disturb the upward trend for any prolonged period."

The market plummeted another 11.7 percent the next day - though trading ended with an impressive rally from the lows. October 31 was a good day with a "vigorous, buoyant rally from bell to bell". Even Rockefeller

joined the myriad buyers. Shares soared. It seemed that the worst was over.

The New York Times was optimistic: "It is thought that stocks will become stabilized at their actual worth levels, some higher and some lower than the present ones, and that the selling prices will be guided in the immediate future by the worth of each particular security, based on its dividend record, earnings ability and prospects. Little is heard in Wall Street these days about 'putting stocks up.'" But it was not long before irate customers began blaming their stupendous losses on advice they received from their brokers. Alec Wilder, a songwriter in New York in 1929, interviewed by Stud Terkel in "Hard Times" four decades later, described this typical exchange with his money manager: "I knew something was terribly wrong because I heard bellboys, everybody, talking about the stock market.

About six weeks before the Wall Street Crash, I persuaded my mother in Rochester to let me talk to our family adviser. I wanted to sell stock which had been left me by my father. He got very sentimental: 'Oh your father wouldn't have liked you to do that.' He was so persuasive, I said O.K. I could have sold it for \$160,000. Four years later, I sold it for \$4,000".

Exhausted and numb from days of hectic trading and back office operations, the brokerage houses pressured the stock exchange to declare a two day trading holiday.

Exchanges around North America followed suit.

At first, the Fed refused to reduce the discount rate. "(There) was no change in financial conditions which the board thought called for its action." - though it did inject liquidity into the money market by purchasing government bonds. Then, it partially succumbed and reduced the New York discount rate, which, curiously, was 1 percent above the other Fed districts - by 1 percent.

This was too little and too late. The market never recovered after November 1. Despite further reductions in the discount rate to 4 percent, it shed a whopping 89 percent in nominal terms when it hit bottom three years later.

Everyone was duped. The rich were impoverished overnight. Small time margin traders - the forerunners of today's day traders - lost their shirts and much else besides. The New York Times: "Yesterday's market crash was one which largely affected rich men, institutions, investment trusts and others who participate in the market on a broad and intelligent scale.

It was not the margin traders who were caught in the rush to sell, but the rich men of the country who are able to swing blocks of 5,000, 10,000, up to 100,000 shares of high-priced stocks. They went overboard with no more consideration than the little trader who was swept out on the first day of the market's upheaval, whose prices, even at their lowest of last Thursday, now look high by comparison ...

To most of those who have been in the market it is all the more awe-inspiring because their financial history is limited to bull markets".

Overseas - mainly European - selling was an important factor. Some conspiracy theorists, such as Webster Tarpley in his "British Financial Warfare", supported by contemporary reporting by the likes of "The Economist", went as far as writing: "When this Wall Street Bubble had reached gargantuan proportions in the autumn of 1929, (Lord) Montagu Norman (governor of the Bank of England 1920-1944) sharply (upped) the British bank rate, repatriating British hot money, and pulling the rug out from under the Wall Street speculators, thus deliberately and consciously imploding the US markets. This caused a violent depression in the United States and some other countries, with the collapse of financial markets and the contraction of production and employment. In 1929, Norman engineered a collapse by puncturing the bubble".

The crash was, in large part, a reaction to a sharp reversal, starting in 1928, of the reflationary, "cheap money", policies of the Fed intended, as Adolph Miller of the Fed's Board of Governors told a Senate committee, "to bring down money rates, the call rate among them, because of the international importance the call rate had come to acquire. The purpose was to start an outflow of gold - to reverse the previous inflow of gold into this country (back to Britain)." But the Fed had already lost control of the speculative rush.

The crash of 1929 was not without its Enrons and World.com's. Clarence Hatry and his associates admitted to forging the accounts of their investment group to show a fake net worth of \$24 million British pounds - rather than the true picture of 19 billion in liabilities. This led to forced liquidation of Wall Street positions by harried British financiers.

The collapse of Middle West Utilities, run by the energy tycoon, Samuel Insull, exposed a web of offshore holding companies whose only purpose was to hide losses and disguise leverage. The former president of NYSE, Richard Whitney was arrested for larceny.

Analysts and commentators thought of the stock exchange as decoupled from the real economy. Only one tenth of the population was invested - compared to 40 percent today. "The World" wrote, with more than a bit of Schadenfreude: "The country has not suffered a catastrophe ... The American people ... has been gambling largely with the surplus of its astonishing prosperity." "The Daily News" concurred: "The sagging of the stocks has not destroyed a single factory, wiped out a single farm or city lot or real estate development, decreased the productive powers of a single workman or machine in the United States." In Louisville, the "Herald Post" commented sagely: "While Wall Street was getting rid of its weak holder to their own most drastic punishment, grain was stronger. That will go to the credit side of the national prosperity and help replace that buying power which some fear has been gravely impaired".

During the Coolidge presidency, according to the Encyclopedia Britannica, "stock dividends rose by 108 percent, corporate profits by 76 percent, and wages by 33 percent. In 1929, 4,455,100 passenger cars were sold by American factories, one for every 27 members of the population, a record that was not broken until

1950.

Productivity was the key to America's economic growth.

Because of improvements in technology, overall labour costs declined by nearly 10 percent, even though the wages of individual workers rose".

Jude Waninski adds in his tome "The Way the World Works" that "between 1921 and 1929, GNP grew to \$103.1 billion from \$69.6 billion. And because prices were falling, real output increased even faster." Tax rates were sharply reduced.

John Kenneth Galbraith noted these data in his seminal "The Great Crash": "Between 1925 and 1929, the number of manufacturing establishments increased from 183,900 to 206,700; the value of their output rose from \$60.8 billions to \$68 billions. The Federal Reserve index of industrial production which had averaged only 67 in 1921 ... had risen to 110 by July 1928, and it reached 126 in June 1929 ... (but the American people) were also displaying an inordinate desire to get rich quickly with a minimum of physical effort".

Personal borrowing for consumption peaked in 1928 - though the administration, unlike today, maintained twin fiscal and current account surpluses and the USA was a large net creditor.

Charles Kettering, head of the research division of General Motors described consumeritis thus, just days before the crash: "The key to economic prosperity is the organized creation of dissatisfaction".

Inequality skyrocketed. While output per man-hour shot up by 32 percent between 1923 and 1929, wages crept up only 8 percent. In 1929, the top 0.1 percent of the population earned as much as the bottom 42 percent.

Business-friendly administrations reduced by 70 percent the exorbitant taxes paid by those with an income of more than \$1 million. But in the summer of 1929, businesses reported sharp increases in inventories. It was the beginning of the end.

Were stocks overvalued prior to the crash? Did all stocks collapse indiscriminately? Not so. Even at the height of the panic, investors remained conscious of real values. On November 3, 1929 the shares of American Can, General Electric, Westinghouse and Anaconda Copper were still substantially higher than on March 3, 1928.

John Campbell and Robert Shiller, author of "Irrational Exuberance", calculated, in a joint paper titled "Valuation Ratios and the Lon-Run Market Outlook: An Update" posted on Yale University' s Web Site, that share prices divided by a moving average of 10 years worth of earnings reached 28 just prior to the crash. Contrast this with 45 on March 2000.

In an NBER working paper published December 2001 and tellingly titled "The Stock Market Crash of 1929 - Irving Fisher was Right", Ellen McGrattan and Edward Prescott boldly claim:

"We find that the stock market in 1929 did not crash because the market was overvalued. In fact, the evidence strongly suggests that stocks were undervalued, even at their 1929 peak".

According to their detailed paper, stocks were trading at 19 times after-tax corporate earning at the peak in 1929, a fraction of today's valuations even after the recent correction. A March 1999 "Economic Letter" published by the Federal Reserve Bank of San-Francisco wholeheartedly concurs. It notes that at the peak, prices stood at 30.5 times the dividend yield, only slightly above the long term average.

Contrast this with an article published in June 1990 issue of the "Journal of Economic History" by Robert Barsky and Bradford De Long and titled "Bull and Bear Markets in the Twentieth Century": "Major bull and bear markets were driven by shifts in assessments of fundamentals: investors had little knowledge of crucial factors, in particular the long run dividend growth rate, and their changing expectations of average dividend growth plausibly lie behind the major swings of this century".

Jude Waninski attributes the crash to the disintegration of the pro-free-trade coalition in the Senate which later led to the notorious Smoot-Hawley Tariff Act of 1930. He traces all the important moves in the market between March 1929 and June 1930 to the intricate protectionist danse macabre in Congress.

This argument may never be decided. Is a similar crash on the cards? This cannot be ruled out.

The 1990's resembled the 1920's in more than one way.

Are we ready for a recurrence of 1929? About as we were prepared in 1928. Human nature - the prime mover behind market meltdowns - seemed not to have changed that much in these intervening seven decades.

Will a stock market crash, should it happen, be followed by another "Great Depression"? It depends which kind of crash. The short term puncturing of a temporary bubble - e.g., in 1962 and 1987 - is usually divorced from other economic fundamentals. But a major correction to a lasting bull market invariably leads to recession or worse.

As the economist Hernan Cortes Douglas reminds us in "The Collapse of Wall Street and the Lessons of History" published by the Friedberg Mercantile Group, this was the sequence in London in 1720 (the infamous "South Sea Bubble"), and in the USA in 1835-40 and 1929-32.

IV. Britain's Real Estate The five ghastly "Jack the Ripper" murders took place in an area less than a quarter square mile in size. Houses in this haunting and decrepit no man's land straddling the City and metropolitan London could be had for 25-50,000 British pounds as late as a decade ago. How things change!

The general buoyancy in real estate prices in the capital coupled with the adjacent Spitalfields urban renewal project have lifted prices. A house not 50 yards from the scene of the Ripper's last - and most ghoulish - slaying now sells for over 1 million pounds. In central London, one bedroom apartments retail for an outlandish half a million.

According to research published in September 2002 by Halifax, the UK's largest mortgage lender, the number of 1 million pound homes sold has doubled in 1999-2002 to 2600. By 2002, it has increased elevenfold since 1995.

According to The Economist's house price index, prices rose by a further 15.6% in 2003, 10.2% in 2004 and a whopping 147% in total since 1997. In Greater London, one in every 90 homes fetches even a higher price. The average UK house now costs 100,000 pounds. In the USA, the ratios of house prices to rents and to median income are at historic highs.

One is reminded of the Japanese boast, at the height of their realty bubble, that the grounds of the royal palace in Tokyo are worth more than the entire real estate of Manhattan. Is Britain headed the same way? A house - much like a Big Mac - is a basket of raw materials, goods, and services. But, unlike the Big Mac - and the purchasing power index it spawned - houses are also investment vehicles and stores of value. They yield often tax exempt capital gains, rental income, or benefits from occupying them (rent payments saved). Real estate is used to hedge against inflation, save for old age, and speculate. Prices of residential and commercial property reflect scarcity, investment fads, and changing moods.

Homeowners in both the UK and the USA - spurred on by aggressive marketing and the lowest interest rates in 30 years - have been refinancing old, more expensive, mortgages and heavily borrowing against their "equity" - i.e., against the meteoric rise in the market prices of their abodes.

According to the Milken Institute in Los Angeles, asset bubbles tend to both enhance and cannibalize each other.

Profits from surging tradable securities are used to buy property and drive up its values. Borrowing against residential equity fuels overvaluations in fervid stock exchanges. When one bubble bursts - the other initially benefits from an influx of funds withdrawn in panic from the shriveling alternative.

Quantitatively, a considerably larger share of the nation's wealth is tied in real estate than in the capital markets.

Yet, the infamous wealth effect - an alleged fluctuation in the will to consume as a result of changing fortunes in the stock exchange - is equally inconspicuous in the realty markets. It seems that consumption is correlated with lifelong projected earnings rather than with the state of one's savings and investments.

This is not the only counter-intuitive finding. Asset inflation - no matter how vertiginous - rarely spills into consumer prices. The recent bubbles in Japan and the USA, for instance, coincided with a protracted period of disinflation. The bursting of bubbles does have a deflationary effect, though.

In a late 2002 survey of global house price movements, "The Economist" concluded that real estate inflation is a global phenomenon. Though Britain far outpaces the United States and Italy (65% rise since 1997), it falls behind Ireland (179%) and South Africa (195%). It is in league with Australia (with 113%) and Spain (132%).

The paper notes wryly: "Just as with equities in the late 1990s, property bulls are now coming up with bogus arguments for why rampant house-price inflation is sure to continue.

Demographic change ... Physical restrictions and tough planning laws ... Similar arguments were heard in Japan in the late 1980s and Germany in the early 1990s - and yet in recent years house prices in these two countries have been falling. British house prices also tumbled in the late 1980s".

They are bound to do so again. In the long run, the rise in house prices cannot exceed the increase in disposable income. The effects of the bursting of a property bubble are invariably more pernicious and prolonged than the outcomes of a bear market in stocks. Real estate is much more leveraged. Debt levels can well exceed home equity ("negative equity") in a downturn. Nowadays, loans are not eroded by high inflation. Adjustable rate mortgages - one third of the annual total in the USA - will make sure that the burden of real indebtedness mushrooms as interest rates rise.

The Economist (April 2005): "An IMF study on asset bubbles estimates that 40% of housing booms are followed by housing busts, which last for an average of four years and see an average decline of roughly 30% in home values. But given how many homebuyers in booming markets seem to be basing their purchasing decisions on expectations of outsized returns-a recent survey of buyers in Los Angeles indicated that they expected their homes to increase in value by a whopping 22% a year over the next decade- nasty downturns in at least some markets seem likely".

With both the equity and realty markets in gloom, people revert to cash and bonds and save more - leading to deflation or recession or both. Japan is a prime example of such a shift of investment preferences. When prices collapse sufficiently to become attractive, investors pile back into both the capital and real estate markets. This cycle is as old and as inevitable as human greed and fear.

X. The Shadowy World of International Finance

Strange, penumbral, characters roam the boardrooms of banks in the countries in transition. Some of them pop apparently from nowhere, others are very well connected and equipped with the most excellent introductions. They all peddle financial transactions which are too good to be true and often are. In the unctuously perfumed propinquity of their Mercedeses, Rolex waving entourage - the polydipsic natives dissolve in their irresistible charm and the temptations of the cash: mountainous returns on capital, effulgent profits, no collaterals, track record, or business plan required. Total security is cloyingly assured.

These Faustus roughly belong to four tribes: The Shoppers These are the shabby operators of the marginal shadows of the world of finance. They broker financial deals with meretricious sweat only to be rewarded their meagre, humiliated fees. Most of their deals do not materialize.

The principle is very simple: They approach a bank, a financial institution, or a borrower and say: "We are connected to banks or financial institutions in the West. We can bring you money in the form of credits. But to do that - you must first express interest in getting this money. You must furnish us with a bank guarantee / promissory note / letter of intent that indicates that you desire the credit and that you are willing to provide a liquid financial instrument to back it up.". Having obtained such instruments, the shoppers begin to "shop around". They approach banks and financial institutions (usually, in the West). This time, they reverse their text: "We have an excellent client, a good borrower. Are you willing to lend to it?" An informal process of tendering ensues. Sometimes it ends in a transaction and the shopper collects a small commission (between one quarter of a percentage point and two percentage points - depending on the amount).

Mostly it doesn't -and the Flying Dutchman resumes his wanderings looking for more venal gulosity and less legal probity.

The Con-Men These are crooks who set up elaborate schemes ("sting operations") to extract money from unsuspecting people and financial institutions. They establish "front" or "phantom" firms and offices throughout the world. They tempt the gullible by offering them enormous, immediate, tax-free, effort-free, profits. They let the victims profit in the first round or two of the scam. Then, they sting: the victims invest money and it evaporates together with the dishonest operators. The "offices" are deserted, the fake identities, the forged bank references, the falsified guarantees are all exposed (often with the help of an inside informant).

Probably the most famous and enduring scam is the "Nigerian-type Connection". Letters - allegedly composed by very influential and highly placed officials - are sent out to unsuspecting businessmen. The latter are asked to make their bank accounts available to the former, who profess to need the third party bank accounts through which to funnel the sweet fruits of corruption. The account owners are promised huge financial rewards if they collaborate and if they bear some minor-by- comparison upfront costs. The con-men pocket these "expenses" and vanish. Sometimes, they even empty the accounts of their entire balance as they evaporate.

The Launderers A lot of cash goes undeclared to tax authorities in countries in transition. The informal economy (the daughter of both criminal and legitimate parents) comprises between 15% (Slovenia) and 50% (Russia, Macedonia) of the official one. Some say these figures are a deliberate and ferocious understatement. These are mind boggling amounts, which circulate between financial centres and off shore havens in the world: Cyprus, the Cayman Islands, Liechtenstein (Vaduz), Panama and dozens of aspiring laundrettes.

The money thus smuggled is kept in low-yielding cash deposits. To escape the cruel fate of inflationary corrosion, it has to be reinvested. It is stealthily re- introduced to the very economy that it so sought to evade, in the form of investment capital or other financial assets (loans and credits). Its anxious owners are preoccupied with legitimising their stillborn cash through the conduit of tax-fearing enterprises, or with lending it to same. The emphasis is on the word: "legitimate". The money surges in through mysterious and anonymous foreign corporations, via off-shore banking centres, even through respectable financial institutions (the Bank of New York we mentioned?). It is easy to recognize a laundering operation. Its hallmark is a pronounced lack of selectivity.

The money is invested in anything and everything, as long as it appears legitimate. Diversification is not sought by these nouveau tycoons and they have no core investment strategy. They spread their illicit funds among dozens of disparate economic activities and show not the slightest interest in the putative yields on their investments, the maturity of their assets, the quality of their newly acquired businesses, their history, or real value. Never the sedulous, they pay exorbitantly for all manner of prestidigital endeavours. The future prospects and other normal investment criteria are beyond them. All they are after is a mirage of lapidarity.

The Investors This is the most intriguing group. Normative, law abiding, businessmen, who stumbled across methods to secure excessive yields on their capital and are looking to borrow their way into increasing it. By cleverly participating in bond tenders, by devising ingenious option strategies, or by arbitraging - yields of up to 300% can be collected in the immature markets of transition without the normally associated risks. This sub-species can be found mainly in Russia and in the Balkans.

Its members often buy sovereign bonds and notes at discounts of up to 80% of their face value. Russian obligations could be had for less in August 1998 and Macedonian ones during the Kosovo crisis. In cahoots with the issuing country's central bank, they then convert the obligations to local currency at par (for 100% of their face value). The difference makes, needless to add, for an immediate and hefty profit, yet it is in (often worthless and vicissitudinal) local currency. The latter is then hurriedly disposed of (at a discount) and sold to multinationals with operations in the country of issue, which are in need of local tender. This fast becomes an almost addictive avocation.

Intoxicated by this pecuniary nectar, the fortunate, those privy to the secret, try to raise more capital by hunting for financial instruments they can convert to cash in Western banks. A bank guarantee, a promissory

note, a confirmed letter of credit, a note or a bond guaranteed by the Central Bank - all will do as deposited collateral against which a credit line is established and cash is drawn. The cash is then invested in a new cycle of inebriation to yield fantastic profits.

It is easy to identify these "investors". They eagerly seek financial instruments from almost any local bank, no matter how suspect. They offer to pay for these coveted documents (bank guarantees, bankers' acceptances, letters of credit) either in cash or by lending to the bank's clients and this within a month or more from the date of their issuance. They agree to "cancel" the locally issued financial instruments by offering a "counter-financial-instrument" (safe keeping receipt, contra-guarantee, counter promissory note, etc.). This "counter-instrument" is issued by the very Prime World or European Bank in which the locally issued financial instruments are deposited as collateral.

The Investors invariably confidently claim that the financial instrument issued by the local bank will never be presented or used (which is true) and that this is a risk free transaction (which is not entirely so). If they are forced to lend to the bank's clients, they often ignore the quality of the credit takers, the yields, the maturities and other considerations which normally tend to interest lenders very much.

Whether a financial instrument cancelled by another is still valid, presentable and should be honoured by its issuer is still debated. In some cases it is clearly so. If something goes horribly (and rarely, admittedly) wrong with these transactions - the local bank stands to suffer, too.

It all boils down to a terrible hunger, the kind of thirst that can be quelled only by the denominated liquidity of lucre.

In the post nuclear landscape of this part of the world, a fantasy is shared by both predators and prey. Circling each other in marble temples, they switch their roles in dizzying progression. Tycoons and politicians, industrialists and bureaucrats all vie for the attention of Mammon. The shifting coalitions of well groomed man in back stabbed suits, an hallucinatory carousel of avarice and guile. But every circus folds and every Luna park is destined to shut down. The dying music, the frozen accounts of the deceived, the bankrupt banks, the Jurassic Park of skeletal industrial beasts - a muted testimony to a wild age of mutual assured destruction and self deceit.

The future of Eastern and South Europe. The present of Russia, Albania and Yugoslavia.

XI. Treasure Island Revisited On Maritime Piracy

The rumors concerning the demise of maritime piracy back in the 19th century were a tad premature. The scourge has so resurged that the International Maritime Board (IMB), founded by the International Chamber of Commerce (ICC) in 1981, is forced to broadcast daily piracy reports to all shipping companies by satellite from its Kuala Lumpur Piracy Reporting Center, established in 1992 and partly funded by maritime insurers. The reports carry this alarming disclaimer: "For statistical purposes, the IMB defines piracy and armed robbery as: An act of boarding or attempting to board any ship with the apparent intent to commit theft or any other crime and with the apparent intent or capability to use force in the furtherance of that act. This definition thus covers actual or attempted attacks whether the ship is berthed, at anchor or at sea. Petty thefts are excluded, unless the thieves are armed".

The 1994 United Nations Convention on the Law of the Sea defines piracy as "any illegal acts of violence or detention, or any act of depredation, committed by individuals (borne aboard a pirate vessel) for private ends against a private ship or aircraft (the victim vessel)".

When no "pirate vessel" is involved - for instance, when criminals embark on a ship and capture it - the legal term is hijacking.

On July 8, 2002 seven pirates, armed with long knives attacked an officer of a cargo ship berthed in Chittagong port in Bangladesh, snatched his gold chain and watch and dislocated his arm. This was the third such attack since the ship dropped anchor in this minacious port.

Three days earlier, in Indonesia, similarly-armed pirates escaped with the crew's valuables, having tied the hands of the duty officer. Pirates in small boats stole anodes from the stern of a bulk carrier in Bangladesh. Others, in Indonesia, absconded with a life raft.

The pirates of Guyana are either unlucky or untrained.

They were consistently scared off by flares hurled at them and alarms set by vigilant hands on deck. A Colombian band, riding a high speed boat, attempted to board a container ship. Warring parties in Somalia hijacked yet another ship in June 2002.

A particularly egregious case - and signs of growing sophistication and coordinated action - is described in the July 1-8, 2002 report of the IMB: "Six armed pirates boarded a chemical tanker from a small boat and stole ship's stores. Another group of pirates broke in to engine room and stole spare parts. Thefts took place in spite of the ship engaging three shore security watchmen." Piracy incidents have been reported in India, Malaysia, Philippines, Thailand, Vietnam, the Red Sea, the Gulf of Aden, Nigeria, Brazil, Colombia, Dominican Republic, Ecuador, Peru, Venezuela.

According to the ICC Year 2001 Piracy Report, more than 330 attacks on seafaring vessels were reported in

2001 - down by a quarter compared to 2000 but 10 percent higher than 1999 and four times the 1991 figure. Piracy rose 40 percent between 1998 and 1999 alone.

Sixteen ships - double the number in 2000 - were captured and taken over in 2001. Eighty seven attacks were reported during the first quarter of 2002 - up from 68 in the corresponding period the year before. Seven of these were hijackings - compared to only 1 in the first quarter of 2001. Nine of every 10 hijacked ships are ultimately recovered, often with the help of the IMB.

Many masters and shipowners do not report piracy for fear of delays due to protracted investigations, increased insurance premiums, bad publicity, and stifling red tape.

The number of unreported attacks in 1999 was estimated by the World Maritime Piracy Report to be 130.

According to "The Economist", the IMO believes that half of all incidents remain untold. Still, increased patrols and international collaboration among law enforcement agencies dented the clear upward trend in maritime crime - even in the piracy capital, Indonesia.

The number of incidents in the pirate-infested Malacca Straits dropped from 75 in 2000 to 17 in 2001 - though the number of crew "kidnap and ransom" operations, especially in Aceh, has increased. Owners usually pay the "reasonable" amounts demanded - c. \$100,000 per ship.

Contrary to folklore, most ships are attacked while at anchor.

Twenty one people, including passengers, were killed in 2001 - and 210 taken hostage. Assaults involving guns were up 50 percent to 73 - those involving mere knives down by a quarter to 105. Piracy seems to ebb and flow with the business cycles of the host economies. The Asian crisis, triggered by the freefall of the Thai baht in 1997-8, gave a boost to East Asian maritime robbers. So did the debt crises of Latin America a decade earlier. Drug transporters - armed with light aircraft and high speed motorboats - sometimes double as pirates during the dry season of crop growth.

Pirates endanger ship and crew. But they often cause collateral damage as well. Pirates have been known to dump noxious cargo into the sea, or tie up the crew and let an oil tanker steam ahead, its navigational aides smashed, or tamper with substances dangerous to themselves and to others, or cast crew and passengers adrift in tiny rafts with little food and water.

Many shipowners resorted to installing on-board satellite tracking systems, such as Shiploc, and aircraft-like "black boxes". A bulletproof life vest, replete with an integral jagged edged knife, was on display in the millennium exhibition at the Millennium Dome two years ago. The International Maritime Organization (IMO) is considering to compel shipowners to tag their vessels with visibly embossed numbers in compliance with the Safety of Life at Sea Convention.

The IMB also advises shipping companies to closely examine the papers of crew and masters, thousands of whom carry forged documents. In 54 maritime administrations surveyed in 2001 by the Seafarers' International Research Centre, Cardiff University in Wales, more than 12,000 cases of forged certificates of competency were unearthed.

Many issuing authorities are either careless or venal or both. The IMB accused the Coast Guard Office of Puerto Rico for issuing 500 such "suspicious" certificates. The Chinese customs and navy - especially along the southern coast - have often been decried for working hand in glove with pirates.

False documents are an integral - and crucial - part of maritime piracy. The IMB says: "Many of the phantom ships that set off to sea with a cargo and then disappear are sailed by crewmen with false passports and competency certificates. They usually escape detection by the port authorities. In a recent case of a vessel located and arrested in South-East Asia further to IMB investigations, it has emerged that all the senior officers had false passports. The ship's registry documents were also false".

As documents go electronic and integrated in proprietary or common cargo tracking systems, such forgery will wane. Bolero - an international digital bill of lading ledger - is backed by the European Union, banks, shipping and insurance companies. The IMO is a proponent of a technology to apply encrypted "digital signatures" to electronic bills of lading. Still, the industry is highly fragmented and many ships and ports don't even possess rudimentary information technology. The protection afforded by the likes of Bolero is at least five years away.

Pirates sometimes work hand in hand with conspiring crew members (or, less often, stowaways). In many countries - in East Asia, Latin America, and Africa - Coast Guard operatives, corrupt drug agents, and other law enforcement officials, moonlight as pirates. Renegade members of British trained Indonesian anti-piracy squads are still roaming the Malacca Straits.

Pirates also enjoy the support of an insidious and vast network of suborned judges and bureaucrats. Local villagers along the coasts of Indonesia and Malaysia - and Africa - welcome pirate business and provide the perpetrators with food and shelter.

Moreover, large tankers, container ships, and cargo vessels are largely computerized and their crew members few. The value of an average vessel's freight has increased dramatically with improvements in container and oil storage technologies. "Flag of convenience" registration has assumed monstrous proportions, allowing ship owners and managers to conceal their identity effectively. Belize, Honduras, and Panama are the most notorious, no questions asked, havens.

Piracy has matured into a branch of organized crime.

Hijacking requires money, equipment, weapons, planning, experience and contacts with corrupt officials.

The loot per vessel ranges from \$8 million to \$200 million.

Pottengal Mukundan, Director of ICC's Commercial Crime Services states in an IMB press release: "(Piracy) typically involves a mother ship from which to launch the attacks, a supply of automatic weapons, false identity papers for the crew and vessel, fake cargo documents, and a broker network to sell the stolen goods illegally. Individual pirates don't have these resources.

Hijackings are the work of organized crime rings".

The IMB describes the aftermath of a typical hijacking: "The Global Mars has probably been given a new name and repainted. Armed with false registration papers and bills of lading, the pirates - or more likely the mafia bosses pulling the strings - will then try to dispose of their booty. The vessel has probably put in to a port where the false identity of vessel and cargo may escape detection.

Even when identified, the gangs have been known to bribe local officials to allow them to sell the cargo and leave the port".

Such a ship is often "recycled" a few times. It earns its operators an average of \$40-50 million per "cycle", according to "The Economist". The pirates contract with sellers or shipping agents to load it with a legitimate consignment of goods or commodities. The sellers and agents are unaware of the true identity of the ship, or of its unsavory "owners/managers".

The pirates invariably produce an authentic vessel registration certificate that they acquired from crooked officials - and provide the sellers or agents with a bill of lading. The payload is then sold to networks of traders in stolen merchandise or to gullible buyers in a different port of destination - and the ship is ready for yet another round.

In January 2002, the Indonesian Navy has permanently stationed six battleships in the Malacca Straits, three of them off the coast of the secessionist region of Aceh. A further 20-30 ships and 10 aircraft conduct daily patrols of the treacherous traffic lane. Some 200-600 ships cross the Straits daily. A mere 50 ships or so are boarded and searched every month.

The Greek government has gunboats patrolling the 2 miles wide Corfu Channel, where yachts frequently fall prey to Albanian pirates. Brazil has imposed an unpopular anti-piracy inspection fee on berthing vessels and used the proceeds to finance a SWAT team to protect ships and their crews while in port. Both India and Thailand have similar units.

International cooperation is also on the rise. About one third of the world's shipping traffic goes through the South China Sea. A conference convened by Japan in March 2000 - Japanese vessels have become favored targets of piracy in the last few years - pushed for the ratification of the International Maritime Organisation's (IMO) 1988 Rome Convention on the Suppression of Unlawful Acts against the Safety of Maritime Navigation by Asian and ASEAN countries.

The Convention makes piracy an extraterritorial crime and, thus, removes the thorny issue of jurisdiction in cases of piracy carried in another country's territorial waters or out on the high seas. The Comité Maritime International - the umbrella organization of national maritime law associations - promulgated a model anti-piracy law last year.

Though it rejected Japan's offer for collaboration, in a sharp reversal of its previous policy, China started handing down death sentences against murderous pirates.

The 13 marauders who seized the Cheung Son and massacred its 23 Chinese sailors were executed five years ago in the southern city of Shanwei. Another 25 people received long prison sentences. The - declared - booty amounted to a mere \$300,000.

India and Iran - two emerging "pirates safe harbor" destinations - have also tightened up sentencing and port inspections. In the Alondra Rainbow hijacking, the Indian Navy captured the Indonesian culprits in a cinematic chase off Goa. They were later sentenced severely under both the Indian Penal Code and international law. Even the junta in Myanmar has taken tentative steps against compatriots with piratical predilections.

Law enforcement does not tolerate a vacuum. "The Economist" reports about two private military companies - Marine Risk Management and Satellite Protection Services (SPS) - which deploy airborne mercenaries to deal with piracy. SPS has even suggested to station 2500 former Dutch marines in Subic Bay in the Philippines - for a mere \$2500 per day per combatant.

Shipowners are desperate. Quoted by "The Economist", they "suggest that the region's governments negotiate the right for navies to chase pirates across national boundaries: the so-called 'right of hot pursuit'. So far, only Singapore and Indonesia have negotiated limited rights.

Some suggest that the American navy should be invited into territorial waters to combat piracy, a 'live' exercise it might relish. At the very least, countries such as Indonesia should advertise which bits of their territorial waters at any time are patrolled and safe from pirates. No countries currently do this".

XII. Legalizing Crime

Also Read: Narcissists, Ethnic or Religious Affiliation, and Terrorists

"Those who have the command of the arms in a country are masters of the state, and have it in their power to make what revolutions they please. [Thus,] there is no end to observations on the difference between the measures likely to be pursued by a minister backed by a standing army, and those of a court awed by the fear of an armed people".

Aristotle (384-322 BC), Greek philosopher "Murder being the very foundation of our social institutions, it is consequently the most imperious necessity of civilised life. If there were no murder, government of any sort would be inconceivable. For the admirable fact is that crime in general, and murder in particular, not simply excuses it but represents its only reason to exist ... Otherwise we would live in complete anarchy, something we find unimaginable ..".

Octave Mirbeau (1848-1917), *The Torture Garden* The state has a monopoly on behaviour usually deemed criminal. It murders, kidnaps, and locks up people.

Sovereignty has come to be identified with the unbridled - and exclusive - exercise of violence. The emergence of modern international law has narrowed the field of permissible conduct. A sovereign can no longer commit genocide or ethnic cleansing with impunity, for instance.

Many acts - such as the waging of aggressive war, the mistreatment of minorities, the suppression of the freedom of association - hitherto sovereign privilege, have thankfully been criminalized. Many politicians, hitherto immune to international prosecution, are no longer so.

Consider Yugoslavia's Milosevic and Chile's Pinochet.

But, the irony is that a similar trend of criminalization - within national legal systems - allows governments to oppress their citizenry to an extent previously unknown.

Hitherto civil torts, permissible acts, and common behaviour patterns are routinely criminalized by legislators and regulators. Precious few are decriminalized.

Consider, for instance, the criminalization in the Economic Espionage Act (1996) of the misappropriation of trade secrets and the criminalization of the violation of copyrights in the Digital Millennium Copyright Act (2000) - both in the USA. These used to be civil torts.

They still are in many countries. Drug use, common behaviour in England only 50 years ago - is now criminal.

The list goes on.

Criminal laws pertaining to property have malignantly proliferated and pervaded every economic and private interaction. The result is a bewildering multitude of laws, regulations statutes, and acts.

The average Babylonian could have memorized and assimilated the Hammurabic code 37 centuries ago - it was short, simple, and intuitively just.

English criminal law - partly applicable in many of its former colonies, such as India, Pakistan, Canada, and Australia - is a mishmash of overlapping and contradictory statutes - some of these hundreds of years old - and court decisions, collectively known as "case law".

Despite the publishing of a Model Penal Code in 1962 by the American Law Institute, the criminal provisions of various states within the USA often conflict. The typical American can't hope to get acquainted with even a negligible fraction of his country's fiendishly complex and hopelessly brobdignagian criminal code. Such inevitable ignorance breeds criminal behaviour - sometimes inadvertently - and transforms many upright citizens into delinquents.

In the land of the free - the USA - close to 2 million adults are behind bars and another 4.5 million are on probation, most of them on drug charges. The costs of criminalization - both financial and social - are mind boggling. According to "The Economist", America's prison system cost it \$54 billion a year - disregarding the price tag of law enforcement, the judiciary, lost product, and rehabilitation.

What constitutes a crime? A clear and consistent definition has yet to transpire.

There are five types of criminal behaviour: crimes against oneself, or "victimless crimes" (such as suicide, abortion, and the consumption of drugs), crimes against others (such as murder or mugging), crimes among consenting adults (such as incest, and in certain countries, homosexuality and euthanasia), crimes against collectives (such as treason, genocide, or ethnic cleansing), and crimes against the international community and world order (such as executing prisoners of war). The last two categories often overlap.

The Encyclopaedia Britannica provides this definition of a crime: "The intentional commission of an act usually deemed socially harmful or dangerous and specifically defined, prohibited, and punishable under the criminal law."

But who decides what is socially harmful? What about acts committed unintentionally (known as "strict liability offences" in the parlance)? How can we establish intention - "mens rea", or the "guilty mind" - beyond a reasonable doubt? A much tighter definition would be: "The commission of an act punishable under the criminal law." A crime is what the law - state law, kinship law, religious law, or any other widely accepted law - says is a crime. Legal systems and texts often conflict.

Murderous blood feuds are legitimate according to the 15th century "Qanoon", still applicable in large parts of Albania. Killing one's infant daughters and old relatives is socially condoned - though illegal - in India,

China, Alaska, and parts of Africa. Genocide may have been legally sanctioned in Germany and Rwanda - but is strictly forbidden under international law.

Laws being the outcomes of compromises and power plays, there is only a tenuous connection between justice and morality. Some "crimes" are categorical imperatives.

Helping the Jews in Nazi Germany was a criminal act - yet a highly moral one.

The ethical nature of some crimes depends on circumstances, timing, and cultural context. Murder is a vile deed - but assassinating Saddam Hussein may be morally commendable. Killing an embryo is a crime in some countries - but not so killing a fetus. A "status offence" is not a criminal act if committed by an adult.

Mutilating the body of a live baby is heinous - but this is the essence of Jewish circumcision. In some societies, criminal guilt is collective. All Americans are held blameworthy by the Arab street for the choices and actions of their leaders. All Jews are accomplices in the "crimes" of the "Zionists".

In all societies, crime is a growth industry. Millions of professionals - judges, police officers, criminologists, psychologists, journalists, publishers, prosecutors, lawyers, social workers, probation officers, wardens, sociologists, non-governmental-organizations, weapons manufacturers, laboratory technicians, graphologists, and private detectives - derive their livelihood, parasitically, from crime. They often perpetuate models of punishment and retribution that lead to recidivism rather than to the reintegration of criminals in society and their rehabilitation.

Organized in vocal interest groups and lobbies, they harp on the insecurities and phobias of the alienated urbanites.

They consume ever growing budgets and rejoice with every new behaviour criminalized by exasperated lawmakers. In the majority of countries, the justice system is a dismal failure and law enforcement agencies are part of the problem, not its solution.

The sad truth is that many types of crime are considered by people to be normative and common behaviours and, thus, go unreported. Victim surveys and self-report studies conducted by criminologists reveal that most crimes go unreported. The protracted fad of criminalization has rendered criminal many perfectly acceptable and recurring behaviours and acts. Homosexuality, abortion, gambling, prostitution, pornography, and suicide have all been criminal offences at one time or another.

But the quintessential example of over-criminalization is drug abuse.

There is scant medical evidence that soft drugs such as cannabis or MDMA ("Ecstasy") - and even cocaine - have an irreversible effect on brain chemistry or functioning.

Last month an almighty row erupted in Britain when Jon Cole, an addiction researcher at Liverpool University, claimed, to quote "The Economist" quoting the "Psychologist", that: "Experimental evidence suggesting a link between Ecstasy use and problems such as nerve damage and brain impairment is flawed ... using this ill-substantiated cause- and-effect to tell the 'chemical generation' that they are brain damaged when they are not creates public health problems of its own".

Moreover, it is commonly accepted that alcohol abuse and nicotine abuse can be at least as harmful as the abuse of marijuana, for instance. Yet, though somewhat curbed, alcohol consumption and cigarette smoking are legal. In contrast, users of cocaine - only a century ago recommended by doctors as tranquilizer - face life in jail in many countries, death in others. Almost everywhere pot smokers are confronted with prison terms.

The "war on drugs" - one of the most expensive and protracted in history - has failed abysmally. Drugs are more abundant and cheaper than ever. The social costs have been staggering: the emergence of violent crime where none existed before, the destabilization of drug- producing countries, the collusion of drug traffickers with terrorists, and the death of millions - law enforcement agents, criminals, and users.

Few doubt that legalizing most drugs would have a beneficial effect. Crime empires would crumble overnight, users would be assured of the quality of the products they consume, and the addicted few would not be incarcerated or stigmatized - but rather treated and rehabilitated.

That soft, largely harmless, drugs continue to be illicit is the outcome of compounded political and economic pressures by lobby and interest groups of manufacturers of legal drugs, law enforcement agencies, the judicial system, and the aforementioned long list of those who benefit from the status quo.

Only a popular movement can lead to the decriminalization of the more innocuous drugs. But such a crusade should be part of a larger campaign to reverse the overall tide of criminalization. Many "crimes" should revert to their erstwhile status as civil torts. Others should be wiped off the statute books altogether. Hundreds of thousands should be pardoned and allowed to reintegrate in society, unencumbered by a past of transgressions against an inane and inflationary penal code.

This, admittedly, will reduce the leverage the state has today against its citizens and its ability to intrude on their lives, preferences, privacy, and leisure. Bureaucrats and politicians may find this abhorrent. Freedom loving people should rejoice.

APPENDIX - Should Drugs be Legalized?

The decriminalization of drugs is a tangled issue involving many separate moral/ethical and practical strands which can, probably, be summarized thus:

(a) Whose body is it anyway? Where do I start and the government begins? What gives the state the right to intervene in decisions pertaining only to my self and contravene them?

PRACTICAL:

The government exercises similar "rights" in other cases (abortion, military conscription, sex)

(b) Is the government the optimal moral agent, the best or the right arbiter, as far as drug abuse is concerned?

PRACTICAL:

For instance, governments collaborate with the illicit drug trade when it fits their realpolitik purposes.

(c) Is substance abuse a personal or a social choice? Can one limit the implications, repercussions and outcomes of one's choices in general and of the choice to abuse drugs, in particular? If the drug abuser in effect makes decisions for others, too - does it justify the intervention of the state? Is the state the agent of society, is it the only agent of society and is it the right agent of society in the case of drug abuse?

(d) What is the difference (in rigorous philosophical principle) between legal and illegal substances? Is it something in the nature of the substances? In the usage and what follows? In the structure of society? Is it a moral fashion?

PRACTICAL:

Does scientific research support or refute common myths and ethos regarding drugs and their abuse?

Is scientific research influenced by the current anti-drugs crusade and hype? Are certain facts suppressed and certain subjects left unexplored?

(e) Should drugs be decriminalized for certain purposes (e.g., marijuana and glaucoma)? If so, where should the line be drawn and by whom?

PRACTICAL:

Recreational drugs sometimes alleviate depression.

Should this use be permitted?

XIII. Begging Your Trust in Africa

The syntax is tortured, the grammar mutilated, but the message - sent by snail mail, telex, fax, or e-mail - is coherent: an African bigwig or his heirs wish to transfer funds amassed in years of graft and venality to a safe bank account in the West. They seek the recipient's permission to make use of his or her inconspicuous services for a percentage of the loot - usually many millions of dollars.

A fee is required to expedite the proceedings, or to pay taxes, or to bribe officials - they plausibly explain. A recent (2005) variant involves payment with expertly forged postal money orders for goods exported to a transit address.

It is a scam two decades old - and it still works. In September 2002, a bookkeeper for a Berkley, Michigan law firm embezzled \$2.1 million and wired it to various bank accounts in South Africa and Taiwan. Other victims were kidnapped for ransom as they traveled abroad to collect their "share". Some never made it back. Every year, there are 5 such murders as well as 8-10 snatchings of American citizens alone. The usual ransom demanded is half a million to a million dollars.

The scam is so widespread that the Nigerians saw fit to explicitly ban it in article 419 of their penal code. The Nigerian President, Olusegun Obasanjo castigated the fraudsters for inflicting "incalculable damage to Nigerian businesses" and for "placing the entire country under suspicion". "Wired" quotes statistics presented at the International Conference on Advance Fee (419) Frauds in New York on Sept. 17, 2002: "Roughly 1 percent of the millions of people who receive 419 e-mails and faxes are successfully scammed. Annual losses to the scam in the United States total more than \$100 million, and law enforcement officials believe global losses may total over \$1.5 billion".

According to the "IFCC 2001 Internet Fraud Report", published by the FBI and the National White Collar Crime Center, Nigerian letter fraud cases amount to 15.5 percent of all grievances. The Internet Fraud Complaint Center refers such rip-offs to the US Secret Service. While the median loss in all manner of Internet fraud was \$435 - in the Nigerian scam it was a staggering \$5575. But only one in ten successful crimes is reported, says the FBI's report.

The IFCC provides this advisory to potential targets: ? Be skeptical of individuals representing themselves as Nigerian or other foreign government officials asking for your help in placing large sums of money in overseas bank accounts. ? Do not believe the promise of large sums of money for your cooperation. ? Do not give out any personal information regarding your savings, checking, credit, or other financial accounts. ? If

you are solicited, do not respond and quickly notify the appropriate authorities.

The "419 Coalition" is more succinct and a lot more pessimistic: 1. "NEVER pay anything up front for ANY reason. 2. NEVER extend credit for ANY reason. 3. NEVER do ANYTHING until their check clears. 4. NEVER expect ANY help from the Nigerian Government. 5. NEVER rely on YOUR Government to bail you out".

The State Department's Bureau of International Narcotics and Law Enforcement Affairs published a brochure titled "Nigerian Advance Fee Fraud". It describes the history of this particular type of swindle: "AFF criminals include university-educated professionals who are the best in the world for nonviolent spectacular crimes. AFF letters first surfaced in the mid-1980s around the time of the collapse of world oil prices, which is Nigeria's main foreign exchange earner. Some Nigerians turned to crime in order to survive. Fraudulent schemes such as AFF succeeded in Nigeria, because Nigerian criminals took advantage of the fact that Nigerians speak English, the international language of business, and the country's vast oil wealth and natural gas reserves - ranked 13th in the world - offer lucrative business opportunities that attract many foreign companies and individuals".

According to London's Metropolitan Police Company Fraud Department, potential targets in the UK and the USA alone receive c. 1500 solicitations a week. The US Secret Service Financial Crime Division takes in 100 calls a day from Americans approached by the con-men. It now acknowledges that "Nigerian organized crime rings running fraud schemes through the mail and phone lines are now so large, they represent a serious financial threat to the country".

Sometimes even the stamps affixed to such letters are forged. Nigerian postal workers are known to be in cahoots with the fraudsters. Names and addresses are obtained from "trade journals, business directories, magazine and newspaper advertisements, chambers of commerce, and the Internet".

Victims are either too intimidated to complain or else reluctant to admit their collusion in money laundering and fraud. Others try in vain to recoup their losses by ploughing more money into the scheme.

Contrary to popular image, the scammers are often violent and involved in other criminal pursuits, such as drug trafficking, According to Nigeria's Drug Law Enforcement Agency. The blight has spread to other countries. Letters from Sierra Leone, Ghana, Congo, Liberia, Togo, Ivory Coast, Benin, Burkina Faso, South Africa, Taiwan, or even Canada, the United Kingdom, Oman, and Vietnam are not uncommon.

The dodges fall into a few categories.

Over-invoiced contract scams involve the ostensible transfer of amounts obtained through inflated invoices to the bank account of an unrelated foreign firm. Contract fraud or "trade default" is simply a bogus order accompanied by a fraudulent bank draft (or fake postal or other money order) for the products of an export company accompanied by demand for "samples" and various transaction "fees and charges".

Some of the rackets are plain outlandish. In the "wash- wash" confidence trick people have been known to pay up to \$200,000 for a special solution to remove stains from millions in defaced dollar notes. Others "bought" heavily "discounted" crude oil stored in "secret" locations - or real estate in rezoned locales. "Clearing houses" or "venture capital organizations" claiming to act on behalf of the Central Bank of Nigeria launder the proceeds of the scams.

In another twist, charities, academic institutions, nonprofit organizations, and religious groups are asked to pay the inheritances tax on a "donation". Some "dignitaries" and their relatives may seek to flee the country and ask the victims to advance the bribe money in return for a generous cut of the wealth they have stashed abroad. "Bankers" may find inactive accounts with millions of dollars - often in lottery winnings - waiting to be transferred to a safe off-shore haven. Bogus jobs with inflated wages are another ostensible way to defraud state- owned companies - as is the sale of the target's used vehicle to them for an extravagant price. There seems to be no end to criminal ingenuity.

Lately, the correspondence purports to be coming from - often white - disinterested professional third parties.

Accountants, lawyers, directors, trustees, security personnel, or bankers pretend to be acting as fiduciaries for the real dignitary in need of help. Less gullible victims are subjected to plain old extortion with verbal intimidation and stalking.

The more heightened public awareness grows with over- exposure and the tighter the net of international cooperation against the scam, the wilder the stories it spawns. Letters have surfaced recently signed by dying refugees, tsunami victims, survivors of the September 11 attacks, and serendipitous US commandos on mission in Afghanistan.

Governments throughout the world have geared up to protect their businessmen. The US Department of Commerce, for instance, publishes the "World Traders data Report", compiled by US embassy in Nigeria. It "provides the following types of information: types of organizations, year established, principal owners, size, product line, and financial and trade references".

Unilateral US activity, inefficacious collaboration with the Nigerian government some of whose officials are rumored to be in on the deals, multilateral efforts in the framework of the OECD and the Interpol, education and information campaigns - nothing seems to be working.

The treatment of 419 fraudsters in Nigeria is so lenient that, according to the "Nigeria Tribune", the United States threatened the country with sanctions if it does not considerably improve its record on financial crime by November 2002. Both the US Treasury's Financial Crime Enforcement Network (FINCEN) and the OECD's Financial Action Task Force (FATF) had characterized the country as "one of the worst perpetrators of

financial crimes in the world". The Nigerian central bank promises to get to grips with this debilitating problem.

Nigerian themselves - though often victims of the scams - take the phenomenon in stride. The Nigerian "Daily Champion", proffered this insightful apologia on behalf of the ruthless and merciless 419 gangs. It is worth quoting at length: "To eradicate the 419 scourge, leaders at all levels should work assiduously to create employment opportunities and people perception of the leaders as role models. The country's very high unemployment figure has made nonsense of the so-called democracy dividends. Great majority of Nigerian youthful school leaver's including University graduates, are without visible means of livelihood... The fact remains that most of these teeming youths cannot just watch our so-called leaders siphon their God-given wealthy. So, they resorted to alternative fraudulent means of livelihood called 419, at least to be seen as have arrived... Some of these 419ers are in the National Assembly and the State Houses of Assembly while some surround the President and governors across the country".

Some swindlers seek to glorify their criminal activities with a political and historical context. The Web site of the "419 Coalition" contains letters casting the scam as a form of forced reparation for slavery, akin to the compensation paid by Germany to survivors of the holocaust. The confidence tricksters boast of defrauding the "white civilization" and unmasking the falsity of its claims for superiority. But a few delusional individuals aside, this is nothing but a smokescreen.

Greed outweighs fear and avarice enmeshes people in clearly criminal enterprises. The "victims" of advance fee scams are rarely incognizant of their alleged role. They knowingly and intentionally collude with self-professed criminals to fleece governments and institutions. This is one of the rare crimes where prey and perpetrator may well deserve each other.

XIV. Organ Trafficking in Eastern Europe

A kidney fetches \$2700 in Turkey. According to the October 2002 issue of the Journal of the American Medical Association, this is a high price. An Indian or Iraqi kidney enriches its former owner by a mere \$1000.

Wealthy clients later pay for the rare organ up to \$150,000.

CBS News aired, five years ago, a documentary, filmed by Antenna 3 of Spain, in which undercover reporters in Mexico were asked, by a priest acting as a middleman for a doctor, to pay close to 1 million dollars for a single kidney. An auction of a human kidney on eBay in February 2000 drew a bid of \$100,000 before the company put a stop to it. Another auction in September 1999 drew \$5.7 million - though, probably, merely as a prank.

Organ harvesting operations flourish in Turkey, in central Europe, mainly in the Czech Republic, and in the Caucasus, mainly in Georgia. They operate on Turkish, Moldovan, Russian, Ukrainian, Belarusian, Romanian, Bosnian, Kosovar, Macedonian, Albanian and assorted east European donors.

They remove kidneys, lungs, pieces of liver, even corneas, bones, tendons, heart valves, skin and other sellable human bits. The organs are kept in cold storage and air lifted to illegal distribution centers in the United States, Germany, Scandinavia, the United Kingdom, Israel, South Africa, and other rich, industrialized locales. It gives "brain drain" a new, spine chilling, meaning.

Organ trafficking has become an international trade. It involves Indian, Thai, Philippine, Brazilian, Turkish and Israeli doctors who scour the Balkan and other destitute regions for tissues. The Washington Post reported, in November 2002, that in a single village in Moldova, 14 out of 40 men were reduced by penury to selling body parts.

Four years ago, Moldova cut off the thriving baby adoption trade due to an - an unfounded - fear the toddlers were being dissected for spare organs. According to the Israeli daily, Ha'aretz, the Romanians are investigating similar allegations in Israel and have withheld permission to adopt Romanian babies from dozens of eager and out of pocket couples. American authorities are scrutinizing a two year old Moldovan harvesting operation based in the United States.

Organ theft and trading in Ukraine is a smooth operation.

According to news agencies, in August 2002, three Ukrainian doctors were charged in Lvov with trafficking in the organs of victims of road accidents. The doctors used helicopters to ferry kidneys and livers to colluding hospitals. They charged up to \$19,000 per organ.

The West Australian daily surveyed in January 2002 the thriving organs business in Bosnia-Herzegovina. Sellers are offering their wares openly, through newspaper ads.

Prices reach up to \$68,000. Compared to an average monthly wage of less than \$200, this is an unimaginable fortune.

National health insurance schemes turn a blind eye.

Israel's participates in the costs of purchasing organs abroad, though only subject to rigorous vetting of the sources of the donation. Still, a May 2001 article in the New York Times Magazine, quotes "the coordinator

of kidney transplantation at Hadassah University Hospital in Jerusalem (as saying that) 60 of the 244 patients currently receiving post-transplant care purchased their new kidney from a stranger - just short of 25 percent of the patients at one of Israel's largest medical centers participating in the organ business".

Many Israelis - attempting to avoid scrutiny - travel to east Europe, accompanied by Israeli doctors, to perform the transplantation surgery. These junkets are euphemistically known as "transplant tourism". Clinics have sprouted all over the benighted region. Israeli doctors have recently visited impoverished Macedonia, Bulgaria, Kosovo and Yugoslavia to discuss with local businessmen and doctors the setting up of kidney transplant clinics.

Such open involvement in what can be charitably described as a latter day slave trade gives rise to a new wave of thinly disguised anti-Semitism. The Ukrainian Echo, quoting the Ukrinform news agency, reported, on January 7, 2002, that, implausibly, a Ukrainian guest worker died in Tel-Aviv in mysterious circumstances and his heart was removed. The Interpol, according to the paper, is investigating this lurid affair.

According to scholars, reports of organ thefts and related abductions, mainly of children, have been rife in Poland and Russia at least since 1991. The buyers are supposed to be rich Arabs.

Nancy Scheper-Hughes, an anthropologist at the University of California at Berkeley and co-founder of Organs Watch, a research and documentation center, is also a member and co-author of the Bellagio Task Force Report on Transplantation, Bodily Integrity and the International Traffic in Organs. In a report presented in June 2001 to the House Subcommittee on International Operations and Human Rights, she substantiated at least the nationality of the alleged buyers, though not the urban legends regarding organ theft:

"In the Middle East residents of the Gulf States (Kuwait, Saudi Arabia, and Oman) have for many years traveled to India, the Philippines, and to Eastern Europe to purchase kidneys made scarce locally due to local fundamentalist Islamic teachings that allow organ transplantation (to save a life), but prohibit organ harvesting from brain-dead bodies.

Meanwhile, hundreds of kidney patients from Israel, which has its own well-developed, but under-used transplantation centers (due to ultra-orthodox Jewish reservations about brain death) travel in 'transplant tourist' junkets to Turkey, Moldova, Romania where desperate kidney sellers can be found, and to Russia where an excess of lucrative cadaveric organs are produced due to lax standards for designating brain death, and to South Africa where the amenities in transplantation clinics in private hospitals can resemble four star hotels.

We found in many countries - from Brazil and Argentina to India, Russia, Romania, Turkey to South Africa and parts of the United States - a kind of 'apartheid medicine' that divides the world into two distinctly different populations of 'organs supplies' and 'organs receivers'."

Russia, together with Estonia, China and Iraq, is, indeed, a major harvesting and trading centre. International news agencies described, five years ago, how a grandmother in Ryazan tried to sell her grandchild to a mediator. The boy was to be smuggled to the West and there dismembered for his organs. The uncle, who assisted in the matter, was supposed to collect \$70,000 - a fortune in Russian terms.

When confronted by the European Union on this issue, Russia responded that it lacks the resources required to monitor organ donations. The Italian magazine, Happy Web, reports that organ trading has taken to the Internet.

A simple query on the Google search engine yields thousands of Web sites purporting to sell various body parts - mostly kidneys - for up to \$125,000. The sellers are Russian, Moldovan, Ukrainian and Romanian.

Scheper-Hughes, an avid opponent of legalizing any form of trade in organs, says that "in general, the movement and flow of living donor organs - mostly kidneys - is from South to North, from poor to rich, from black and brown to white, and from female to male bodies".

Yet, in the summer of 2002, bowing to reality, the American Medical Association commissioned a study to examine the effects of paying for cadaveric organs would have on the current shortage. The 1984 National Organ Transplant Act that forbids such payments is also under attack. Bills to amend it were submitted recently by several Congressmen. These are steps in the right direction.

Organ trafficking is the outcome of the international ban on organ sales and live donor organs. But wherever there is demand there is a market. Excruciating poverty of potential donors, lengthening patient waiting lists and the better quality of organs harvested from live people make organ sales an irresistible proposition. The medical professions and authorities everywhere would do better to legalize and regulate the trade rather than transform it into a form of organized crime. The denizens of Moldova would surely appreciate it.

XV. Selling Arms to Rogue States

Also Read Russian Roulette - The Security Apparatus

In a desperate bid to fend off sanctions, the Bosnian government banned yesterday all trade in arms and munitions. A local, Serb-owned company was documented by the State Department selling spare parts and

maintenance for military aircraft to Iraq via Yugoslav shell companies.

Heads rolled. In the Republika Srpska, the Serb component of the ramshackle Bosnian state, both the Defense Minister Slobodan Bilic and army Chief of Staff Novica Simic resigned. Another casualty was the general director of the Orao Aircraft Institute of Bijeljina - Milan Prica. On the Yugoslav side, Jugoinport chief Gen Jovan Cekovic and federal Deputy Defense Minister Ivan Djokic stood down.

Bosnia's is only the latest in a series of embarrassing disclosures in practically every country of the former eastern bloc, including all the EU accession candidates.

With the crumbling of the Warsaw pact and the economies of the region, millions of former military and secret service operators resorted to peddling weapons and martial expertise to rogue states, terrorist outfits, and organized crime. The confluence - and, lately, convergence - of these interests is threatening Europe's very stability.

Last week, the Polish "Rzeczpospolita" accused the Military Information services (WSI) of illicit arms sales between 1992-6 through both private and state-run entities. The weapons were plundered from the Polish army and sold at half price to Croatia and Somalia, both under UN arms embargo.

Deals were struck with the emerging international operations of the Russian mafia. Terrorist middlemen and Latvian state officials were involved. Breaching Poland's democratic veneer, the Polish Ministry of Defense threatened to sue the paper for disclosing state secrets.

Police in Lodz is still investigating the alarming disappearance of 4 Arrow anti-aircraft missiles from a train transporting arms from a factory to the port of Gdansk, to be exported. The private security escort claim innocence.

The Czech Military Intelligence Services (VZS) have long been embroiled in serial scandals. The Czech defense attaché to India, Miroslav Kvasnak, was recently fired for disobeying explicit orders from the minister of defense.

According to Jane's, Kvasnak headed URNA - the elite anti-terrorist unit of the Czech National Police. He was sacked in 1995 for selling Semtex, the notorious Czech plastic explosive, as well as weapons and munitions to organized crime gangs.

In late August, the Czechs arrested arms traffickers, members of an international ring, for selling Russian weapons - including, incredibly, tanks, fighter planes, naval vessels, long range rockets, and missile platforms - to Iraq. The operation has lasted 3 years and was conducted from Prague.

According to the "Wall Street Journal", the Czech intelligence services halted the sale of \$300 million worth of the Tamara radar systems to Iraq in 1997. Czech firms, such as Agroplast, a leading waste processing company, have often been openly accused of weapons smuggling. "The Guardian" tracked in February a delivery of missiles and guidance systems from the Czech Republic through Syria to Iraq.

German go-betweens operate in the Baltic countries. In May a sale of more than two pounds of the radioactive element cesium-137 was thwarted in Vilnius, the capital of Lithuania. The substance was sold to terrorist groups bent on producing a "dirty bomb", believe US officials quoted by "The Guardian". The Director of the CIA, John Deutsch, testified in Congress in 1996 about previous cases in Lithuania involving two tons of radioactive wolfram and 220 pounds of uranium-238.

Still, the epicenters of the illicit trade in weapons are in the Balkan, in Russia, and in the republics of the former Soviet Union. Here, domestic firms intermesh with Western intermediaries, criminals, terrorists, and state officials to engender a pernicious, ubiquitous and malignant web of smuggling and corruption.

According to the Center for Public Integrity and the Western media, over the last decade, renegade Russian army officers have sold weapons to every criminal and terrorist organization in the world - from the IRA to al-Qaida and to every failed state, from Liberia to Libya.

They are protected by well-connected, bribe-paying, arms dealers and high-level functionaries in every branch of government. They launder the proceeds through Russian oil multinationals, Cypriot, Balkan, and Lebanese banks, and Asian, Swiss, Austrian, and British trading conglomerates - all obscurely owned and managed.

The most serious breach of the united international front against Iraq may be the sale of the \$100 million anti-stealth Ukrainian Kolchuga radar to the pariah state two years ago. Taped evidence suggests that president Leonid Kuchma himself instructed the General Director of the Ukrainian arms sales company, UkrSpetzExport, Valery Malev to conclude the deal. Malev died in a mysterious car accident on March 6, three days after his taped conversation with Kuchma surfaced.

The Ukrainians insist that they were preempted by Russian dealers who sold a similar radar system to Iraq - but this is highly unlikely as the Russian system was still in development at the time. The American and British are currently conducting a high-profile investigation in Kyiv.

In Russia, illegal arms are traded mainly by the Western Group of Forces in cahoots with private companies, both domestic and foreign. The Air Defense Army specializes in selling light arms. The army is the main source of weapons - plastic explosives, grenade launchers, munitions - of both Chechen rebels and Chechen criminals. Contrary to received opinion, volunteer-soldiers, not conscripts, control the arms trade. The state itself is involved in arms proliferation. Sales to China and Iran were long classified. From June, all sales of materiel enjoy "state secret" status.

There is little the US can do. The Bush administration has imposed in May sanctions on Armenian and

Moldovan companies, among others, for aiding and abetting Iran's efforts to obtain weapons of mass destruction. Armenian president, Robert Kocharian, indignantly denied knowledge of such transactions and vowed to get to the bottom of the American allegations.

The Foreign Policy Research Institute, quoted by Radio Free Europe/Radio Liberty, described a "Department of Energy (DOE) initiative, underway since 1993, to improve 'material protection, control and accountability' at former Soviet nuclear enterprises. The program enjoys substantial bipartisan support in the United States and is considered the first line of defense against unwanted proliferation episodes."

"As of February 2000, more than 8 years after the collapse of the USSR, new security systems had been installed at 113 buildings, most of them in Russia; however, these sites contained only 7 percent of the estimated 650 tons of weapons-usable material considered at risk for theft or diversion. DOE plans call for safeguarding 60 percent of the material by 2006 and the rest in 10 to 15 years or longer".

Russian traders learned to circumvent official channels and work through Belarus. Major General Stsyapan Sukharenka, the first deputy chief of the Belarusian KGB, denied, in March, any criminal arms trading in his country. This vehement protest is gainsaid by the preponderance of Belarusian arms traders replete with fake end-user certificates in Croatia during the Yugoslav wars of secession (1992-5).

Deputy Assistant Secretary of State Steven Pifer said that UN inspectors unearthed Belarusian artillery in Iraq in 1996. Iraqis are also being trained in Belarus to operate various advanced weapons systems. The secret services and armies of Ukraine, Russia, and even Romania use Belarus to mask the true origin of weapons sold in contravention of UN sanctions.

Western arms manufacturers lobby their governments to enhance their sales. Legitimate Russian and Ukrainian sales are often thwarted by Western political arm-twisting.

When Macedonia, in the throes of a civil war it was about to lose, purchased helicopter gunships from Ukraine, the American Embassy leaned on the government to annul the contracts and threatened to withhold aid and credits if it does not succumb.

The duopoly, enjoyed by the USA and Russia, forces competitors to go underground and to seek rogue or felonious customers. Yugoslav scientists, employed by Jugoinport and other firms run by former army officers, are developing cruise missiles for Iraq, alleges the American administration. The accusation, though, is dubious as Iraq has no access to satellites to guide such missiles.

Another Yugoslav firm, Brunner, constructed a Libyan rocket propellant manufacturing facility. In an interview to the "Washington Post", Yugoslavia's president Vojislav Kostunica brushed off the American complaints about, as he put it disdainfully, "overhauling older-generation aircraft engines".

Such exploits are not unique to Yugoslavia or Bosnia. The Croat security services are notorious for their collusion in drug and arms trafficking, mainly via Hungary.

Macedonian construction companies collaborate with manufacturers of heavy machinery and purveyors of missile technology in an effort to recoup hundreds of millions of dollars in Iraqi debts. Albanian crime gangs collude with weapon smugglers based in Montenegro and Kosovo. The Balkan - from Greece to Hungary - is teeming with these penumbral figures.

Arms smuggling is a by-product of criminalized societies, destitution, and dysfunctional institutions. The prolonged period of failed transition in countries such as Yugoslavia, Macedonia, Bosnia, Moldova, Belarus, and Ukraine has entrenched organized crime. It now permeates every legitimate economic sphere and every organ of the state.

Whether this situation is reversible is the subject of heated debate. But it is the West which pays the price in increased crime rates and, probably in Iraq, in added fatalities once it launches war against that murderous regime.

XVI. The Industrious Spies

By: Dr. Sam Vaknin Also published by United Press International (UPI)

The Web site of GURPS (Generic Universal Role Playing System) lists 18 "state of the art equipments (sic) used for advanced spying". These include binoculars to read lips, voice activated bugs, electronic imaging devices, computer taps, electromagnetic induction detectors, acoustic stethoscopes, fiber optic scopes, detectors of acoustic emissions (e.g., of printers), laser mikes that can decipher and amplify voice-activated vibrations of windows, and other James Bond gear.

Such contraptions are an integral part of industrial espionage. The American Society for Industrial Security (ASIC) estimated a few years ago that the damage caused by economic or commercial espionage to American industry between 1993-5 alone was c. \$63 billion.

The average net loss per incident reported was \$19 million in high technology, \$29 million in services, and \$36 million in manufacturing. ASIC then upped its estimate to \$300 billion in 1997 alone - compared to \$100 billion assessed by the 1995 report of the White House Office of Science and Technology.

This figures are mere extrapolations based on anecdotal tales of failed espionage. Many incidents go

unreported.

In his address to the 1998 World Economic Forum, Frank Ciluffo, Deputy Director of the CSIS Global Organized Crime Project, made clear why: "The perpetrators keep quiet for obvious reasons. The victims do so out of fear. It may jeopardize shareholder and consumer confidence. Employees may lose their jobs.

It may invite copycats by inadvertently revealing vulnerabilities. And competitors may take advantage of the negative publicity. In fact, they keep quiet for all the same reasons corporations do not report computer intrusions".

Interactive Television Technologies complained - in a press release dated August 16, 1996 - that someone broke into its Amherst, NY, offices and stole "three computers containing the plans, schematics, diagrams and specifications for the BUTLER, plus a number of computer disks with access codes." BUTLER is a proprietary technology which helps connect television to computer networks, such as the Internet. It took four years to develop.

In a single case, described in the Jan/Feb 1996 issue of "Foreign Affairs", Ronald Hoffman, a software scientist, sold secret applications developed for the Strategic Defense Initiative to Japanese corporations, such as Nissan Motor Company, Mitsubishi Electric, Mitsubishi Heavy Industries, and Ishikawajima-Harima Heavy Industries. He was caught in 1992, having received \$750,000 from his "clients", who used the software in their civilian aerospace projects.

Canal Plus Technologies, a subsidiary of French media giant Vivendi, filed a lawsuit last March against NDS, a division of News Corp. Canal accused NDS of hacking into its pay TV smart cards and distributing the cracked codes freely on a piracy Web site. It sued NDS for \$1.1 billion in lost revenues. This provided a rare glimpse into information age, hacker-based, corporate espionage tactics.

Executives of publicly traded design software developer Avant! went to jail for purchasing batches of computer code from former employees of Cadence in 1997.

Reuters Analytics, an American subsidiary of Reuters Holdings, was accused in 1998 of theft of proprietary information from Bloomberg by stealing source codes from its computers.

In December 2001, Say Lye Ow, a Malaysian subject and a former employee of Intel, was sentenced to 24 months in prison for illicitly copying computer files containing advanced designs of Intel's Merced (Itanium) microprocessor. It was the crowning achievement of a collaboration between the FBI's High-Tech squad and the US Attorney's Office CHIP - Computer Hacking and Intellectual Property - unit.

U.S. Attorney David W. Shapiro said: "People and companies who steal intellectual property are thieves just as bank robbers are thieves. In this case, the Itanium microprocessor is an extremely valuable product that took Intel and HP years to develop. These cases should send the message throughout Silicon Valley and the Northern District that the U.S. Attorney's Office takes seriously the theft of intellectual property and will prosecute these cases to the full extent of the law".

Yet, such cases are vastly more common than publicly acknowledged. "People have struck up online friendships with employers and then lured them into conspiracy to commit espionage.

People have put bounties on laptops of executives. People have disguised themselves as janitors to gain physical access," Richard Power, editorial director of the Computer Security Institute told MSNBC.

Marshall Phelps, IBM Vice President for Commercial and Industry Relations admitted to the Senate Judiciary Committee as early as April 1992: "Among the most blatant actions are outright theft of corporate proprietary assets. Such theft has occurred from many quarters: competitors, governments seeking to bolster national industrial champions, even employees.

Unfortunately, IBM has been the victim of such acts".

Raytheon, a once thriving defense contractor, released "SilentRunner", a \$25,000-65,000 software package designed to counter the "insider threat". Its brochure, quoted by "Wired", says: "We know that 84 percent of your network threats can be expected to come from inside your organization.... This least intrusive of all detection systems will guard the integrity of your network against abuses from unauthorized employees, former employees, hackers or terrorists and competitors".

This reminds many of the FBI's Carnivore massive network sniffer software. It also revives the old dilemma between privacy and security. An Omni Consulting survey of 3200 companies worldwide pegged damage caused by insecure networks at \$12 billion.

There is no end to the twists and turns of espionage cases and to the creativity shown by the perpetrators.

On June 2001 an indictment was handed down against Nicholas Daddona. He stands accused of a unique variation on the old theme of industrial espionage: he was employed by two firms - transferring trade secrets from one (Fabricated Metal Products) to the other (Eyelet).

Jungsheng Wang was indicted last year for copying the architecture of the Sequoia ultrasound machine developed by Acuson Corporation. He sold it to Bell Imaging, a Californian company which, together with a Chinese firm, owns a mainland China corporation, also charged in the case. The web of collaboration between foreign - or foreign born - scientists with access to trade and technology secrets, domestic corporations and foreign firms, often a cover for government interests - is clearly exposed here.

Kenneth Cullen and Bruce Zak were indicted on April 2001 for trying to purchase a printed or text version of the source code of a computer application for the processing of health care benefit claim forms developed by ZirMed.

The legal status of printed source code is unclear. It is undoubtedly intellectual property - but of which kind? Is it software or printed matter? Peter Morch, a senior R&D team leader for CISCO was accused on March 2001 for simply burning onto compact discs all the intellectual property he could lay his hands on with the intent of using it in his new workplace, Calix Networks, a competitor of CISCO.

Perhaps the most bizarre case involves Fausto Estrada. He was employed by a catering company that served the private lunches to Mastercard's board of directors. He offered to sell Visa proprietary information that he claimed to have stolen from Mastercard. In a letter signed "Cagliostro", Fausto demanded \$1 million. He was caught red-handed in an FBI sting operation on February 2001.

Multinationals are rarely persecuted even when known to have colluded with offenders. Steven Louis Davis pleaded guilty on January 1998 to stealing trade secrets and designs from Gillette and selling them to its competitors, such as Bic Corporation, American Safety Razor, and Warner Lambert. Yet, it seems that only he paid the price for his misdeeds - 27 months in prison. Bic claims to have immediately informed Gillette of the theft and to have collaborated with Gillette's Legal Department and the FBI.

Nor are industrial espionage or the theft of intellectual property limited to industry. Mayra Justine Trujillo-Cohen was sentenced on October 1998 to 48 months in prison for stealing proprietary software from Deloitte-Touche, where she worked as a consultant, and passing it for its own.

Carroll Lee Campbell, the circulation manager of Gwinette Daily Post (GDP), offered to sell proprietary business and financial information of his employer to lawyers representing a rival paper locked in bitter dispute with GDP.

Nor does industrial espionage necessarily involve clandestine, cloak and dagger, operations. The Internet and information technology are playing an increasing role.

In a bizarre case, Caryn Camp developed in 1999 an Internet-relationship with a self-proclaimed entrepreneur, Stephen Martin. She stole her employer's trade secrets for Martin in the hope of attaining a senior position in Martin's outfit - or, at least, of being richly rewarded.

Camp was exposed when she mis-addressed an e-mail expressing her fears - to a co-worker.

Steven Hallstead and Brian Pringle simply advertised their wares - designs of five advanced Intel chips - on the Web.

They were, of course, caught and sentenced to more than 5 years in prison. David Kern copied the contents of a laptop inadvertently left behind by a serviceman of a competing firm. Kern trapped himself. He was forced to plead the Fifth Amendment during his deposition in a civil lawsuit he filed against his former employer. This, of course, provoked the curiosity of the FBI.

Stolen trade secrets can spell the difference between extinction and profitability. Jack Shearer admitted to building an \$8 million business on trade secrets pilfered from Caterpillar and Solar Turbines.

United States Attorney Paul E. Coggins stated: "This is the first EEA case in which the defendants pled guilty to taking trade secret information and actually converting the stolen information into manufactured products that were placed in the stream of commerce. The sentences handed down today (June 15, 2000) are among the longest sentences ever imposed in an Economic Espionage case".

Economic intelligence gathering - usually based on open sources - is both legitimate and indispensable. Even reverse engineering - disassembling a competitor's products to learn its secrets - is a grey legal area. Spying is different. It involves the purchase or theft of proprietary information illicitly. It is mostly committed by firms. But governments also share with domestic corporations and multinationals the fruits of their intelligence networks.

Former - and current - intelligence operators (i.e., spooks), political and military information brokers, and assorted shady intermediaries - all switched from dwindling Cold War business to the lucrative market of "competitive intelligence".

US News and World Report described on May 6, 1996, how a certain Mr. Kota - an alleged purveyor of secret military technology to the KGB in the 1980's - conspired with a scientist, a decade later, to smuggle biotechnologically modified hamster ovaries to India.

This transition fosters international tensions even among allies. "Countries don't have friends - they have interests!" - screamed a DOE poster in the mid-nineties. France has vigorously protested US spying on French economic and technological developments - until it was revealed to be doing the same. French relentless and unscrupulous pursuit of purloined intellectual property in the USA is described in Peter Schweizer's "Friendly Spies: How America's Allies Are Using Economic Espionage to Steal Our Secrets." "Le Mond" reported back in 1996 about intensified American efforts to purchase from French bureaucrats and legislators information regarding France's WTO, telecommunications, and audio-visual policies. Several CIA operators were expelled.

Similarly, according to Robert Dreyfuss in the January 1995 issue of "Mother Jones", Non Official Cover (NOC) CIA operators - usually posing as businessmen - are stationed in Japan. These agents conduct economic and technological espionage throughout Asia, including in South Korea and China.

Even the New York Times chimed in, accusing American intelligence agents of assisting US trade negotiators by eavesdropping on Japanese officials during the car imports row in 1995. And President Clinton admitted openly that intelligence gathered by the CIA regarding the illegal practices of French competitors allowed American aerospace firms to win multi-billion dollar contracts in Brazil and Saudi Arabia.

The respected German weekly, Der Spiegel, castigated the USA, in 1990, for arm-twisting the Indonesian government into splitting a \$200 million satellite contract between the Japanese NEC and US manufacturers. The American, alleged the magazines, intercepted messages pertaining to the deal, using the infrastructure of the National Security Agency (NSA). Brian Gladwell, a former NATO computer expert, calls it "state-sponsored information piracy".

Robert Dreyfuss, writing in "Mother Jones", accused the CIA of actively gathering industrial intelligence (i.e., stealing trade secrets) and passing them on to America's Big Three carmakers. He quoted Clinton administration officials as saying: "(the CIA) is a good source of information about the current state of technology in a foreign country ... We've always managed to get intelligence to the business community. There is contact between business people and the intelligence community, and information flows both ways, informally".

A February 1995 National Security Strategy statement cited by MSNBC declared: "Collection and analysis can help level the economic playing field by identifying threats to U.S. companies from foreign intelligence services and unfair trading practices".

The Commerce Department's Advocacy Center solicits commercial information thus: "Contracts pursued by foreign firms that receive assistance from their home governments to pressure a customer into a buying decision; unfair treatment by government decision-makers, preventing you from a chance to compete; tenders tied up in bureaucratic red tape, resulting in lost opportunities and unfair advantage to a competitor. If these or any similar export issues are affecting your company, it's time to call the Advocacy Center".

And then, of course, there is Echelon.

Exposed two years ago by the European Parliament in great fanfare, this telecommunications interception network, run by the US, UK, New Zealand, Australia, and Canada has become the focus of bitter mutual recriminations and far flung conspiracy theories.

These have abated following the brutal terrorist attacks of September 11 when the need for Echelon-like system with even laxer legal control was made abundantly clear.

France, Russia, and 28 other nations operate indigenous mini-Echelons, their hypocritical protestations to the contrary notwithstanding.

But, with well over \$600 billion a year invested in easily pilfered R&D, the US is by far the prime target and main victim of such activities rather than their chief perpetrator.

The harsh - and much industry lobbied - "Economic Espionage (and Protection of Proprietary Economic Information) Act of 1996" defines the criminal offender thus: "Whoever, intending or knowing that the offense will benefit any foreign government, foreign instrumentality, or foreign agent, knowingly" and "whoever, with intent to convert a trade secret, that is related to or included in a product that is produced for or placed in interstate or foreign commerce, to the economic benefit of anyone other than the owner thereof, and intending or knowing that the offense will , injure any owner of that trade secret": "(1) steals, or without authorization appropriates, takes, carries away, or conceals, or by fraud, artifice, or deception obtains a trade secret (2) without authorization copies, duplicates, sketches, draws, photographs, downloads, uploads, alters, destroys, photocopies, replicates, transmits, delivers, sends, mails, communicates, or conveys a trade secret (3) receives, buys, or possesses a trade secret, knowing the same to have been stolen or appropriated, obtained, or converted without authorization (4) attempts to commit any offense described in any of paragraphs (1) through (3); or (5) conspires with one or more other persons to commit any offense described in any of paragraphs (1) through (4), and one or more of such persons do any act to effect the object of conspiracy".

Other countries either have similar statutes (e.g., France) - or are considering to introduce them. Taiwan's National Security Council has been debating a local version of an economic espionage law lat month. There have been dozens of prosecutions under the law hitherto. Companies - such as "Four Pillars" which stole trade secrets from Avery Dennison - paid fines of millions of US dollars.

Employees - such as PPG's Patrick Worthing - and their accomplices were jailed.

Foreign citizens - like the Taiwanese Kai-Lo Hsu and Prof. Charles Ho from National Chiao Tung university - were detained. Mark Halligan of Welsh and Katz in Chicago lists on his Web site more than 30 important economic espionage cases tried under the law by July last year.

The Economic Espionage law authorizes the FBI to act against foreign intelligence gathering agencies toiling on US soil with the aim of garnering proprietary economic information. During the Congressional hearings that preceded the law, the FBI estimated that no less that 23 governments, including the Israeli, French, Japanese, German, British, Swiss, Swedish, and Russian, were busy doing exactly that. Louis Freeh, the former director of the FBI, put it succinctly: "Economic Espionage is the greatest threat to our national security since the Cold War".

The French Ministry of Foreign Affairs runs a program which commutes military service to work at high tech US firms. Program-enrolled French computer engineers were arrested attempting to steal proprietary source codes from their American employers.

In an interview he granted to the German ZDF Television quoted by "Daily Yomiuri" and Netsafe, the former Director of the French foreign counterintelligence service, the DGSE, freely confessed: "...All secret services of the big democracies undertake economic espionage ... Their role is to peer into hidden corners and in that context business plays an important part ... In France the state is not just responsible for the laws, it is also an entrepreneur. There are state-owned and semi-public companies. And that is why it is correct that

for decades the French state regulated the market with its right hand in some ways and used its intelligence service with its left hand to furnish its commercial companies ... It is among the tasks of the secret services to shed light on and analyze the white, grey and black aspects of the granting of such major contracts, particularly in far-off countries".

The FBI investigated 400 economic espionage cases in 1995 - and 800 in 1996. It interfaces with American corporations and obtains investigative leads from them through its 26 years old Development of Espionage, Counterintelligence, and Counter terrorism Awareness (DECA) Program renamed ANSIR (Awareness of National Security Issues and Response). Every local FBI office has a White Collar Crime squad in charge of thwarting industrial espionage. The State Department runs a similar outfit called the Overseas Security Advisory Council (OSAC).

These are massive operations. In 1993-4 alone, the FBI briefed well over a quarter of a million corporate officers in more than 20,000 firms. By 1995, OSAC collaborated on overseas security problems with over 1400 private enterprises. "Country Councils", comprised of embassy official and private American business, operate in dozens of foreign cities. They facilitate the exchange of timely "unclassified" and threat-related security information.

More than 1600 US companies and organization are currently permanently affiliated with OSAC. Its Advisory Council is made up of twenty-one private sector and four public sector member organizations that, according to OSAC, "represent specific industries or agencies that operate abroad. Private sector members serve for two to three years. More than fifty U.S. companies and organizations have already served on the Council.

Member organizations designate representatives to work on the Council.

These representatives provide the direction and guidance to develop programs that most benefit the U.S. private sector overseas. Representatives meet quarterly and staff committees tasked with specific projects. Current committees include Transnational Crime, Country Council Support, Protection of Information and Technology, and Security Awareness and Education".

But the FBI is only one of many agencies that deal with the problem in the USA. The President's Annual Report to Congress on "Foreign Economic Collection and Industrial Espionage" dated July 1995, describes the multiple competitive intelligence (CI) roles of the Customs Service, the Department of Defense, the Department of Energy, and the CIA.

The federal government alerts its contractors to CI threats and subjects them to "awareness programs" under the DOD's Defense Information Counter Espionage (DICE) program. The Defense Investigative Service (DIS) maintains a host of useful databases such as the Foreign Ownership, Control, or Influence (FOCI) register. It is active otherwise as well, conducting personal security interviews by industrial security representatives and keeping tabs on the foreign contacts of security cleared facilities. And the list goes on.

According to the aforementioned report to Congress: "The industries that have been the targets in most cases of economic espionage and other collection activities include biotechnology; aerospace; telecommunications, including the technology to build the 'information superhighway'; computer software/hardware; advanced transportation and engine technology; advanced materials and coatings, including 'stealth' technologies; energy research; defense and armaments technology; manufacturing processes; and semiconductors. Proprietary business information-that is, bid, contract, customer, and strategy in these sectors is aggressively targeted. Foreign collectors have also shown great interest in government and corporate financial and trade data".

The collection methods range from the traditional - agent recruitment and break ins - to the technologically fantastic. Mergers, acquisitions, joint ventures, research and development partnerships, licensing and franchise agreements, friendship societies, international exchange programs, import-export companies - often cover up for old fashioned reconnaissance. Foreign governments disseminate disinformation to scare off competitors - or lure them into well-set traps.

Foreign students, foreign employees, foreign tourist guides, tourists, immigrants, translators, affable employees of NGO's, eager consultants, lobbyists, spin doctors, and mock journalists are all part of national concerted efforts to prevail in the global commercial jungle. Recruitment of traitors and patriots is at its peak in international trade fairs, air shows, sabbaticals, scientific congresses, and conferences.

On May 2001, Takashi Okamoto and Hiroaki Serizwa were indicted of stealing DNA and cell line reagents from Lerner Research Institute and the Cleveland Clinic Foundation. This was done on behalf of the Institute of Physical and Chemical Research (RIKEN) in Japan - an outfit 94 funded by the Japanese government. The indictment called RIKEN "an instrumentality of the government of Japan".

The Chinese Ministry of Posts and Telecommunications was involved on May 2001 in an egregious case of theft of intellectual property. Two development scientists of Chinese origin transferred the PathStar Access Server technology to a Chinese corporation owned by the ministry. The joint venture it formed with the thieves promptly came out with its own product probably based on the stolen secrets.

The following ad appeared in the Asian Wall Street Journal in 1991 - followed by a contact phone number in western Europe: "Do you have advanced/privileged information of any type of project/contract that is going to be carried out in your country? We hold commission/agency agreements with many large European companies and could introduce them to your project/contract. Any commission received would be shared with yourselves".

Ben Venzke, publisher of Intelligence Watch Report, describes how Mitsubishi filed c. 1500 FOIA (Freedom of Information Act) requests in 1987 alone, in an effort to enter the space industry. The US Patent office is another great source of freely available proprietary information.

Industrial espionage is not new. In his book, "War by Other Means: Economic Espionage in America", The Wall Street Journal's John Fialka, vividly describes how Frances Cabot Lowell absconded from Britain with the plans for the cutting edge Cartwright loom in 1813.

Still, the phenomenon has lately become more egregious and more controversial. As Cold War structures - from NATO to the KGB and the CIA - seek to redefine themselves and to assume new roles and new functions, economic espionage offers a tempting solution.

Moreover, decades of increasing state involvement in modern economies have blurred the traditional demarcation between the private and the public sectors.

Many firms are either state-owned (in Europe) or state-financed (in Asia) or sustained by state largesse and patronage (the USA). Many businessmen double as politicians and numerous politicians serve on corporate boards.

Eisenhower's "military-industrial complex" though not as sinister as once imagined is, all the same, a reality. The deployment of state intelligence assets and resources to help the private sector gain a competitive edge is merely its manifestation.

As foreign corporate ownership becomes widespread, as multinationals expand, as nation-states dissolve into regions and coalesce into supranational states - the classic, exclusionary, and dichotomous view of the world ("we" versus "they") will fade. But the notion of "proprietary information" is here to stay. And theft will never cease as long as there is profit to be had.

XVII. Russia's Idled Spies

Also Read" The Industrious Spies Russian Roulette - The Security Apparatus

On November 11, 2002, Sweden expelled two Russian diplomats for spying on radar and missile guidance technologies for the JAS 39 British-Swedish Gripen fighter jet developed by Telefon AB LM Ericsson, the telecommunications multinational. The Russians threatened to reciprocate. Five current and former employees of the corporate giant are being investigated.

Ironically, the first foreign buyer of the aircraft may well be Poland, a former Soviet satellite state and a current European Union candidate.

Sweden arrested in February 2001 a worker of the Swiss-Swedish engineering group, ABB, on suspicion of spying for Russia. The man was released after two days for lack of evidence and reinstated. But the weighty Swedish daily, Dagens Nyheter, speculated that the recent Russian indiscretion was in deliberate retaliation for Swedish espionage in Russia. Sweden is rumored to have been in the market for Russian air radar designs and the JAS radar system is said by some observers to uncannily resemble its eastern counterparts.

The same day, a Russian military intelligence (GRU) colonel, Aleksander Sipachev, was sentenced in Moscow to eight years in prison and stripped of his rank.

According to Russian news agencies, he was convicted of attempting to sell secret documents to the CIA. Russian secret service personnel, idled by the withering of Russia's global presence, resort to private business or are re-deployed by the state to spy on industrial and economic secrets in order to aid budding Russian multinationals.

According to the FBI and the National White-collar Crime Center, Russian former secret agents have teamed with computer hackers to break into corporate networks to steal vital information about product development and marketing strategies. Microsoft has admitted to such a compromising intrusion.

In a December 1999 interview to Segodnya, a Russia paper, Eyer Winkler, a former high-ranking staffer with the National Security Agency (NSA) confirmed that "corruption in the Russian Government, the Foreign Intelligence Service, and the Main Intelligence Department allows Russian organized criminal groups to use these departments in their own interests. Criminals receive the major part of information collected by the Russian special services by means of breaking into American computer networks".

When the KGB was dismantled and replaced by a host of new acronyms, Russian industrial espionage was still in diapers. as a result, it is a bureaucratic no-man's land roamed by agents of the GRU, the Foreign Intelligence Service (SVR), and smaller outfits, such as the Federal Agency on Government Communications and Information (FAPSI).

According to Stratfor, the strategic forecasting consultancy, "the SVR and GRU both handle manned intelligence on U.S. territory, with the Russian Federal Security Service (FSB) doing counterintelligence in America. Also, both the SVR and GRU have internal counterintelligence units created for finding foreign intelligence moles." This, to some extent, is the division of labor in Europe as well.

Germany's Federal Prosecutor has consistently warned against \$5 billion worth of secrets pilfered annually from German industrial firms by foreign intelligence services, especially from east Europe and Russia. The Counterintelligence News and Developments newsletter pegs the damage at \$13 billion in 1996 alone: "Modus operandi included placing agents in international organizations, setting up joint-ventures with German companies, and setting up bogus companies. The (Federal Prosecutor's) report also warned business

leaders to be particularly wary of former diplomats or people who used to work for foreign secret services because they often had the language skills and knowledge of Germany that made them excellent agents".

Russian spy rings now operate from Canada to Japan.

Many of the spies have been dormant for decades and recalled to service following the implosion of the USSR.

According to Asian media, Russians have become increasingly active in the Far East, mainly in Japan, South Korea, Taiwan, and mainland China.

Russia is worried about losing its edge in avionics, electronics, information technology and some emerging defense industries such as laser shields, positronics, unmanned vehicles, wearable computing, and real time triple C (communication, command and control) computerized battlefield management. The main targets are, surprisingly, Israel and France. According to media reports, the substantive clients of Russia's defense industry - such as India - insist on hollowing out Russian craft and installing Israeli and west European systems instead.

Russia's paranoid state of mind extends to its interior.

Uralinformbureau reported earlier in 2002 that the Yamal- Nenets autonomous okrug (district) restricted access to foreigners citing concerns about industrial espionage and potential sabotage of oil and gas companies. The Kremlin maintains an ever-expanding list of regions and territories with limited - or outright - forbidden - access to foreigners.

The FSB, the KGB's main successor, is busy arresting spies all over the vast country. To select a random events of the dozens reported every year - and many are not - the Russian daily Kommersant recounted in February 2002 how when the Trunov works at the Novolipetsk metallurgical combine concluded an agreement with a Chinese company to supply it with slabs, its chief negotiator was nabbed as a spy working for "circles in China". His crime? He was in possession of certain documents which contained "intellectual property" of the crumbling and antiquated mill pertaining to a slab quality enhancement process.

Foreigners are also being arrested, though rarely. An American businessman, Edmund Pope, was detained in April 2000 for attempting to purchase the blueprints of an advanced torpedo from a Russian scientist. There have been a few other isolated apprehensions, mainly for "proper", military, espionage. But Russians bear the brunt of the campaign against foreign economic intelligence gathering.

Strana.ru reported in December 2001 that, speaking on the occasion of Security Services Day, Putin - himself a KGB alumnus - warned veterans that the most crucial task facing the services today is "protecting the country's economy against industrial espionage".

This is nothing new. According to History of Espionage Web site, long before they established diplomatic relations with the USA in 1933, the Soviets had Amtorg Trading Company. Ostensibly its purpose was to encourage joint ventures between Russian and American firms. Really it was a hub of industrial undercover activities. Dozens of Soviet intelligence officers supervised, at its peak during the Depression, 800 American communists. The Soviet Union's European operations in Berlin (Handelsvertretung) and in London (Arcos, Ltd.) were even more successful.

XVIII. The Business of Torture

Also Read The Argument for Torture

On January 16, 2003, the European Court of Human Rights agreed - more than two years after the applications have been filed - to hear six cases filed by Chechens against Russia. The claimants accuse the Russian military of torture and indiscriminate killings. The Court has ruled in the past against the Russian Federation and awarded assorted plaintiffs thousands of euros per case in compensation.

As awareness of human rights increased, as their definition expanded and as new, often authoritarian polities, resorted to torture and repression - human rights advocates and non-governmental organizations proliferated. It has become a business in its own right: lawyers, consultants, psychologists, therapists, law enforcement agencies, scholars and pundits tirelessly peddle books, seminars, conferences, therapy sessions for victims, court appearances and other services.

Human rights activists target mainly countries and multinationals.

In June 2001, the International Labor Rights Fund filed a lawsuit on behalf of 11 villagers against the American oil behemoth, ExxonMobile, for "abetting" abuses in Aceh, Indonesia. They alleged that the company provided the army with equipment for digging mass graves and helped in the construction of interrogation and torture centers.

In November 2002, the law firm of Cohen, Milstein, Hausfeld & Toll joined other American and South African law firms in filing a complaint that "seeks to hold businesses responsible for aiding and abetting the apartheid regime in South Africa ... forced labor, genocide, extrajudicial killing, torture, sexual assault, and unlawful detention".

Among the accused: "IBM and ICL which provided the computers that enabled South Africa to ... control

the black South African population. Car manufacturers provided the armored vehicles that were used to patrol the townships. Arms manufacturers violated the embargoes on sales to South Africa, as did the oil companies. The banks provided the funding that enabled South Africa to expand its police and security apparatus".

Charges were leveled against Unocal in Myanmar and dozens of other multinationals. In September 2002, Berger & Montague filed a class action complaint against Royal Dutch Petroleum and Shell Transport. The oil giants are charged with "purchasing ammunition and using ... helicopters and boats and providing logistical support for 'Operation Restore Order in Ogoniland'" which was designed, according to the law firm, to "terrorize the civilian population into ending peaceful protests against Shell's environmentally unsound oil exploration and extraction activities".

The defendants in all these court cases strongly deny any wrongdoing.

But this is merely one facet of the torture business.

Torture implements are produced - mostly in the West - and sold openly, frequently to nasty regimes in developing countries and even through the Internet. Hi-tech devices abound: sophisticated electroconvulsive stun guns, painful restraints, truth serums, chemicals such as pepper gas.

Export licensing is universally minimal and non-intrusive and completely ignores the technical specifications of the goods (for instance, whether they could be lethal, or merely inflict pain).

Amnesty International and the UK-based Omega Foundation, found more than 150 manufacturers of stun guns in the USA alone. They face tough competition from Germany (30 companies), Taiwan (19), France (14), South Korea (13), China (12), South Africa (nine), Israel (eight), Mexico (six), Poland (four), Russia (four), Brazil (three), Spain (three) and the Czech Republic (two).

Many torture implements pass through "off-shore" supply networks in Austria, Canada, Indonesia, Kuwait, Lebanon, Lithuania, Macedonia, Albania, Russia, Israel, the Philippines, Romania and Turkey. This helps European Union based companies circumvent legal bans at home.

The US government has traditionally turned a blind eye to the international trading of such gadgets.

American high-voltage electro-shock stun shields turned up in Turkey, stun guns in Indonesia, and electro-shock batons and shields, and dart-firing taser guns in torture-prone Saudi Arabia. American firms are the dominant manufacturers of stun belts. Explains Dennis Kaufman, President of Stun Tech Inc, a US manufacturer of this innovation: "Electricity speaks every language known to man. No translation necessary. Everybody is afraid of electricity, and rightfully so." (Quoted by Amnesty International).

The Omega Foundation and Amnesty claim that 49 US companies are also major suppliers of mechanical restraints, including leg-irons and thumbcuffs. But they are not alone. Other suppliers are found in Germany (8), France (5), China (3), Taiwan (3), South Africa (2), Spain (2), the UK (2) and South Korea (1).

Not surprisingly, the Commerce Department doesn't keep tab on this category of exports.

Nor is the money sloshing around negligible. Records kept under the export control commodity number A985 show that Saudi Arabia alone spent in the United States more than \$1 million a year between 1997-2000 merely on stun guns. Venezuela's bill for shock batons and such reached \$3.7 million in the same period. Other clients included Hong Kong, Taiwan, Mexico and - surprisingly - Bulgaria. Egypt's notoriously brutal services - already well-equipped - spent a mere \$40,000.

The United States is not the only culprit. The European Commission, according to an Amnesty International report titled "Stopping the Torture Trade" and published in 2001: "Gave a quality award to a Taiwanese electro-shock baton, but when challenged could not cite evidence as to independent safety tests for such a baton or whether member states of the European Union (EU) had been consulted. Most EU states have banned the use of such weapons at home, but French and German companies are still allowed to supply them to other countries".

Torture expertise is widely proffered by former soldiers, agents of the security services made redundant, retired policemen and even rogue medical doctors. China, Israel, South Africa, France, Russia, the United Kingdom and the United States are founts of such useful knowledge and its propagators.

How rooted torture is was revealed in September 1996 when the US Department of Defense admitted that "intelligence training manuals" were used in the Federally sponsored School of the Americas - one of 150 such facilities - between 1982 and 1991. The manuals, written in Spanish and used to train thousands of Latin American security agents, "advocated execution, torture, beatings and blackmail", says Amnesty International.

Where there is demand there is supply. Rather than ignore the discomfiting subject, governments would do well to legalize and supervise it. Alan Dershowitz, a prominent American criminal defense attorney, proposed, in an op-ed article in the Los Angeles Times, published November 8, 2001, to legalize torture in extreme cases and to have judges issue "torture warrants". This may be a radical departure from the human rights tradition of the civilized world. But dispensing export carefully reviewed licenses for dual-use implements is a different matter altogether - and long overdue.

XIX. The Criminality of Transition

Lecture given at the Netherlands Economic Institute (NEI) on 18/4/2001

Human vice is the most certain thing after death and taxes, to paraphrase Benjamin Franklin. The only variety of economic activity, which will surely survive even a nuclear holocaust, is bound to be crime. Prostitution, gambling, drugs and, in general, expressly illegal activities generate c. 400 billion USD annually to their perpetrators, thus making crime the third biggest industry on Earth (after the medical and pharmaceutical industries).

Many of the so called Economies in Transition and of HPICs (Highly Indebted Poor Countries) do resemble post-nuclear-holocaust ashes. GDPs in most of these economies either tumbled nominally or in real terms by more than 60% in the space of less than a decade. The average monthly salary is the equivalent of the average daily salary of the German industrial worker. The GDP per capita - with very few notable exceptions - is around 20% of the EU's average and the average wages are 14% the EU's average (2000). These are the telltale overt signs of a comprehensive collapse of the infrastructure and of the export and internal markets. Mountains of internal debt, sky high interest rates, cronyism, other forms of corruption, environmental, urban and rural dilapidation - characterize these economies.

Into this vacuum - the interregnum between centrally planned and free market economies - crept crime. In most of these countries criminals run at least half the economy, are part of the governing elites (influencing them behind the scenes through money contributions, outright bribes, or blackmail) and - through the mechanism of money laundering - infiltrate slowly the legitimate economy.

What gives crime the edge, the competitive advantage versus the older, ostensibly more well established elites? The free market does. When communism collapsed, only criminals, politicians, managers, and employees of the security services were positioned to benefit from the upheaval. Criminals, for instance, are much better equipped to deal with the onslaught of this new conceptual beast, the mechanism of the market, than most other economic players in these tattered economies are.

Criminals, by the very nature of their vocation, were always private entrepreneurs. They were never state owned or subjected to any kind of central planning. Thus, they became the only group in society that was not corrupted by these un-natural inventions. They invested their own capital in small to medium size enterprises and ran them later as any American manager would have done. To a large extent the criminals, single handedly, created a private sector in these derelict economies.

Having established a private sector business, devoid of any involvement of the state, the criminal-entrepreneurs proceeded to study the market. Through primitive forms of market research (neighbourhood activists) they were able to identify the needs of their prospective customers, to monitor them in real time and to respond with agility to changes in the patterns of supply and demand. Criminals are market-animals and they are geared to respond to its gyrations and vicissitudes. Though they were not likely to engage in conventional marketing and advertising, they always stayed attuned to the market's vibrations and signals. They changed their product mix and their pricing to fit fluctuations in demand and supply.

Criminals have proven to be good organizers and managers. They have very effective ways of enforcing discipline in the workplace, of setting revenue targets, of maintaining a flexible hierarchy combined with rigid obedience - with very high upward mobility and a clear career path. A complex system of incentives and disincentives drives the workforce to dedication and industriousness. The criminal rings are well run conglomerates and the more classic industries would have done well to study their modes of organization and management. Everything - from sales through territorially exclusive licences (franchises) to effective "stock" options - has been invented in the international crime organizations long before it acquired the respectability of the corporate boardroom.

The criminal world has replicated those parts of the state which were rendered ineffective by unrealistic ideology or by pure corruption. The court system makes a fine example. The criminals instituted their own code of justice ("law") and their own court system. A unique - and often irreversible - enforcement arm sees to it that respect towards these indispensable institutions is maintained. Effective - often interactive - legislation, an efficient court system, backed by ominous and ruthless agents of enforcement - ensure the friction-free functioning of the giant wheels of crime. Crime has replicated numerous other state institutions. Small wonder that when the state disintegrated - crime was able to replace it with little difficulty. The same pattern is discernible in certain parts of the world where terrorist organizations duplicate the state and overtake it, in time.

Schools, clinics, legal assistance, family support, taxation, the court system, transportation and telecommunication services, banking and industry - all have a criminal doppelganger.

To summarize: At the outset of transition, the underworld constituted an embryonic private sector, replete with international networks of contacts, cross-border experience, capital agglomeration and wealth formation, sources of venture (risk) capital, an entrepreneurial spirit, and a diversified portfolio of investments, revenue generating assets, and sources of wealth. Criminals were used to private sector practices: price signals, competition, joint venturing, and third party dispute settlement.

To secure this remarkable achievement - the underworld had to procure and then maintain - infrastructure and technologies. Indeed, criminals are great at innovating and even more formidable at making use of cutting edge technologies. There is not a single technological advance, invention or discovery that criminals were not the first to utilize or the first to contemplate and to grasp its full potential. There are enormous industries of services rendered to the criminal in his pursuits. Accountants and lawyers, forgers and cross border guides, weapons experts and bankers, mechanics and hit-men - all stand at the disposal of the average

criminal. The choice is great and prices are always negotiable. These auxiliary professionals are no different to their legitimate counterparts, despite the difference in subject matter. A body of expertise, know-how and acumen has accumulated over centuries of crime and is handed down the generations in the criminal universities known as jail- houses and penitentiaries. Roads less travelled, countries more lenient, passports to be bought, sold, or forged, how to manuals, classified ads, goods and services on offer and demand - all feature in this mass media cum educational (mostly verbal) bulletins. This is the real infrastructure of crime. As with more mundane occupations, human capital is what counts.

Criminal activities are hugely profitable (though wealth accumulation and capital distribution are grossly non- egalitarian). Money is stashed away in banking havens and in more regular banks and financial institutions all over the globe. Electronic Document Interchange and electronic commerce transformed what used to be an inconveniently slow and painfully transparent process - into a speed-of-light here-I-am, here-I-am-gone type of operation. Money is easily movable and virtually untraceable. Special experts take care of that: tax havens, off shore banks, money transactions couriers with the right education and a free spirit. This money, in due time and having cooled off - is reinvested in legitimate activities. Crime is a major engine of economic growth in some countries (where drugs are grown or traded, or in countries such as Italy, in Russia and elsewhere in CEE).

In many a place, criminals are the only ones who have any liquidity at all. The other, more visible, sectors of the economy are wallowing in the financial drought of a demonetized economy. People and governments tend to lose both their scruples and their sense of fine distinctions under these unhappy circumstances. They welcome any kind of money to ensure their very survival. This is where crime comes in. In Central and Eastern Europe the process was code-named: "privatization".

Moreover, most of the poor economies are also closed economies. They are the economies of nations xenophobic, closed to the outside world, with currency regulations, limitations on foreign ownership, constrained (instead of free) trade. The vast majority of the populace of these economic wretches has never been further than the neighbouring city - let alone outside the borders of their countries. Freedom of movement is still restricted.

The only ones to have travelled freely - mostly without the required travel documents - were the criminals. Crime is international. It involves massive, intricate and sophisticated operations of export and import, knowledge of languages, extensive and frequent trips, an intimate acquaintance with world prices, the international financial system, demand and supply in various markets, frequent business negotiations with foreigners and so on. This list would fit any modern businessman as well. Criminals are international businessmen. Their connections abroad coupled with their connections with the various elites inside their country and coupled with their financial prowess - made them the first and only true businessmen of the economies in transition. There simply was no one else qualified to fulfil this role - and the criminals stepped in willingly.

They planned and timed their moves as they always do: with shrewdness, an uncanny knowledge of human psychology and relentless cruelty. There was no one to oppose them - and so they won the day. It will take one or more generations to get rid of them and to replace them by a more civilized breed of entrepreneurs. But it will not happen overnight.

In the 19th century, the then expanding USA went through the same process. Robber barons seized economic opportunities in the Wild East and in the Wild West and really everywhere else. Morgan, Rockefeller, Pullman, Vanderbilt - the most ennobled families of latter day America originated with these rascals. But there is one important difference between the USA at that time and Central and Eastern Europe today. A civic culture with civic values and an aspiration to, ultimately, create a civic society permeated the popular as well as the high-brow culture of America. Criminality was regarded as a shameful stepping stone on the way to an orderly society of learned, civilized, law-abiding citizens. This cannot be said about Russia, for instance. The criminal there is, if anything, admired and emulated. The language of business in countries in transition is suffused with the criminal parlance of violence. The next generation is encouraged to behave similarly because no clear (not to mention well embedded) alternative is propounded. There is no - and never was - a civic tradition in these countries, a Bill of Rights, a veritable Constitution, a modicum of self rule, a true abolition of classes and nomenclatures.

The future is grim because the past was grim. Used to being governed by capricious, paranoiac, criminal tyrants - these nations know no better. The current criminal class seems to them to be a natural continuation and extension of generations-long trends. That some criminals are members of the new political, financial and industrial elites (and vice versa) - surprises them not.

In most countries in transition, the elites (the political- managerial complex) make use of the state and its simulacrum institutions in close symbiosis with the criminal underworld. The state is often an oppressive mechanism deployed in order to control the populace and manipulate it. Politicians allocate assets, resources, rights, and licences to themselves, and to their families and cronies. Patronage extends to collaborating criminals.

Additionally, the sovereign state is regarded as a means to extract foreign aid and credits from donors, multilaterals, and NGOs.

The criminal underworld exploits the politicians.

Politicians give criminals access to state owned assets and resources. These are an integral part of the money laundering cycle. "Dirty" money is legitimized through the purchase of businesses and real estate from the state.

Politicians induce state institutions to turn a blind eye to the criminal activities of their collaborators and

ensure lenient law enforcement. They also help criminals eliminate internal and external competition in their territories.

In return, criminals serve as the "long and anonymous arm" of politicians. They obtain illicit goods for them and provide them with illegal services. Corruption often flows through criminal channels or via the mediation and conduit of delinquents. Within the shared sphere of the informal economy, assets are often shifted among these economic players. Both have an interest to maintain a certain lack of transparency, a bureaucracy (=dependence on state institutions and state employees) and NAIRU (Non Abating Internal Recruitment Unemployment).

Nationalism and racism, the fostering of paranoia and grievances are excellent tactics of mobilization of foot soldiers. And the needs to dispense with a continuous stream of patronage and provide venues for the legitimization of illegally earned funds delay essential reforms and the disposal of state assets.

This urge to become legitimate - largely the result of social pressure - leads to a deterministic, four stroke cycle of co-habitation between politicians and criminals. In the first phase, politicians grope for a new ideological cover for their opportunism. This is followed by a growing partnership between the elites and the crime world. A divergence then occurs. Politicians team up with legitimacy-seeking, established crime lords. Both groups benefit from a larger economic pie. They fight against other, less successful, criminals, who wish to persist in their old ways. This is low intensity warfare and it inevitably ends in the triumph of the former over the latter.

XX. The Economics of Conspiracy Theories

Barry Chamish is convinced that Shimon Peres, Israel's wily old statesman, ordered the assassination of Yitzhak Rabin, back in 1995, in collaboration with the French. He points to apparent tampering with evidence. The blood-stained song sheet in Mr. Rabin's pocket lost its bullet hole between the night of the murder and the present.

The murderer, Yigal Amir, should have been immediately recognized by Rabin's bodyguards. He has publicly attacked his query before. Israel's fierce and fearsome internal security service, the Shabak, had moles and agents provocateurs among the plotters. Chamish published a book about the affair. He travels and lectures widely, presumably for a fee.

Chamish's paranoia-larded prose is not unique. The transcripts of Senator Joseph McCarthy's inquisitions are no less outlandish. But it was the murder of John F.

Kennedy, America's youthful president, that ushered in a golden age of conspiracy theories.

The distrust of appearances and official versions was further enhanced by the Watergate scandal in 1973-4.

Conspiracies and urban legends offer meaning and purposefulness in a capricious, kaleidoscopic, maddeningly ambiguous, and cruel world. They empower their otherwise helpless and terrified believers.

New Order one world government, Zionist and Jewish cabals, Catholic, black, yellow, or red subversion, the machinations attributed to the freemasons and the illuminati - all flourished yet again from the 1970's onwards. Paranoid speculations reached frenzied nadirs following the deaths of celebrities, such as "Princess Di".

Books like "The Da Vinci Code" (which deals with an improbable Catholic conspiracy to erase from history the true facts about the fate of Jesus) sell millions of copies worldwide.

Tony Blair, Britain's ever righteous prime minister denounced the "Diana Death Industry". He was referring to the tomes and films which exploited the wild rumors surrounding the fatal car crash in Paris in 1997. The Princess, her boyfriend Dodi al-Fayed, heir to a fortune, as well as their allegedly inebriated driver were killed in the accident.

Among the exploiters were "The Times" of London which promptly published a serialized book by Time magazine reports. Britain's TV networks, led by Live TV, capitalized on comments made by al-Fayed's father to the "Mirror" alleging foul play.

But there is more to conspiracy theories than mass psychology. It is also big business. Voluntary associations such as the Ku Klux Klan and the John Birch Society are past their heyday. But they still gross many millions of dollars a year.

The monthly "Fortean Times" is the leading brand in "strange phenomena and experiences, curiosities, prodigies and portents". It is widely available on both sides of the Atlantic. In its 29 years of existence it has covered the bizarre, the macabre, and the ominous with panache and open-mindedness.

It is named after Charles Fort who compiled unexplained mysteries from the scientific literature of his age (he died in 1932). He published four bestsellers in his lifetime and lived to see "Fortean societies" established in many countries.

A 12 months subscription to "Fortean Times" costs c. \$45.

With a circulation of 60,000, the magazine was able to spin off "Fortean Television" - a TV show on Britain's

Channel Four. Its reputation was further enhanced when it was credited with inspiring the TV hit series X-Files and The Sixth Sense. "Lobster Magazine" - a bi-annual publication - is more modest at \$15 a year. It is far more "academic" looking and it sells CD ROM compilations of its articles at between \$80 (for individuals) and \$160 (for institutions and organizations) a piece. It also makes back copies of its issues available.

Its editor, Robin Ramsay, said in a lecture delivered to the "Unconvention 96", organized by the "Fortean Times": "Conspiracy theories certainly are sexy at the moment ...

I've been contacted by five or six TV companies in the past six months - two last week - all interested in making programmes about conspiracy theories. I even got a call from the Big Breakfast Show, from a researcher who had no idea who I was, asking me if I'd like to appear on it ...

These days we've got conspiracy theories everywhere; and about almost everything".

But these two publications are the tip of a gigantic and ever-growing iceberg. "Fortean Times" reviews, month in and month out, books, PC games, movies, and software concerned with its subject matter. There is an average of 8 items per issue with a median price of \$20 per item.

There are more than 186,600 Web sites dedicated to conspiracy theories in Google's database of 3 billion pages. The "conspiracy theories" category in the Open Directory Project, a Web directory edited by volunteers, contains hundreds of entries.

There are 1077 titles about conspiracies listed in Amazon and another 12078 in its individually-operated ZShops. A new (1996) edition of the century-old anti-Semitic propaganda pamphlet faked by the Czarist secret service, "Protocols of the Learned Elders of Zion", is available through Amazon. Its sales rank is a respectable 64,000 - out of more than 2 million titles stocked by the online bookseller.

In a disclaimer, Amazon states: "The Protocols of the Learned Elders of Zion is classified under "controversial knowledge" in our store, along with books about UFOs, demonic possession, and all manner of conspiracy theories".

Yet, cinema and TV did more to propagate modern nightmares than all the books combined. The Internet is starting to have a similar impact compounded by its networking capabilities and by its environment of simulated reality - "cyberspace". In his tome, "Enemies Within: The Culture of Conspiracy in Modern America", Robert Alan Goldberg comes close to regarding the paranoid mode of thinking as a manifestation of mainstream American culture.

According to the Internet Movie Database, the first 50 all time hits include at least one "straight" conspiracy theory movie (in the 13th place) - "Men in Black" with \$587 million in box office receipts. JFK (in the 193rd place) grossed another \$205 million. At least ten other films among the first 50 revolve around a conspiracy theory disguised as science fiction or fantasy. "The Matrix" - in the 28th place - took in \$456 million. "The Fugitive" closes the list with \$357 million. This is not counting "serial" movies such as James Bond, the reification of paranoia shaken and stirred.

X-files is to television what "Men in Black" is to cinema.

According to "Advertising Age", at its peak, in 1998, a 30 seconds spot on the show cost \$330,000 and each chapter raked in \$5 million in ad revenues. Ad prices declined to \$225,000 per spot two years later, according to CMR Business to Business.

Still, in its January 1998 issue, "Fortune" claimed that "X-Files" (by then a five year old phenomenon) garnered Fox TV well over half a billion dollars in revenues. This was before the eponymous feature film was released. Even at the end of 2000, the show was regularly being watched by 12.4 million households - compared to 22.7 million viewers in 1998. But X-files was only the latest, and the most successful, of a line of similar TV shows, notably "The Prisoner" in the 1960's.

It is impossible to tell how many people feed off the paranoid frenzy of the lunatic fringe. I found more than 3000 lecturers on these subjects listed by the Google search engine alone. Even assuming a conservative schedule of one lecture a month with a modest fee of \$250 per appearance - we are talking about an industry of c. \$10 million.

Collective paranoia has been boosted by the Internet.

Consider the computer game "Majestic" by Electronic Arts. It is an interactive and immersive game, suffused with the penumbral and the surreal. It is a Web reincarnation of the borderlands and the twilight zone - centered around a nefarious and lethal government conspiracy. It invades the players' reality - the game leaves them mysterious messages and "tips" by phone, fax, instant messaging, and e-mail. A typical round lasts 6 months and costs \$10 a month.

Neil Young, the game's 31-years old, British-born, producer told Salon.com recently: "... The concept of blurring the lines between fact and fiction, specifically around conspiracies. I found myself on a Web site for the conspiracy theory radio show by Art Bell ... the Internet is such a fabulous medium to blur those lines between fact and fiction and conspiracy, because you begin to make connections between things.

It's a natural human reaction - we connect these dots around our fears. Especially on the Internet, which is so conspiracy-friendly. That was what was so interesting about the game; you couldn't tell whether the sites you were visiting were Majestic-created or normal Web sites..".

Majestic creates almost 30 primary Web sites per episode.

It has dozens of "bio" sites and hundreds of Web sites created by fans and linked to the main conspiracy threads.

The imaginary gaming firm at the core of its plots, "Amin-X", has often been confused with the real thing. It even won the E3 Critics Award for best original product...

Conspiracy theories have pervaded every facet of our modern life. A.H. Barbee describes in "Making Money the Telefunding Way" (published on the Web site of the Institute for First Amendment Studies) how conspiracy theorists make use of non-profit "para-churches".

They deploy television, radio, and direct mail to raise billions of dollars from their followers through "telefunding". Under section 170 of the IRS code, they are tax-exempt and not obliged even to report their income.

The Federal Trade commission estimates that 10% of the \$143 billion donated to charity each year may be solicited fraudulently.

Lawyers represent victims of the Gulf Syndrome for hefty sums. Agencies in the USA debug bodies - they "remove" brain "implants" clandestinely placed by the CIA during the Cold War. They charge thousands of dollars a pop.

Cranks and whackos - many of them religious fundamentalists - use inexpensive desktop publishing technology to issue scaremongering newsletters (remember Mel Gibson in the movie "Conspiracy Theory"?).

Tabloids and talk shows - the only source of information for nine tenths of the American population - propagate these "news". Museums - the UFO museum in New Mexico or the Kennedy Assassination museum in Dallas, for instance - immortalize them. Memorabilia are sold through auction sites and auction houses for thousands of dollars an item.

Numerous products were adversely affected by conspiratorial smear campaigns. In his book "How the Paranoid Style Flourishes and Where it Comes From", Daniel Pipes describes how the sales of Tropical Fantasy plummeted by 70% following widely circulated rumors about the sterilizing substances it allegedly contained - put there by the KKK. Other brands suffered a similar fate: Kool and Uptown cigarettes, Troop Sport clothing, Church's Fried Chicken, and Snapple soft drinks.

It all looks like one giant conspiracy to me. Now, here's one theory worth pondering...

XXI. The Demise of the Work Ethic

"When work is a pleasure, life is a joy!
When work is a duty, life is slavery".

Maxim Gorky (1868-1936), Russian novelist, author, and playwright

Airplanes, missiles, and space shuttles crash due to lack of maintenance, absent-mindedness, and pure ignorance.

Software support personnel, aided and abetted by Customer Relationship Management application suites, are curt (when reachable) and unhelpful. Despite expensive, state of the art supply chain management systems, retailers, suppliers, and manufacturers habitually run out of stocks of finished and semi-finished products and raw materials. People from all walks of life and at all levels of the corporate ladder skirt their responsibilities and neglect their duties.

Whatever happened to the work ethic? Where is the pride in the immaculate quality of one's labor and produce? Both dead in the water. A series of earth-shattering social, economic, and technological trends converged to render their jobs loathsome to many - a tedious nuisance best avoided. 1. Job security is a thing of the past. Itinerancy in various McJobs reduces the incentive to invest time, effort, and resources into a position that may not be yours next week.

Brutal layoffs and downsizing traumatized the workforce and produced in the typical workplace a culture of obsequiousness, blind obeisance, the suppression of independent thought and speech, and avoidance of initiative and innovation. Many offices and shop floors now resemble prisons. 2. Outsourcing and offshoring of back office (and, more recently, customer relations and research and development) functions sharply and adversely effected the quality of services from helpdesks to airline ticketing and from insurance claims processing to remote maintenance.

Cultural mismatches between the (typically Western) client base and the offshore service department (usually in a developing country where labor is cheap and plenty) only exacerbated the breakdown of trust between customer and provider or supplier. 3. The populace in developed countries are addicted to leisure time. Most people regard their jobs as a necessary evil, best avoided whenever possible. Hence phenomena like the permanent temp - employees who prefer a succession of temporary assignments to holding a proper job. The media and the arts contribute to this perception of work as a drag - or a potentially dangerous addiction (when they portray raging and abusive workaholics). 4. The other side of this dismal coin is workaholism - the addiction to work. Far from valuing it, these addicts resent their dependence. The job performance of the typical workaholic leaves a lot to be desired. Workaholics are fatigued, suffer from ancillary addictions, and short attention spans. They frequently abuse substances, are narcissistic and destructively competitive (being driven, they are incapable of team work). 5. The depersonalization of manufacturing - the intermediated divorce between the artisan/worker and his client - contributed a lot to the

indifference and alienation of the common industrial worker, the veritable "anonymous cog in the machine".

Not only was the link between worker and product broken - but the bond between artisan and client was severed as well. Few employees know their customers or patrons first hand. It is hard to empathize with and care about a statistic, a buyer whom you have never met and never likely to encounter. It is easy in such circumstances to feel immune to the consequences of one's negligence and apathy at work. It is impossible to be proud of what you do and to be committed to your work - if you never set eyes on either the final product or the customer! Charlie Chaplin's masterpiece, "Modern Times" captured this estrangement brilliantly. 6. Many former employees of mega-corporations abandon the rat race and establish their own businesses - small and home enterprises. Undercapitalized, understaffed, and outperformed by the competition, these fledgling and amateurish outfits usually spew out shoddy products and lamentable services - only to expire within the first year of business. 7. Despite decades of advanced notice, globalization caught most firms the world over by utter surprise. Ill-prepared and fearful of the onslaught of foreign competition, companies big and small grapple with logistical nightmares, supply chain calamities, culture shocks and conflicts, and rapacious competitors. Mere survival (and opportunistic managerial plunder) replaced client satisfaction as the prime value. 8. The decline of the professional guilds on the one hand and the trade unions on the other hand greatly reduced worker self-discipline, pride, and peer-regulated quality control. Quality is monitored by third parties or compromised by being subjected to Procrustean financial constraints and concerns.

The investigation of malpractice and its punishment are now at the hand of vast and ill-informed bureaucracies, either corporate or governmental. Once malpractice is exposed and admitted to, the availability of malpractice insurance renders most sanctions unnecessary or toothless.

Corporations prefer to bury mishaps and malfeasance rather than cope with and rectify them. 9. The quality of one's work, and of services and products one consumed, used to be guaranteed. One's personal idiosyncrasies, eccentricities, and problems were left at home. Work was sacred and one's sense of self-worth depended on the satisfaction of one's clients. You simply didn't let your personal life affect the standards of your output.

This strict and useful separation vanished with the rise of the malignant-narcissistic variant of individualism. It led to the emergence of idiosyncratic and fragmented standards of quality. No one knows what to expect, when, and from whom. Transacting business has become a form of psychological warfare. The customer has to rely on the goodwill of suppliers, manufacturers, and service providers - and often finds himself at their whim and mercy. "The client is always right" has gone the way of the dodo. "It's my (the supplier's or provider's) way or the highway" rules supreme.

This uncertainty is further exacerbated by the pandemic eruption of mental health disorders - 15% of the population are severely pathologized according to the latest studies. Antisocial behaviors - from outright crime to pernicious passive-aggressive sabotage - once rare in the workplace, are now abundant.

The ethos of teamwork, tempered collectivism, and collaboration for the greater good is now derided or decried. Conflict on all levels has replaced negotiated compromise and has become the prevailing narrative.

Litigiousness, vigilante justice, use of force, and "getting away with it" are now extolled. Yet, conflicts lead to the misallocation of economic resources. They are non-productive and not conducive to sustaining good relations between producer or provider and consumer. 10. Moral relativism is the mirror image of rampant individualism. Social cohesion and discipline diminished, ideologies and religions crumbled, and anomic states substituted for societal order. The implicit contracts between manufacturer or service provider and customer and between employee and employer were shredded and replaced with ad-hoc negotiated operational checklists.

Social decoherence is further enhanced by the anonymization and depersonalization of the modern chain of production (see point 5 above).

Nowadays, people facilely and callously abrogate their responsibilities towards their families, communities, and nations. The mushrooming rate of divorce, the decline in personal thrift, the skyrocketing number of personal bankruptcies, and the ubiquity of venality and corruption both corporate and political are examples of such dissipation. No one seems to care about anything. Why should the client or employer expect a different treatment? 11. The disintegration of the educational systems of the West made it difficult for employers to find qualified and motivated personnel. Courtesy, competence, ambition, personal responsibility, the ability to see the bigger picture (synoptic view), interpersonal aptitude, analytic and synthetic skills, not to mention numeracy, literacy, access to technology, and the sense of belonging which they foster - are all products of proper schooling. 12. Irrational beliefs, pseudo-sciences, and the occult rushed in to profitably fill the vacuum left by the crumbling education systems. These wasteful preoccupations encourage in their followers an overpowering sense of fatalistic determinism and hinder their ability to exercise judgment and initiative. The discourse of commerce and finance relies on unmitigated rationality and is, in essence, contractual. Irrationality is detrimental to the successful and happy exchange of goods and services.

XXII. The Morality of Child Labor

From the comfort of their plush offices and five to six figure salaries, self-appointed NGO's often denounce child labor as their employees rush from one five star hotel to another, \$3000 subnotebooks and PDA's in

hand.

The hairsplitting distinction made by the ILO between "child work" and "child labor" conveniently targets impoverished countries while letting its budget contributors - the developed ones - off-the-hook.

Reports regarding child labor surface periodically.

Children crawling in mines, faces ashen, body deformed.

The agile fingers of famished infants weaving soccer balls for their more privileged counterparts in the USA. Tiny figures huddled in sweatshops, toiling in unspeakable conditions. It is all heart-rending and it gave rise to a veritable not-so-cottage industry of activists, commentators, legal eagles, scholars, and opportunistically sympathetic politicians.

Ask the denizens of Thailand, sub-Saharan Africa, Brazil, or Morocco and they will tell you how they regard this altruistic hyperactivity - with suspicion and resentment.

Underneath the compelling arguments lurks an agenda of trade protectionism, they wholeheartedly believe.

Stringent - and expensive - labor and environmental provisions in international treaties may well be a ploy to fend off imports based on cheap labor and the competition they wreak on well-ensconced domestic industries and their political stooges.

This is especially galling since the sanctimonious West has amassed its wealth on the broken backs of slaves and kids. The 1900 census in the USA found that 18 percent of all children - almost two million in all - were gainfully employed. The Supreme Court ruled unconstitutional laws banning child labor as late as 1916. This decision was overturned only in 1941.

The GAO published a report last week in which it criticized the Labor Department for paying insufficient attention to working conditions in manufacturing and mining in the USA, where many children are still employed. The Bureau of Labor Statistics pegs the number of working children between the ages of 15-17 in the USA at 3.7 million. One in 16 of these worked in factories and construction. More than 600 teens died of work-related accidents in the last ten years.

Child labor - let alone child prostitution, child soldiers, and child slavery - are phenomena best avoided. But they cannot and should not be tackled in isolation. Nor should underage labor be subjected to blanket castigation.

Working in the gold mines or fisheries of the Philippines is hardly comparable to waiting on tables in a Nigerian or, for that matter, American restaurant.

There are gradations and hues of child labor. That children should not be exposed to hazardous conditions, long working hours, used as means of payment, physically punished, or serve as sex slaves is commonly agreed. That they should not help their parents plant and harvest may be more debatable.

As Miriam Wasserman observes in "Eliminating Child Labor", published in the Federal Bank of Boston's "Regional Review", second quarter of 2000, it depends on "family income, education policy, production technologies, and cultural norms." About a quarter of children under-14 throughout the world are regular workers. This statistic masks vast disparities between regions like Africa (42 percent) and Latin America (17 percent).

In many impoverished locales, child labor is all that stands between the family unit and all-pervasive, life threatening, destitution. Child labor declines markedly as income per capita grows. To deprive these bread-earners of the opportunity to lift themselves and their families incrementally above malnutrition, disease, and famine - is an apex of immoral hypocrisy.

Quoted by "The Economist", a representative of the much decried Ecuador Banana Growers Association and Ecuador's Labor Minister, summed up the dilemma neatly: "Just because they are under age doesn't mean we should reject them, they have a right to survive. You can't just say they can't work, you have to provide alternatives".

Regrettably, the debate is so laden with emotions and self-serving arguments that the facts are often overlooked.

The outcry against soccer balls stitched by children in Pakistan led to the relocation of workshops ran by Nike and Reebok. Thousands lost their jobs, including countless women and 7000 of their progeny. The average family income - anyhow meager - fell by 20 percent.

Economists Drusilla Brown, Alan Deardorif, and Robert Stern observe wryly: "While Baden Sports can quite credibly claim that their soccer balls are not sewn by children, the relocation of their production facility undoubtedly did nothing for their former child workers and their families".

Such examples abound. Manufacturers - fearing legal reprisals and "reputation risks" (naming-and-shaming by overzealous NGO's) - engage in preemptive sacking.

German garment workshops fired 50,000 children in Bangladesh in 1993 in anticipation of the American never-legislated Child Labor Deterrence Act.

Quoted by Wasserstein, former Secretary of Labor, Robert Reich, notes: "Stopping child labor without doing anything else could leave children worse off. If they are working out of necessity, as most are, stopping them could force them into prostitution or other employment with greater personal dangers. The most important thing is that they be in school and receive the education to help them leave poverty".

Contrary to hype, three quarters of all children work in agriculture and with their families. Less than 1 percent work in mining and another 2 percent in construction.

Most of the rest work in retail outlets and services, including "personal services" - a euphemism for prostitution. UNICEF and the ILO are in the throes of establishing school networks for child laborers and providing their parents with alternative employment.

But this is a drop in the sea of neglect. Poor countries rarely proffer education on a regular basis to more than two thirds of their eligible school-age children. This is especially true in rural areas where child labor is a widespread blight. Education - especially for women - is considered an unaffordable luxury by many hard-pressed parents. In many cultures, work is still considered to be indispensable in shaping the child's morality and strength of character and in teaching him or her a trade. "The Economist" elaborates: "In Africa children are generally treated as mini-adults; from an early age every child will have tasks to perform in the home, such as sweeping or fetching water. It is also common to see children working in shops or on the streets. Poor families will often send a child to a richer relation as a housemaid or houseboy, in the hope that he will get an education".

A solution recently gaining steam is to provide families in poor countries with access to loans secured by the future earnings of their educated offspring. The idea - first proposed by Jean-Marie Baland of the University of Namur and James A. Robinson of the University of California at Berkeley - has now permeated the mainstream.

Even the World Bank has contributed a few studies, notably, in June, "Child Labor: The Role of Income Variability and Access to Credit Across Countries" authored by Rajeev Dehejia of the NBER and Roberta Gatti of the Bank's Development Research Group.

Abusive child labor is abhorrent and should be banned and eradicated. All other forms should be phased out gradually. Developing countries already produce millions of unemployable graduates a year - 100,000 in Morocco alone. Unemployment is rife and reaches, in certain countries - such as Macedonia - more than one third of the workforce. Children at work may be harshly treated by their supervisors but at least they are kept off the far more menacing streets. Some kids even end up with a skill and are rendered employable.

XXIII. The Myth of the Earnings Yield

In American novels, well into the 1950's, one finds protagonists using the future stream of dividends emanating from their share holdings to send their kids to college or as collateral. Yet, dividends seemed to have gone the way of the Hula-Hoop. Few companies distribute erratic and ever-declining dividends. The vast majority don't bother. The unfavorable tax treatment of distributed profits may have been the cause.

The dwindling of dividends has implications which are nothing short of revolutionary. Most of the financial theories we use to determine the value of shares were developed in the 1950's and 1960's, when dividends were in vogue. They invariably relied on a few implicit and explicit assumptions: 1. That the fair "value" of a share is closely correlated to its market price; 2. That price movements are mostly random, though somehow related to the aforementioned "value" of the share. In other words, the price of a security is supposed to converge with its fair "value" in the long term; 3. That the fair value responds to new information about the firm and reflects it - though how efficiently is debatable. The strong efficiency market hypothesis assumes that new information is fully incorporated in prices instantaneously.

But how is the fair value to be determined? A discount rate is applied to the stream of all future income from the share - i.e., its dividends. What should this rate be is sometimes hotly disputed - but usually it is the coupon of "riskless" securities, such as treasury bonds.

But since few companies distribute dividends - theoreticians and analysts are increasingly forced to deal with "expected" dividends rather than "paid out" or actual ones.

The best proxy for expected dividends is net earnings. The higher the earnings - the likelier and the higher the dividends. Thus, in a subtle cognitive dissonance, retained earnings - often plundered by rapacious managers - came to be regarded as some kind of deferred dividends.

The rationale is that retained earnings, once re-invested, generate additional earnings. Such a virtuous cycle increases the likelihood and size of future dividends. Even undistributed earnings, goes the refrain, provide a rate of return, or a yield - known as the earnings yield. The original meaning of the word "yield" - income realized by an investor - was undermined by this Newspeak.

Why was this oxymoron - the "earnings yield" - perpetuated? According to all current theories of finance, in the absence of dividends - shares are worthless. The value of an investor's holdings is determined by the income he stands to receive from them. No income - no value. Of course, an investor can always sell his holdings to other investors and realize capital gains (or losses). But capital gains - though also driven by earnings hype - do not feature in financial models of stock valuation.

Faced with a dearth of dividends, market participants - and especially Wall Street firms - could obviously not live with the ensuing zero valuation of securities. They resorted to substituting future dividends - the outcome of capital accumulation and re-investment - for present ones.

The myth was born.

Thus, financial market theories starkly contrast with market realities.

No one buys shares because he expects to collect an uninterrupted and equiponderant stream of future income in the form of dividends. Even the most gullible novice knows that dividends are a mere apologue, a relic of the past. So why do investors buy shares? Because they hope to sell them to other investors later at a higher price.

While past investors looked to dividends to realize income from their shareholdings - present investors are more into capital gains. The market price of a share reflects its discounted expected capital gains, the discount rate being its volatility. It has little to do with its discounted future stream of dividends, as current financial theories teach us.

But, if so, why the volatility in share prices, i.e., why are share prices distributed? Surely, since, in liquid markets, there are always buyers - the price should stabilize around an equilibrium point.

It would seem that share prices incorporate expectations regarding the availability of willing and able buyers, i.e., of investors with sufficient liquidity. Such expectations are influenced by the price level - it is more difficult to find buyers at higher prices - by the general market sentiment, and by externalities and new information, including new information about earnings.

The capital gain anticipated by a rational investor takes into consideration both the expected discounted earnings of the firm and market volatility - the latter being a measure of the expected distribution of willing and able buyers at any given price. Still, if earnings are retained and not transmitted to the investor as dividends - why should they affect the price of the share, i.e., why should they alter the capital gain? Earnings serve merely as a yardstick, a calibrator, a benchmark figure. Capital gains are, by definition, an increase in the market price of a security. Such an increase is more often than not correlated with the future stream of income to the firm - though not necessarily to the shareholder. Correlation does not always imply causation.

Stronger earnings may not be the cause of the increase in the share price and the resulting capital gain. But whatever the relationship, there is no doubt that earnings are a good proxy to capital gains.

Hence investors' obsession with earnings figures. Higher earnings rarely translate into higher dividends. But earnings - if not fiddled - are an excellent predictor of the future value of the firm and, thus, of expected capital gains. Higher earnings and a higher market valuation of the firm make investors more willing to purchase the stock at a higher price - i.e., to pay a premium which translates into capital gains.

The fundamental determinant of future income from share holding was replaced by the expected value of share- ownership. It is a shift from an efficient market - where all new information is instantaneously available to all rational investors and is immediately incorporated in the price of the share - to an inefficient market where the most critical information is elusive: how many investors are willing and able to buy the share at a given price at a given moment.

A market driven by streams of income from holding securities is "open". It reacts efficiently to new information. But it is also "closed" because it is a zero sum game. One investor's gain is another's loss. The distribution of gains and losses in the long term is pretty even, i.e., random. The price level revolves around an anchor, supposedly the fair value.

A market driven by expected capital gains is also "open" in a way because, much like less reputable pyramid schemes, it depends on new capital and new investors. As long as new money keeps pouring in, capital gains expectations are maintained - though not necessarily realized.

But the amount of new money is finite and, in this sense, this kind of market is essentially a "closed" one. When sources of funding are exhausted, the bubble bursts and prices decline precipitously. This is commonly described as an "asset bubble".

This is why current investment portfolio models (like CAPM) are unlikely to work. Both shares and markets move in tandem (contagion) because they are exclusively swayed by the availability of future buyers at given prices.

This renders diversification inefficacious. As long as considerations of "expected liquidity" do not constitute an explicit part of income-based models, the market will render them increasingly irrelevant.

XXIV. The Future of the Securities and Exchange Commission (SEC)

Interview with Gary Goodenow

In June 2005, William H. Donaldson was forced to resign as Chairman of the Securities and Exchange Commission (SEC). The reason? As the New York Times put it: "criticism that his enforcement was too heavy-handed".

President Bush chose California Rep. Christopher Cox, a Republican, to replace him.

Gary Langan Goodenow is an attorney licensed to practice in the State of Florida and the District of Columbia. The Webmaster of www.RealityAtTheSEC.com, he worked at the Miami office of the SEC for about

six years, in the Division of Enforcement.

His experience is varied. As a staff attorney, he investigated and prosecuted cases enforcing the federal securities laws. As a branch chief, he supervised the work of several staff attorneys. As a Senior Trial Counsel, he was responsible for litigating about thirty enforcement cases at any one time in federal court. As Senior Counsel, he made the final recommendations on which cases the office would investigate and prosecute, or decline.

He describes an experience he had after he left the SEC. "I represented an Internet financial writer with a Web site that touted stocks, Mr. Ted Melcher of SGA Whisper Stocks. The SEC sued Ted because as he was singing the praises of certain stocks in his articles, he was selling them into a rising market. He got his shares from the issuers in exchange for doing the promotional touting. Unfortunately for him, the SEC and the Department of Justice made an example of his case, and he went to jail".

Q. The SEC is often accused of lax and intermittent enforcement of the law. Is the problem with the enforcement division - or with the law? Can you describe a typical SEC investigation from start to finish? A. The problem lies with both.

At the SEC, the best argument in support of a proposed course of action is "that's what we did last time". That will inevitably please the staff attorney's superiors.

SEC rules and regulations remind me of an old farmhouse that has been altered and adapted, sometimes for convenience, other times for necessity. But it has never been just plain pulled down and rebuilt despite incredible changes around it. To the uninitiated, the house is rambling with hidden passages, dark corners, low ceilings, folklore and horror stories, and accumulations of tons of antique rubbish that sometimes no one - not even some SEC Commissioners - can wade through.

Wandering from room to room in this farmhouse are the SEC staff. Regretfully, I found that many are ignorant or indifferent to their mission, or scornful of investors' plight, too addicted to their petty specializations in their detailed job descriptions, and way too prone to follow only the well-trodden path.

They are stunned by the rapidity, multiplicity, immensity and intelligence behind the scams. Their tools of research, investigation and prosecution are confusingly changed periodically when Congress passes some new "reform" legislation, or a new Chairman or new Enforcement Director issues some memo edict on a "new approach".

Staff attorneys typically bring investors only bad news and are numbed by the latter's emotional reactions, in a kind of "shell shock". The SEC lost one quarter of its staff in the last two years. The turnover of its 1200 attorneys, at 14%, is nearly double the government's average.

One SEC official was quoted as saying "We are losing our future - the people who would have had the experience to move into the senior ranks". Those that stay behind and rise in the ranks are often the least inspired. At the SEC enforcement division, one is often confronted with the "evil of banality".

The SEC is empowered by the Securities Act of 1933 and the Securities Exchange Act of 1934 to seek injunctive relief where it appears that a person is engaged or about to engage in violations of the federal securities laws. This is a civil remedy, not a criminal law sanction. Under well-settled case law, the purpose of injunctive relief is deterrence, rather than punishment, of those who commit violations. Investors do not know that, and are uniformly shocked when told.

The "likelihood requirement" means that, once the Commission demonstrates a violation, for injunctive relief it needs only show that there is some reasonable likelihood of future violations. "Positive proof" of likelihood, as one court demanded, is hard to provide. At the other extreme, I had one former Commissioner tell me that, as he understood the law, if the person is alive and breathing, the Commission enforcement staff can show likelihood of future violations.

The broad powers of the federal courts are used in actions brought by the Commission to prevent securities violators from enjoying the fruits of their misconduct. But because this is a civil and not a criminal remedy, the SEC has a unique rule where defendants can consent to an injunction without "admitting or denying the allegations of the complaint". This leads to what are called "waivers", and I submit that "waivers" are the fundamental flaw in U.S. securities laws enforcement.

In a nutshell, here is the problem. A "fraudster" commits a fraud. The Commission sues for an injunction.

The fraudster consents to the injunction as per above. The Court then orders the fraudster to "disgorge" his "ill gotten gains" from the scam, usually within 30 days and with interest.

In most cases, the fraudster doesn't pay it all and the Commission moves to hold him in civil contempt for disobeying the Court's order. The fraudster claims to the Court that it is impossible for him to comply because the money is gone and he is "without the financial means to pay". The Commission then issues a "waiver" and that's the way many cases end. Thus both sides can put the case behind them. The fraudster agrees to the re-opening of the case if he turns out to have lied.

This procedure is problematic. The Commission typically alleges that these fraudsters have lied through their teeth in securities sales - but is forced to accept their word in an affidavit swearing that they have no money to pay the disgorgement. So the waivers are based on an assumption of credibility that has no basis in experience and possibly none in fact.

Moreover, the Division of Enforcement has no mechanism in place to check if the fraudster has, indeed, lied. After the waiver, the files of the case get stored. The case is closed. I don't know if there's even a central place where the records of waivers are kept.

In the six years I was at the Commission, I never heard of a case involving a breach of waiver affidavit. I doubt if one has ever been brought by the Commission - anywhere. UPI ought to do a Freedom Of Information Act Request on that.

Something similar happens with the Commission's much vaunted ability to levy civil penalties. The statute requires that a court trial be held to determine the egregiousness of the fraud. Based on its findings, the court can levy the fines. But, according to some earlier non- SEC case law, a fraudster can ask for a jury trial regarding the amount of the civil penalties because he or she lack the means to pay them. U.S. district courts being as busy as they are, there's no way the court is going to hold a jury trial.

Instead, the fraudster consents to a court order "noting the appropriateness of civil penalties for the case, but declining to set them based on a demonstrated inability to pay". Again, if the fraudster lied, the Commission can ask the Court to revisit the issue.

Q. Internet fraud, corporate malfeasance, derivatives, off- shore special purpose entities, multi-level marketing, scams, money laundering - is the SEC up to it? Isn't its staff overwhelmed and under-qualified? A. The staff is overwhelmed. The longest serving are often the least qualified because the talented usually leave.

We've already got the criminal statutes on the books for criminal prosecution of securities fraud at the federal level. Congress should pass a law deputizing staff attorneys of the Commission Division of Enforcement, with at least one-year experience and high performance ratings, as Special Assistant United States Attorneys for the prosecution of securities fraud. In other words, make them part of the Department of Justice to make criminal, not just civil cases, against the fraudsters.

The US Department of Justice does not have the person power to pursue enough criminal securities cases in the Internet Age. Commission attorneys have the expertise, but not the legal right, to bring criminal prosecution. The afore-described waiver system only makes the fraudsters more confident that the potential gain from fraud outweighs the risk.

I'd keep the civil remedies. In an ongoing fraud, with no time to make out a criminal case, the Commission staff can seek a Temporary Restraining Order and an asset freeze. This more closely resembles the original intent of Congress in the 1930s. But after the dust settles, the investing public deserves to demand criminal accountability for the fraud, not just waivers.

Q. Is the SEC - or at least its current head - in hock to special interests, e.g., the accounting industry? A. "In hock to special interests" is too explicit a statement about US practice. It makes a good slogan for a Marxist law school professor, but reality is far subtler.

By unwritten bipartisan agreement, the Chairman of the SEC is always a political figure. Two of the five SEC Commissioners are always Democrats, two Republicans, and the Chairman belongs to the political party of the President. I am curious to see if this same agreement will apply to the boards established under the Sarbanes-Oxley Act.

Thus, both parties typically choose a candidate for Chairman of impeccable partisan credentials and consistent adherence to the "party line". The less connected, the less partisan, and academicians serve as Commissioners, not Chairmen.

The Chairman's tenure normally overlaps with a specific President's term in office, even when, as with President Bush the elder following President Reagan, the same party remains in power. SEC jobs lend themselves to lucrative post-Commission employment. This explains the dearth of "loyal opposition". Alumni pride themselves on their connections following their departure.

The Chairman is no more and no less "in hock" than any leading member of a US political party. Still, I faulted Chairman Pitt, and became the first former member of SEC management to call for his resignation, in an Op/Ed item in the Miami Herald. In my view, he was impermissibly indulgent of his former law clients at the expense of SEC enforcement.

Q. What more could stock exchanges do to help the SEC? A. At the risk of being flippant, enforce their own rules. The major enforcement action against the NASDAQ brokers a few years ago, for instance, was toothless. Presently, Merrill Lynch is being scrutinized by the State of New York, but there is not a word from the NYSE.

Q. Do you regard the recent changes to the law - especially the Sarbanes-Oxley Act - as toothless or an important enhancement to the arsenal of law enforcement agencies? Do you think that the SEC should have any input in professional self-regulating and regulatory bodies, such as the recently established accountants board? A. It remains to be seen. The Act establishes a Public Accounting Oversight Board ("the Board"). It reflects one major aspect of SEC enforcement practice: unlike in many countries, the SEC does not recognize an accountant/client privilege, though it does recognize an attorney/client privilege.

Regrettably, in my experience, attorneys organize at least as much securities fraud as accountants. Yet in the US, one would never see an "attorneys oversight board". For one thing, Congress has more attorneys than accountants.

Section 3 of the Act, titled "Commission Rules and

Enforcement", treats a violation of the Rules of the Public Company Accounting Oversight Board as a violation of the '34 Act, giving rise to the same penalties. It is unclear if this means waiver after waiver, as in present SEC enforcement. Even if it does, the Rules may still be more effective because US state regulators can forfeit an accountant's license based on a waived injunction.

The Act's provision, in Section 101, for the membership of said Board has yet to be fleshed out. Appointed to five- year terms, two of the members must be - or have been - certified public accountants, and the remaining three must not be and cannot have been CPAs. Lawyers are the likeliest to be appointed to these other seats. The Chairmanship may be held by one of the CPA members, provided that he or she has not been engaged as a practicing CPA for five years, meaning, ab initio, that he or she will be behind the practice curb at a time when change is rapid.

No Board member may, during their service on the Board, "share in any of the profits of, or receive payments from, a public accounting firm," other than "fixed continuing payments," such as retirement payments. This mirrors SEC practice with the securities industry, but does little to tackle "the revolving door".

The Board members are appointed by the SEC, "after consultation with" the Federal Reserve Board Chairman and the Treasury Secretary. Given the term lengths, it is safe to predict that every new presidential administration will bring with it a new Board.

The major powers granted to the Board will effectively change the accounting profession in the USA, at least with regards to public companies, from a self-regulatory body licensed by the states, into a national regulator.

Under Act Section 103, the Board shall: (1) register public accounting firms; (2) establish "auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers;" (3) inspect accounting firms; and (4) investigate and discipline firms to enforce compliance with the Act, the Rules, professional standards and the federal securities laws. This is a sea change in the US.

As to professional standards, the Board must "cooperate on an on-going basis" with certain accountants advisory groups. Yet, US federal government Boards do not "co- operate" - they dictate. The Board can "to the extent that it determines appropriate" adopt proposals by such groups.

More importantly, it has authority to reject any standards proffered by said groups. This will then be reviewed by the SEC, because the Board must report on its standards to the Commission every year. The SEC may - by rule - require the Board to cover additional ground. The Board, and the SEC through the Board, now run the US accounting profession.

The Board is also augments the US effort to establish hegemony over the global practice of accounting. Act Section 106, Foreign Public Accounting Firms, subjects foreigners who audit U.S. companies - including foreign firms that perform audit work that is used by the primary auditor on a foreign subsidiary of a U.S. company - to registration with the Board.

I am amazed that the EU was silent on this inroad to their sovereignty. This may prove more problematic in US operations in China. I do not think the US can force its accounting standards on China without negatively affecting our trade there.

Under Act Section 108, the SEC now decides what are "generally" accepted accounting principles. Registered public accounting firms are barred from providing certain non-audit services to an issuer they audit. Thus, the split, first proposed by the head of Arthur Anderson in 1974, is now the law.

Act Section 203, Audit Partner Rotation, is a gift to the accounting profession. The lead audit or coordinating partner and the reviewing partner must rotate every 5 years. That means that by law, the work will be spread around. Note that the law says "partner", not "partnership". Thus, we are likely to continue to see institutional clients serviced by "juntas" at accounting firms, not by individuals. This will likely end forever the days when a single person controlled major amounts of business at an accounting firm. US law firms would never countenance such a change, as the competition for major clients is intense.

Act Section 209, Consideration by Appropriate State Regulatory Authorities, "throws a bone" to the states. It requires state regulators to make an independent determination whether Board standards apply to small and mid-size non-registered accounting firms. No one can seriously doubt the outcome of these determinations. But we now pretend that we still have real state regulation of the accounting profession, just as we pretend that we have state regulation of the securities markets through "blue sky laws". The reality is that the states will be confined hence to the initial admission of persons to the accounting profession. Like the "blue sky laws", it will be a revenue source, but the states will be completely junior to the Board and the SEC.

Act Section 302, Corporate Responsibility For Financial Reports, mandates that the CEO and CFO of each issuer shall certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer". This may prove problematic with global companies. We have already seen resistance by Daimler-Benz of Germany.

Act Section 305: Officer And Director Bars And Penalties; Equitable Relief, will be used by the SEC to counterattack arguments arising out of the Central Bank case. As I maintained in the American Journal of Trial Advocacy, the real significance of the Supreme Court decision in Central Bank was that the remedial sanctions of the federal securities laws should be narrowly construed.

Well, now the SEC has a Congressional mandate. Federal courts are authorized to "grant any equitable

relief that may be appropriate or necessary for the benefit of investors". That is an incredibly broad delegation of rights, and is an end run around Central Bank. I was surprised that this received no publicity.

Lastly, Act Section 402, Prohibition on Personal Loans to Executives, shows how low this generation of US leadership has sunk. President Bush has signed a law that makes illegal the type of loans from which he and his extended family have previously benefited.

Tacitly, the Act admits that some practices of Enron were not illegal inter se. Act Section 401, Study and Report on Special Purpose Entities, provides that the SEC should study off-balance sheet disclosures to determine their extent and whether they are reported in a sufficiently transparent fashion. The answer will almost certainly be no, and the Board will change GAAP accordingly.

Q. Does the SEC collaborate with other financial regulators and law enforcement agencies internationally? Does it share information with other US law enforcement agencies? Is there interagency rivalry and does it hamper investigations? Can you give us an example? A. The SEC and other regulators - as well as two House subcommittees - have only very recently begun considering information sharing between financial regulators.

This comes too late for the victims of Martin Frankel, who, having been barred for life from the securities industry by the SEC and NASD in 1992, simply moved over to the insurance industry to perpetrate a scam where investors have lost an estimated \$200 million dollars.

Had the state insurance regulators known this person's background, he would have been unable to set up multiple insurance companies. Failure to share information is a genuine problem, but "turf" considerations generally trump any joint efforts.

XXV. Trading from a Suitcase. The Case of Shuttle Trade

They all sport the same shabby clothes, haggard looks, and bulging suitcases bound with frayed ropes. These are the shuttle traders. You can find them in Mongolia and Russia, China and Ukraine, Bulgaria and Kosovo, the West Bank and Turkey. They cross the border as "tourists", sometimes as often as 10 times a year, and come back with as much merchandise as they can carry in their enormous luggage. Some of them resort to freight forwarding their "personal belongings".

They distort trade figures, smuggle goods across ill-guarded borders, ignore international treaties and conventions and, in short, revive moribund economies.

They are the life-blood and the only manifestation of true entrepreneurship in swathes of economic wastelands.

They meet demands for consumer goods unmet by domestic manufacturers or by officially-sanctioned importers.

In recognition of their vital role, the worried Kyrgyz government held a round table discussion last summer about the precarious state of Kyrgyzstan's shuttle trade.

Many former Soviet republics have tightened up their border controls. In May last year, Russian officials seized half a million dollars worth of shuttle goods belonging to 1500 traders. When two million dollars worth of goods were confiscated in a similar incident in fall 2001, eight Kyrgyz traders committed suicide.

The number of Kyrgyz shuttle traders dropped in 2002 to 300,000 (from 500,000 in 1996). The majority of those who remain are insolvent. Many of them emigrated to other countries. The shuttle traders asked the government to legalize and regulate their vanishing trade and thus to save them from avaricious and minacious customs officials.

Even prim international financial institutions recognize the survival-value of shuttle trade to the economies of developing and transition countries. It employs millions, boosts investments in transport and infrastructure, and encourages grassroots capitalism. The IMF - in the 11th meeting of its Committee on Balance of Payments Statistics in 1998 - officially recognized shuttle trade as a business activity to be recorded under "goods".

But there is a seedier and seamier side to shuttle trade where it interfaces with organized crime and official corruption. Shuttle trade also constitutes unfair competition to legitimate, tax and customs duties paying enterprises - the manufacturers of textiles, shoes, cigarettes, alcoholic drinks, and food products. Shuttled goods are not subject to health and safety inspections, or quality control.

According to the March 27th 2002 issue of East West Institute's "Russian Regional Report", the value of Chinese goods shuttled into the borderlands of the Russian Far East is a whopping \$50 million a month.

China benefits from the serendipitous proceeds of these informal exports - but is unhappy at the lost tax revenues.

EWI claims that Russian banks in the region (such as DalOVK, Primsotsbank, and Regiobank) are already offering money transfer services to China. DalOVK alone transfers \$1 million a month - a fortune in local terms. But even these figures may be a serious under-estimate. The trade between Khabarovsk Territory in Russia and Heilongjiang Province in China - most of it in shuttle form - was \$1.5 billion in 2001. The bulk of it was one way, from China to Russia.

Shuttle trade is even more prominent between Iraq and Turkey. The Anatolia News Agency expected it to increase to \$2 billion in 2002. By comparison, the official exports of Turkey to Iraq amount to \$800 million. The then prime minister Bulent Ecevit himself stated to the Ankara Anatolia news agency: "We have provided necessary support to increase shuttle trade".

"The Economist" reports about the flourishing "petty trade" between China and Vietnam. Western and counterfeit goods are smuggled to bazaars in Vietnam, owned and operated by Chinese nationals. The border between these two erstwhile enemies opened in 1990.

This led to the rise of criminal networks which involve border guards and policemen.

Another hot spot is the Balkan. In a report dated July 2001, the Balkan Information Exchange describes the "Tulip Market" in Istanbul. Vendors are fluent in Russian, Bulgarian and Romanian and most of the clients are East European. They buy wholesale and use special vans and buses to transport the goods - mainly textiles - northwards, frequently to destinations in the Balkan. This kind of trade is estimated to be worth \$8 billion a year - more than one quarter of Turkey's official exports.

Bulgarian customs officials, border patrols, and policemen form part of these efficient rings - as do their Macedonian and, to a lesser extent, Greek counterparts. The Sofia-based Center for the Study of Democracy thinks that a third of the Bulgarian workforce (i.e., c. 1 million people) may be involved. Many of the traders maintain mom-and-pop establishments or stalls in public bazaars, where members of their family sell the goods.

Some of the merchandise ends up in Serbia, which was subjected to UN sanctions until lately. Fuel smuggling on bikes and other forms of sanctions busting have largely ended but they have been replaced by cigarettes, alcohol, firearms, stolen cars, and mobile phones.

The Serbian authorities often round up and deport Bulgarian shuttle traders, provoking furious resentment in Bulgaria. Headlines like "(Serbian) Policemen take away our countrymen's money" and "Serbs searching (Bulgarian) women's genitals for money" are pretty common. The Bulgarians are embittered. They used to smuggle medicines and fuel into embargoed Serbia - only to be abused by Serb officials now, that the embargo has been lifted.

East European buyers used to reach as far as India where they shopped wholesale in winter. Russians used to buy readymade clothes, leather goods, and cheap jewelry in New Delhi and elsewhere and sell the goods in the numerous flea markets back home.

To finance their purchases, they used to sell in India Russian cosmetics and consumer goods such as watches, cameras, or hair dryers. But the 1998 financial crisis and sub-standard wares offered by unscrupulous Indian traders put a stop to this particular venue.

Governments are trying to stem the shuttle trade. The Russian news agency, ITAR-TASS, reports that Sergei Stepashin, the dynamic chairman of the Russian Audit Chamber (and a former short-lived prime minister of Russia) is bent on tightening the cooperation between member states of the Shanghai Cooperation Organization.

The audit agencies of China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan will exchange information and strive to control the thriving shuttle trade across their porous borders. China and Russia are poised to sign a bilateral accord regarding these issues in October.

The WPS Monitoring Agency reported last November that the Economic Development and Trade Ministry of Russia intends to treat cargos of more than 50 kilos as a consignment of commercial goods, subject to import tariffs (on top of the current tax of 30 percent).

The Ministry claimed that shuttle trade accounts for up to 90 percent of all imported goods "in certain spheres" (e.g., furs). As late as 1994, Russians were allowed to import up to \$5000 of duty-free goods in their accompanied baggage - a relic of communist days when only the privileged few were allowed to travel.

Up to 2 million Russian citizens may be engaged in shuttle trade and the value of "gray" goods may be as high as \$10 billion annually. Goods from Turkey alone amounted in 2002 to \$1.5-2 billion, according to then vice-premier Viktor Khristenko, but shuttle traders also operate in the United Arab Emirates, Syria, Israel, Pakistan, India, China, Poland, Hungary, and Italy.

A set of figures published for the first quarter of 2001 shows that shuttle trade amounted to \$2.6 billion, or 8 percent of Russia's total foreign trade. Shuttle traded goods made up 1.5 percent of exports - but a full quarter of imports.

But the shuttle trade's coup de grace may well be EU enlargement. Already a new "iron curtain", comprised of visas and regulations, is rising between EU candidates and other East European and Balkan countries.

Consider the EU's eastern boundary. More than a million people cross the busy Ukrainian-Polish border every month. Enhanced regulation on the Polish side and new, IMF-inspired, tax laws on the Ukrainian side led to a massive increase in corruption and smuggling. Truck owners now bribe customs officials to the tune of \$300 per vehicle, according to a January 2001 report by CEPS.

The results are grave. Following the introduction of these new measures, cross border traffic fell by 50 percent and unemployment in the Polish border zones jumped by 40 percent in 2002 alone. It has since doubled. The IMF and the EU are much decried by the Polish minority now trapped in Western Ukraine.

The situation is likely to be further exacerbated with the introduction of a reciprocal visa regime between the two countries. Shuttle trade may be decimated by the resulting bureaucratic bottlenecks.

Still, it may no longer be needed now that Poland acceded to the EU. Shuttle trade thrives on poverty. It arbitrates between inefficient markets. It satisfies unrequited demand for goods. The single market ought to rid Europe of all these distortions - and, thus, most probably of this makeshift though resilient solution, the shuttle trader.

XXVI. The Blessings of the Black Economy

Some call it the "unofficial" or "informal" economy, others call it the "grey economy" but the old name fits it best: the "black economy". In the USA "black" means "profitable, healthy" and this is what the black economy is. Macedonia should count its blessings for having had a black economy so strong and thriving to see it through the transition. If Macedonia had to rely only on its official economy it would have gone bankrupt long ago.

The black economy is made up of two constituent activities: 1. Legal activities that are not reported to the tax authorities and the income from which goes untaxed and unreported. For instance: it is not illegal to clean someone's house, to feed people or to drive them. It is, however, illegal to hide the income generated by these activities and not to pay tax on it. In most countries of the world, this is a criminal offence, punishable by years in prison. 2. Illegal activities which, needless to say, are also not reported to the state (and, therefore, not taxed).

These two types of activities together are thought to comprise between 15% (USA, Germany) to 60% (Russia) of the economic activity (as measured by the GDP), depending on the country. It would probably be an underestimate to say that 40% of the GDP in Macedonia is "black". This equals 1.2 billion USD per annum. The money generated by these activities is largely held in foreign exchange outside the banking system or smuggled abroad (even through the local banking system).

Experience in other countries shows that circa 15% of the money "floats" in the recipient country and is used to finance consumption. This should translate to 1 billion free floating dollars in the hands of the 2 million citizens of Macedonia. Billions are transferred to the outside world (mostly to finance additional transactions, some of it to be saved in foreign banks away from the long hand of the state). A trickle of money comes back and is "laundered" through the opening of small legal businesses.

These are excellent news for Macedonia. It means that when the macro-economic, geopolitical and (especially) the micro-economic climates will change - billions of USD will flow back to Macedonia. People will bring their money back to open businesses, to support family members and just to consume it. It all depends on the mood and on the atmosphere and on how much these people feel that they can rely on the political stability and rational management. Such enormous flows of capital happened before: in Argentina after the Generals and their corrupt regime were ousted by civilians, in Israel when the peace process started and in Mexico following the signature of NAFTA, to mention but three cases. These reserves can be lured back and transform the economy.

But the black economy has many more important functions.

The black economy is a cash economy. It is liquid and fast. It increases the velocity of money. It injects much needed foreign exchange to the economy and inadvertently increases the effective money supply and the resulting money aggregates. In this sense, it defies the dictates of "we know better" institutions such as the IMF.

It fosters economic activity and employs people. It encourages labour mobility and international trade. Black economy, in short, is very positive. With the exception of illegal activities, it does everything that the official economy does - and, usually, more efficiently.

So, what is morally wrong with the black economy? The answer, in brief: it is exploitative. Other parts of the economy, which are not hidden (though would have liked to be), are penalized for their visibility. They pay taxes.

Workers in a factory owned by the state or in the government service cannot avoid paying taxes. The money that the state collects from them is invested, for instance, in infrastructure (roads, phones, electricity) or used to pay for public services (education, defence, policing). The operators of the black economy enjoy these services without paying for them, without bearing the costs and worse: while others bear the costs. These encourages them, in theory to use these resources less efficiently.

And all this might be true in a highly efficient, almost ideal market economy. The emphasis is on the word "market". Unfortunately, we all live in societies which are regulated by bureaucracies which are controlled (in theory, rarely in practice) by politicians. These elites have a tendency to misuse and to abuse resources and to allocate them in an inefficient manner. Even economic theory admits that any dollar left in the hands of the private sector is much more efficiently used than the same dollar in the hands of the most honest and well meaning and well planning civil servant. Governments all over the world distort economic decisions and misallocate scarce economic resources.

Thus, if the goals are to encourage employment and economic growth - the black economy should be welcomed. This is precisely what it does and, by definition, it does so more efficiently than the government. The less tax dollars a government has - the less damage it does. This is an opinion shared by most economists in the world today. Lower tax rates are an admission of this fact and a legalization of parts of the black

economy.

The black economy is especially important in times of economic hardships. Countries in transition are a private case of emerging economies which are a private case of developing countries which used to be called (in less politically correct times) "Third World Countries". They suffer from all manner of acute economic illnesses. They lost their export markets, they are technologically backward, their unemployment skyrockets, their plant and machinery are dilapidated, their infrastructure decrepit and dysfunctional, they are lethally illiquid, they become immoral societies (obligations not honoured, crime flourishes), their trade deficits and budget deficits balloon and they are conditioned to be dependent on handouts and dictates from various international financial institutions and donor countries.

Read this list again: isn't the black economy a perfect solution until the dust settles? It enhances exports (and competitiveness through imports), it encourages technology transfers, it employs people, it invests in legitimate businesses (or is practised by them), it adds to the wealth of the nation (black marketeers are big spenders, good consumers and build real estate), it injects liquidity to an otherwise dehydrated market. Mercifully, the black economy is out of the reach of zealous missionaries such as the IMF. It goes its own way, unnoticed, unreported, unbeknownst, untamed. It doesn't pay attention to money supply targets (it is much bigger than the official money supply figure), or to macroeconomic stability goals. It plods on: doing business and helping the country to survive the double scourges of transition and Western piousness and patronizing. As long as it is there, Macedonia has a real safety net. The government is advised to turn a blind eye to it for it is a blessing in disguise.

There is one sure medicine: eliminate the population and both unemployment and inflation will be eliminated.

Without the black economy, the population of Macedonia would not have survived. This lesson must be remembered as the government prepares to crack down on the only sector of the economy which is still alive and kicking.

Operational Recommendations The implementation of these recommendations and reforms should be obliged to be GRADUAL. The informal economy is an important pressure valve for the release of social pressures, it ameliorates the social costs inherent to the period of transition and it constitutes an important part of the private sector.

As we said in the body of our report, these are the reasons for the existence of an informal economy and they should be obliged to all be tackled: ? High taxation level (in Macedonia, high payroll taxes); ? Onerous labour market regulations; ? Red tape and bureaucracy (which often leads to corruption); ? Complexity and unpredictability of the tax system.

Reporting Requirements and Transparency ? All banks should be obliged to report foreign exchange transactions of more than 10,000 DM (whether in one transaction or cumulatively by the same legal entity). The daily report should be submitted to the Central Bank. In extreme cases, the transactions should be investigated. ? All the ZPP account numbers of all the firms in Macedonia should be publicly available through the Internet and in printed form. ? Firms should be obliged by law to make a list of all their bank accounts available to the ZPP, to the courts and to plaintiffs in lawsuits. ? All citizens should be obliged to file annual, personal tax returns (universal tax returns, like in the USA). This way, discrepancies between personal tax returns and other information can lead to investigations and discoveries of tax evasion and criminal activities. ? All citizens should be obliged to file bi-annual declarations of personal wealth and assets (including real estate, vehicles, movables, inventory of business owned or controlled by the individual, financial assets, income from all sources, shares in companies, etc.). ? All retail outlets and places of business should be required to install - over a period of 3 years - cash registers with "fiscal brains". These are cash registers with an embedded chip. The chips are built to save a trail (detailed list) of all the transactions in the place of business. Tax inspectors can pick the chip at random, download its contents to the tax computers and use it to issue tax assessments. The information thus gathered can also be crossed with and compared to information from other sources (see: "Databases and Information Gathering"). This can be done only after the full implementation of the recommendations in the section titled "Databases and Information Gathering". I do not regard it as an effective measure. While it increases business costs - it is not likely to prevent cash or otherwise unreported transactions. ? All taxis should be equipped with taximeters, which include a printer. This should be a licencing condition. ? Industrial norms (for instance, the amount of sugar needed to manufacture a weight unit of chocolate, or juice) should be revamped. Norms should NOT be determined according to statements provided by the factory - but by a panel of experts. Each norm should be signed by three people, of which at least one is an expert engineer or another expert in the relevant field. Thought should be dedicated to the possibility of employing independent laboratories to determine norms and supervise them. ? Payments in wholesale markets should be done through a ZPP counter or branch in the wholesale market itself. Release of the goods and exiting the physical location of the wholesale market should be allowed only against presentation of a ZPP payment slip.

Reduction of Cash Transactions ? Cash transactions are the lifeblood of the informal economy. Their reduction and minimization is absolutely essential in the effort to contain it. One way of doing it is by issuing ZPP payment (debit) cards to businesses, firm and professionals. Use of the payment cards should be mandatory in certain business-to-business transactions. ? All exchange offices should be obliged to issue receipt for every cash transaction above 100 DM and to report to the Central Bank all transactions above 1000 DM. Suspicious transactions (for instance, transactions which exceed the financial wherewithal of the client involved) should be duly investigated. ? The government can reduce payroll taxes if the salary is not paid in cash (for instance, by a transfer to the bank account of the employee). The difference between payroll taxes collected on cash salaries and lower payroll taxes collected on noncash salaries - should be recovered by imposing a levy on all cash withdrawals from banks. The banks can withhold the tax and transfer it to the state monthly. ? Currently, checks issued to account-holders by banks are virtually guaranteed by the issuing

banks. This transforms checks into a kind of cash and checks are used as cash in the economy. To prevent this situation, it is recommended that all checks will be payable to the beneficiary only. The account-holder will be obliged to furnish the bank with a monthly list of checks he or she issued and their details (to whom, date, etc.). Checks should be valid for 5 working days only. ? An obligation can be imposed to oblige businesses to effect payments only through their accounts (from account to account) or using their debit cards. Cash withdrawals should be subject to a withholding tax deducted by the bank. The same withholding tax should be applied to credits given against cash balances or to savings houses (stedilnicas). Alternatively, stedilnicas should also be obliged to deduct, collect and transfer the cash withdrawal withholding tax. ? In the extreme and if all other measures fail after a reasonable period of time, all foreign trade related payments should be conducted through the Central Bank. But this is really a highly irregular, emergency measure, which I do not recommend at this stage. ? The interest paid on cash balances and savings accounts in the banks should be increased (starting with bank reserves and deposits in the central bank). ? The issuance of checkbook should be made easy and convenient. Every branch should issue checkbooks. All the banks and the post office should respect and accept each other's checks. ? A Real Time Gross Settlement System should be established to minimize float and facilitate interbank transfers.

Government Tenders ? Firms competing for government tenders should be obliged to acquire a certificate from the tax authorities that they owe no back-taxes.

Otherwise, they should be barred from bidding in government tenders and RFPs (Requests for Proposals).

Databases and Information Gathering ? Estimating the informal economy should be a priority objective of the Bureau of Statistics, which should devote considerable resources to this effort. In doing so, the Bureau of Statistics should coordinate closely with a wide variety of relevant ministries and committees that oversee various sectors of the economy. ? All registrars should be computerized: land, real estate, motor vehicles, share ownership, companies registration, tax filings, import and export related documentation (customs), VAT, permits and licences, records of flights abroad, ownership of mobile phones and so on. The tax authorities and the Public Revenue Office (PRO) should have unrestricted access to ALL the registers of all the registrars. Thus, they should be able to find tax evasion easily (ask for sources of wealth- how did you build this house and buy a new car if you are earning 500 DM monthly according to your tax return?). ? The PRO should have complete access to the computers of the ZPP and to all its computerized and non-computerized records. ? The computer system should constantly compare VAT records and records and statements related to other taxes in order to find discrepancies between them. ? Gradually, submissions of financial statements, tax returns and wealth declarations should be computerized and done even on a monthly basis (for instance, VAT statements). ? A system of informants and informant rewards should be established, including anonymous phone calls. Up to 10% of the intake or seizure value related to the information provided by the informant should go to the informant.

Law Enforcement ? Tax inspectors and customs officials should receive police powers and much higher salaries (including a percentage of tax revenues). The salaries of all tax inspectors - regardless of their original place of employment - should be equalized (of course, taking into consideration tenure, education, rank, etc.). ? Judges should be trained and educated in matters pertaining to the informal economy. Special courts for taxes, for instance, are a good idea (see recommendation below). Judges have to be trained in tax laws and the state tax authorities should provide BINDING opinions to entrepreneurs, businessmen and investors regarding the tax implications of their decisions and actions. ? It is recommended to assign tax inspectors to the public prosecutors' office to work as teams on complex or big cases. ? To establish an independent Financial and Tax Police with representatives from all relevant ministries but under the exclusive jurisdiction of the PRO. The remit of this Police should include all matters financial (including foreign exchange transactions, property and real estate transactions, payroll issues, etc.). ? Hiring and firing procedures in all the branches of the tax administration should be simplified. The number of administrative posts should be reduced and the number of tax inspectors and field agents increased. ? Tax arrears and especially the interest accruing thereof should be the first priority of the ZPP, before all other payments. ? All manufacturers and sellers of food products (including soft drinks, sweetmeats and candy, meat products, snacks) should purchase a licence from the state and be subjected to periodic and rigorous inspections. ? All contracts between firms should be registered in the courts and stamped to become valid. Contracts thus evidenced should be accompanied by the registration documents (registrar extract) of the contracting parties. Many "firms" doing business in Macedonia are not even legally registered.

Reforms and Amnesty ? A special inter-ministerial committee with MINISTER-MEMBERS and headed by the PM should be established. Its roles: to reduce bureaucracy, to suggest appropriate new legislation and to investigate corruption. ? Bureaucracy should be pared down drastically.

The more permits, licences, tolls, fees and documents needed - the more corruption. Less power to state officials means less corruption. The One Stop Shop concept should be implemented everywhere. ? A general amnesty should be declared. Citizens declaring their illegal wealth should be pardoned BY LAW and either not taxed or taxed at a low rate once and forever on the hitherto undeclared wealth.

The Tax Code ? To impose a VAT system. VAT is one the best instruments against the informal economy because it tracks the production process throughout a chain of value added suppliers and manufacturers. ? The Tax code needs to be simplified. Emphasis should be placed on VAT, consumption taxes, customs and excise taxes, fees and duties. To restore progressivity, the government should directly compensate the poor for the excess relative burden. ? After revising the tax code in a major way, the government should declare a moratorium on any further changes for at least four years. ? The self-employed and people whose main employment is directorship in companies should be given the choice between paying a fixed % of the market value of their assets (including financial assets) or income tax. ? All property rental contracts should be registered with the courts. Lack of registration in the courts and payment of a stamp tax should render the contract invalid. The courts should be allowed to evidence and stamp a contract only after it carries the

stamp of the Public Revenue Office (PRO).

The PRO should register the contract and issue an immediate tax assessment. Contracts, which are for less than 75% of the market prices, should be subject to tax assessment at market prices. Market prices should be determined as the moving average of the last 100 rental contracts from the same region registered by the PRO. ? Filing of tax returns - including for the self-employed - should be only with the PRO and not with any other body (such as the ZPP).

Legal Issues ? The burden of proof in tax court cases should shift from the tax authorities to the person or firm assessed. ? Special tax courts should be established within the existing courts. They should be staffed by specifically trained judges. Their decisions should be appealed to the Supreme Court. They should render their decisions within 180 days. All other juridical and appeal instances should be cancelled - except for an appeal instance within the PRO.

Thus, the process of tax collection should be greatly simplified. A tax assessment should be issued by the tax authorities, appealed internally (within the PRO), taken to a tax court session (by a plaintiff) and, finally, appealed to the Supreme Court (in very rare cases). ? The law should allow for greater fines, prison terms and for the speedier and longer closure of delinquent businesses. ? Seizure and sale procedures should be specified in all the tax laws and not merely by way of reference to the Income Tax Law. Enforcement provisions should be incorporated in all the tax laws. ? To amend the Law on Tax Administration, the Law on Personal Income Tax and the Law on Profits Tax as per the recommendations of the IRS experts (1997-9).

Customs and Duties ? Ideally, the customs service should be put under foreign contract managers. If this is politically too sensitive, the customs personnel should be entitled to receive a percentage of customs and duties revenues, on a departmental incentive basis. In any case, the customs should be subjected to outside inspection by expert inspectors who should be rewarded with a percentage of the corruption and lost revenues that they expose. ? In the case of imports or payments abroad, invoices, which include a price of more than 5% above the list price of a product, should be rejected and assessment for the purposes of paying customs duties and other taxes should be issued at the list price. ? In the case of exports or payments from abroad, invoices which include a discount of more than 25% on the list price of a product should be rejected and assessment for the purposes of paying customs duties and other taxes should be issued at the list price. ? The numbers of tax inspectors should be substantially increased and their pay considerably enhanced. A departmental incentive system should be instituted involving a percentage of the intake (monetary fines levied, goods confiscated, etc.). ? The computerized database system (see "Databases and Information Gathering") should be used to compare imports of raw materials for the purposes of re-export and actual exports (using invoices and customs declarations). Where there are disparities and discrepancies, severe and immediate penal actions should be taken. Anti-dumping levies and measures, fines and criminal charges should be adopted against exporters colluding with importers in hiding imported goods or reducing their value. ? Often final products are imported and declared to the customs as raw materials (to minimize customs duties paid). Later these raw materials are either sold outright in the domestic or international markets or bartered for finished products (for example: paints and lacquers against furniture or sugar against chocolate). This should be a major focus of the fight against the informal economy. I follow with an analysis of two products, which are often abused in this manner. ? I study two examples (white sugar and cooking oil) though virtually all raw materials and foods are subject to the aforementioned abuse. ? White Sugar is often imported as brown sugar.

One way to prevent this is to place sugar on the list of LB (import licence required) list, to limit the effective period of each licence issued, to connect each transaction of imported brown sugar to a transaction of export, to apply the world price of sugar to customs duties, to demand payment of customs duties in the first customs terminal, to demand a forwarder's as well as an importer's guarantee and to require a certificate of origin. The same goes for Cooking Oil (which - when it is imported packaged - is often declared as some other goods). ? All payments to the customs should be made only through the ZPP. Customs and tax inspectors should inspect these receipts periodically. ? All goods should be kept in the customs terminal until full payment of the customs duties, as evidenced by a ZPP receipt, is effected.

Public Campaign ? The government should embark on a massive Public Relations and Information campaign. The citizens should be made to understand what is a budget, how the taxes are collected, how they are used. They should begin to view tax evaders as criminals. "He who does not pay his taxes - is stealing from you and from your children", "Why should YOU pay for HIM?" "If we all did not pay taxes- there would be no roads, bridges, schools, or hospitals" (using video to show disappearing roads, bridges, suffering patients and students without classes), "Our country is a partnership - and the tax-evader is stealing from the till (kasa)" and so on.

* The phrase "Gray Economy" should be replaced by the more accurate phrases "Black Economy" or "Criminal Economy".

XXVII. Public Procurement and Very Private Benefits

In every national budget, there is a part called "Public Procurement". This is the portion of the budget allocated to purchasing services and goods for the various ministries, authorities and other arms of the executive branch. It was the famous management consultant, Parkinson, who once wrote that government officials are likely to approve a multi-billion dollar nuclear power plant much more speedily that they are likely to authorize a hundred dollar expenditure on a bicycle parking device.

This is because everyone came across 100 dollar situations in real life - but precious few had the fortune to expend with billions of USD.

This, precisely, is the problem with public procurement: people are too acquainted with the purchased items. They tend to confuse their daily, household-type, decisions with the processes and considerations which should permeate governmental decision making. They label perfectly legitimate decisions as "corrupt" - and totally corrupt procedures as "legal" or merely "legitimate", because this is what was decreed by the statal mechanisms, or because "this is the law".

Procurement is divided to defence and non-defence spending. In both these categories - but, especially in the former - there are grave, well founded, concerns that things might not be all what they seem to be.

Government - from India's to Sweden's to Belgium's - fell because of procurement scandals which involved bribes paid by manufacturers or service providers either to individual in the service of the state or to political parties.

Other, lesser cases, litter the press daily. In the last few years only, the burgeoning defence sector in Israel saw two such big scandals: the developer of Israel's missiles was involved in one (and currently is serving a jail sentence) and Israel's military attache to Washington was implicated - though, never convicted - in yet another.

But the picture is not that grim. Most governments in the West succeeded in reigning in and fully controlling this particular budget item. In the USA, this part of the budget remained constant in the last 35(!) years at 20% of the GDP.

There are many problems with public procurement. It is an obscure area of state activity, agreed upon in "customized" tenders and in dark rooms through a series of undisclosed agreements. At least, this is the public image of these expenditures.

The truth is completely different.

True, some ministers use public money to build their private "empires". It could be a private business empire, catering to the financial future of the minister, his cronies and his relatives. These two plagues - cronyism and nepotism - haunt public procurement. The spectre of government official using public money to benefit their political allies or their family members - haunts public imagination and provokes public indignation.

Then, there are problems of plain corruption: bribes or commissions paid to decision makers in return for winning tenders or awarding of economic benefits financed by the public money. Again, sometimes these moneys end in secret bank accounts in Switzerland or in Luxembourg. At other times, they finance political activities of political parties. This was rampantly abundant in Italy and has its place in France. The USA, which was considered to be immune from such behaviours - has proven to be less so, lately, with the Bill Clinton alleged election financing transgressions.

But, these, with all due respect to "clean hands" operations and principles, are not the main problems of public procurement.

The first order problem is the allocation of scarce resources. In other words, prioritizing. The needs are enormous and ever growing. The US government purchases hundreds of thousands of separate items from outside suppliers. Just the list of these goods - not to mention their technical specifications and the documentation which accompanies the transactions - occupies tens of thick volumes. Supercomputers are used to manage all these - and, even so, it is getting way out of hand. How to allocate ever scarcer resources amongst these items is a daunting - close to impossible - task. It also, of course, has a political dimension. A procurement decision reflects a political preference and priority. But the decision itself is not always motivated by rational - let alone noble - arguments. More often, it is the by product and end result of lobbying, political hand bending and extortionist muscle. This raises a lot of hackles among those who feel that were kept out of the pork barrel. They feel underprivileged and discriminated against. They fight back and the whole system finds itself in a quagmire, a nightmare of conflicting interests. Last year, the whole budget in the USA was stuck - not approved by Congress - because of these reactions and counter-reactions.

The second problem is the supervision, auditing and control of actual spending. This has two dimensions: 1. How to make sure that the expenditures match and do not exceed the budgetary items. In some countries, this is a mere ritual formality and government departments are positively expected to overstep their procurement budgets. In others, this constitutes a criminal offence. 2. How to prevent the criminally corrupt activities that we have described above - or even the non criminal incompetent acts which government officials are prone to do.

The most widespread method is the public, competitive, tender for the purchases of goods and services.

But, this is not as simple as it sounds.

Some countries publish international tenders, striving to secure the best quality in the cheapest price - no matter what is its geographical or political source. Other countries are much more protectionist (notably: Japan and France) and they publish only domestic tenders, in most cases. A domestic tender is open only to domestic bidders.

Yet other countries limit participation in the tenders on various backgrounds: the size of the competing company, its track record, its ownership structure, its human rights or environmental record and so on. Some countries publish the minutes of the tender committee (which has to explain WHY it selected this or that supplier). Others keep it a closely guarded secret ("to protect commercial interests and secrets").

But all countries state in advance that they have no obligation to accept any kind of offer - even if it is the cheapest. This is a needed provision: the cheapest is not necessarily the best. The cheapest offer could be coming from a very unreliable supplier with a bad past performance or a criminal record or from a supplier who offers goods of shoddy quality.

The tendering policies of most of the countries in the world also incorporates a second principle: that of "minimum size". The cost of running a tender is prohibitive in the cases of purchases in small amounts.

Even if there is corruption in such purchases it is bound to cause less damage to the public purse than the costs of the tender which is supposed to prevent it! So, in most countries, small purchases can be authorized by government officials - larger amounts go through a tedious, multi-phase tendering process. Public competitive bidding is not corruption-proof: many times officials and bidders collude and conspire to award the contract against bribes and other, noncash, benefits. But we still know of no better way to minimize the effects of human greed.

Procurement policies, procedures and tenders are supervised by state auditing authorities. The most famous is, probably, the General Accounting Office, known by its acronym: the GAO.

It is an unrelenting, very thorough and dangerous watchdog of the administration. It is considered to be highly effective in reducing procurement - related irregularities and crimes. Another such institutions the Israeli State Reviser. What is common to both these organs of the state is that they have very broad authority.

They possess (by law) judicial and criminal prosecution powers and they exercise it without any hesitation. They have the legal obligation to review the operations and financial transactions of all the other organs of the executive branch. Their teams select, each year, the organs to be reviewed and audited. They collect all pertinent documents and correspondence. They cross the information that they receive from elsewhere. They ask very embarrassing questions and they do it under the threat of perjury prosecutions. They summon witnesses and they publish damning reports which, in many cases, lead to criminal prosecutions.

Another form of review of public procurement is through powers granted to the legislative arm of the state (Congress, Parliament, Bundestag, or Knesset). In almost every country in the world, the elected body has its own procurement oversight committee. It supervises the expenditures of the executive branch and makes sure that they conform to the budget. The difference between such supervisory, parliamentary, bodies and their executive branch counterparts - is that they feel free to criticize public procurement not only in the context of its adherence to budget constraints or its cleanliness - but also in a political context. In other words, these committees do not limit themselves to asking HOW - but also engage in asking WHY. Why this specific expense in this given time and location - and not that expense, somewhere else or some other time. These elected bodies feel at liberty - and often do - intervene in the very decision making process and in the order of priorities.

They have the propensity to alter both quite often.

The most famous such committee is, arguably, the Congressional Budget Office (CBO). It is famous because it is non-partisan and technocratic in nature. It is really made of experts which staff its offices.

Its apparent - and real - neutrality makes its judgements and recommendations a commandment not to be avoided and, almost universally, to be obeyed. The CBO operates for and on behalf of the American Congress and is, really, the research arm of that venerable parliament. Parallely, the executive part of the American system - the Administration - has its own guard against waste and worse: the Office of Management and Budget (OMB).

Both bodies produce learned, thickset, analyses, reports, criticism, opinions and recommendations. Despite quite a prodigious annual output of verbiage - they are so highly regarded, that virtually anything that they say (or write) is minutely analysed and implemented to the last letter with an air of awe.

Only a few other parliaments have committees that carry such weight. The Israeli Knesset have the extremely powerful Finance Committee which is in charge of all matters financial, from appropriations to procurement.

Another parliament renowned for its tight scrutiny is the French Parliament - though it retains very few real powers.

But not all countries chose the option of legislative supervision. Some of them relegated parts or all of these functions to the executive arm.

In Japan, the Ministry of Finance still scrutinizes (and has to authorize) the smallest expense, using an army of clerks. These clerks became so powerful that they have the theoretical potential to secure and extort benefits stemming from the very position that they hold. Many of them suspiciously join companies and organizations which they supervised or to which they awarded contracts - immediately after they leave their previous, government, positions. The Ministry of Finance is subject to a major reform in the reform-bent government of Prime Minister Hashimoto. The Japanese establishment finally realized that too much supervision, control, auditing and prosecution powers might be a Pyrrhic victory: it might encourage corruption - rather than discourage it.

Britain opted to keep the discretion to use public funds and the clout that comes with it in the hands of the political level. This is a lot like the relationship between the butter and the cat left to guard it. Still, this idiosyncratic British arrangement works surprisingly well.

All public procurement and expenditure items are approved by the EDX Committee of the British Cabinet (=inner, influential, circle of government) which is headed by the Ministry of Finance. Even this did not prove

enough to restrain the appetites of Ministers, especially as quid pro quo deals quickly developed. So, now the word is that the new Labour Prime Minister will chair it- enabling him to exert his personal authority on matters of public money.

Britain, under the previous, Tory, government also pioneered an interesting and controversial incentive system for its public servants as top government officials are euphemistically called there. They receive, added to their salaries, a portion of the savings that they effect in their departmental budgets. This means that they get a small fraction of the end of the fiscal year difference between their budget allowances and what they actually spent. This is very useful in certain segments of government activity - but could prove very problematic in others. Imagine health officials saving on medicines, or others saving on road maintenance or educational consumables. This, naturally, will not do.

Needless to say that no country officially approves of the payment of bribes or commission to officials in charge of public spending, however remote the connection is between the payment and the actions.

Yet, law aside many countries accept the intertwining of elites - business and political - as a fact of life, albeit a sad one. Many judicial systems in the world even make a difference between a payment which is not connected to an identifiable or discernible benefit and those that are.

The latter - and only the latter - are labelled "bribery".

Where there is money - there is wrongdoing. Humans are humans - and sometimes not even that.

But these unfortunate derivatives of social activity can be minimized by the adoption of clear procurement policies, transparent and public decision making processes and the right mix of supervision, auditing and prosecution. Even then the result is bound to be dubious, at best.

XXVIII. Crisis of the Bookkeepers

The Future of the Accounting Profession Interview with David Jones

On May 31, 2005, the US Supreme Court overturned the conviction of accounting firm Arthur Anderson on charges related to its handling of the books of the now defunct energy concern, Enron. It was only the latest scene in a drama which unfolded at the height of the wave of corporate malfeasance in the USA.

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He had joined the World Bank, as a senior financial analyst, in 1970, after working as a technical assistance advisor for the British Government in East Africa. He began his career in British local government. He is a Chartered Public Finance Accountant and a Chartered Certified Accountant (UK). He is the author of "Municipal Accounting for Developing Countries" originally published by the World Bank and the Chartered Institute of Public Finance and Accountancy (UK) in 1982.

Q: Accounting scandals seem to form the core of corporate malfeasance in the USA. Is there something wrong with the GAAP - or with American accountants? A: Accounting is based on some fundamental principles.

As I say at the beginning of my textbook, the accountant "records and interprets variations in financial position ... during any period of time, at the end of which he can balance net results (of past operations) against net resources (available for future operations)".

Accountancy includes the designing of financial records, the recording of financial information based on actual financial transactions (i.e., bookkeeping), the production of financial statements from the recorded information, giving advice on financial matters, and interpreting and using financial data to assist in making the best management decisions.

Simple as these principles may sound, they are, in practice, rather complicated to implement, to interpret and to practice. About 80% of the transactions require only about 20% of the effort because they are straightforward and obvious to a book-keeper, once the rules are learned.

But - and it is a big but - the other 20% or so of transactions require 80% of the intellectual effort. These transactions are most likely to have major impacts on the profit and loss account and the balance sheet.

My colleagues and I, all qualified accountants, have heated discussion over something as simple as the definition of a debit or a credit. Debits can be records of either expenses or assets. The former counts against income in the statement of profit and loss. The latter is treated as a continuing resource in a balance sheet. It is sometimes gradually allocated (expensed) against income in subsequent years, sometimes not.

A fundamental problem with the financial reporting of WorldCom, for example, was that huge quantities of expenses were misallocated in the accounts as assets.

Thus, by reducing expenditures, profit appeared to be increased. The effect of this on stock values and, thereby, on executive rewards are secondary and tertiary outcomes not caused directly by the accountancy.

Another example concerns interest on loans that may have been raised to finance capital investment, while

a large asset is under construction, often for several years.

Some argue that the interest should be accounted for as part of the capital cost until the asset is operational. Others claim that because the interest is an expense, it should be charged against that year's profits. Yet, the current year's income includes none of the income generated by the new asset, so profit is under-stated. And what if a hydro- electric power station starts to operate three of its ten turbines while still under construction? How does one allocate what costs, as expenses or assets, in such cases? Interestingly, the Generally Accepted Accounting Principles (GAAP) require that "interest during construction" be capitalized, that is included in the cost of the asset. The International Accounting Standards (IAS) prefer expensing but allow capitalization. From an economic viewpoint, both are wrong - or only partially right! The accountancy profession should get together to establish common practices for comparing companies, limiting the scope for judgment. Accountants used to make the rules in the USA and elsewhere until the business community demanded input from other professionals, to provide a more "balanced" view.

This led to the establishment of the Financial Accounting Standards Board (FASB), with non-accountants as members. The GAAP has been tempered by political and business lobbying. Moreover, accounting rules for taxation purposes and applied to companies quoted on stock exchanges are not always consistent with the GAAP.

Accountants who do not follow the rules are disciplined.

American accountants are among the best educated and best-trained in the world. Those who wish to be recognized as auditors of significant enterprises must be CPAs. Thus, they must have obtained at least a finance- related bachelor's degree and then have passed a five-part examination that is commonly set, nationwide, by the American Institute of Certified Public Accountants (AICPA). To practice publicly, they must be licensed by the state in which they live or practice. To remain a CPA, each must abide by the standards of conduct and ethics of the AICPA, including a requirement for continuing professional education.

Most other countries have comparable rules. Probably the closest comparisons to the USA are found in the UK and its former colonies.

Q: Can you briefly compare the advantages and disadvantages of the GAAP and the IAS? A: It is asserted that the GAAP tend to be "rule-based" and the IAS are "principle-based." GAAP, because they are founded on the business environment of the USA are closely aligned to its laws and regulations. The IAS seek to prescribe how credible accounting practices can operate within a country's existing legal structure and prevailing business practices.

Alas, sometimes the IAS and the GAAP are in disagreement. The two rule-making bodies - FASB and IASB - are trying to cooperate to eliminate such differences.

The Inter-American Development Bank, having reviewed the situation in Latin America, concluded that most of the countries in that region - as well as Canada and the EU aspirants - are IAS-orientated. Still, the USA is by far the largest economy in the world, with significant political influence. It also has the world's most important financial markets.

Q: Can accounting cope with derivatives, off-shore entities, stock options - or is there a problem in the very effort to capture dynamics and uncertainties in terms of a static, numerical representation? A: Most, if not all, of these matters can be handled by proper application of accounting principles and practices.

Much has been made of expensing employee stock options, for instance. But an FASB proposal in the early nineties was watered down at the insistence of US company lobbyists and legislators.

How to value stock options and when to recognize them is not clear. A paper on the topic identified sixteen different valuation parameters. But accountants are accustomed to dealing with such practical matters.

Q: Can you describe the state of the art (i.e., recent trends) of municipal finance in the USA, Europe, Latin America (mainly Argentina and Brazil), and in emerging economies (e.g., central and eastern Europe)? A: There are no standard practices for governmental accounting - whether national, federal, state, or local. The International Federation of Accountants (IFAC) urged accountants to follow various practices. It subsequently settled mainly on accrual accounting standards.

Some countries - the UK, for local government, New Zealand for both central and local government - use full accrual at current value, which is beyond many private sector practices. This is being reviewed in the UK. The central government there is introducing "resource-based" accounting, approximating full accrual at current value.

The US Governmental Accounting Standards Board has recently recommended that US local governments produce dual financial reports, combining "commercially- based" practices with those emanating from the truly unique US "fund accounting" system.

In my book I recognized that fixed assets are being funded less and less entirely by debt, private sector accounting practices increasingly intrude into the public sector, and costs of services must be much more carefully assessed.

Q: Are we likely to witness municipal Enrons and World.com's? A: We already have! Remember the financial downfall and restructuring of New York City in the seventies.

Other state and local governments have had serious defaults in USA and elsewhere. Shortcomings of their accounting, politicians choosing to ignore predictive budgeting, borrowing used to cover operating expenditures - similar to WorldCom. In the case of the New York City debacle, operating expenditures were treated as capital expenditures to balance the operating budget.

More recently, I testified to the US Congress about Washington DC, where the City Council ran up a huge accumulated operating deficit, of c. \$700 million. It then sought Congressional approval to cover this deficit by borrowing.

Even more recently, the State of Virginia decided to abolish the property tax on domestic vehicles. This left a huge gap in the following year's current budget. The governor proposed to use a deceptive accounting device and to set up a separate - and, thus not subject to a referendum - "revenue" bond-issuing entity (shades of Enron's "Special Purpose Entities"). The bonds were then to be serviced by expected annual receipts from the negotiated tobacco settlement, at that time not even finalized. This crazy and illegal plan was abandoned.

The fact that both accounting and financial reporting for local governments are very often in slightly modified cash-based formats adds to the confusion. But these formats could be built on. Indeed, in the very tight budgetary situations facing virtually every local government, it is essential that cash management on a day- to-day basis be given high priority.

Still, the system can be misleading. It produces extremely scant information on costs - the use of resources - compared with expenditures (i.e., cash-flows). More seriously, cash accounting allows indiscriminate allocation of funds between capital and recurrent purposes, thus permitting no useful assessment of annual or other periodic financial performance.

A cash-based system cannot engender a credible balance sheet. It produces meaningless and incoherent information on assets and liabilities and the ownership, or trusteeship, of separate (or separable) funds. It is not a sound system of budgetary control. When year-end unpaid invoices are held over, it creates a false impression of operating within approved budgetary limits. Thus, local government units can run serious budgetary deficits that are hidden from public view merely by not paying their bills on time and in full! A cash accounting system will not reveal this.

Still, moving to an accrual system should be done slowly and cautiously. Private sector experience, in former Soviet countries, of changing to accrual accounting was administratively traumatic. Their public sector systems may not easily survive any major tinkering, let alone an - eventually inevitable - full overhaul. Skills, tools, and access to proper professional knowledge are required before this is attempted.

Q: Can you compare municipal and corporate accounting and financing practices as far as governance and control are concerned? A: In corporate accounting practice, the notional owners and managers are the shareholders. In practice, through the use of proxies and other devices, the real control is normally in the hands of a board of directors. Actual day to day control reverts to the company chairmen, president, chief executive or chief operating officer. The chief financial officer is often - though not necessarily - an accountant and he or she oversees qualified accountants.

The company's accountants must produce the annual and other financial statements. It is not the responsibility of the auditors whose obligation is to report to the shareholders on the credibility and legality of the financial statements. The shareholders may appoint an audit committee to review the audit reports on their behalf. The audit is carried out by Certified Public Accountants with recognized accounting credentials. Both the qualified accountants in the audit firm and those in the corporation are subject to professional discipline of their accounting institutions and of the law.

In local government accounting practice, the public trustees and managers are normally a locally elected council. Often, the detailed control over financial management is in the hands of a finance committee or finance commission, usually comprised only of elected members.

Traditionally, only the elected council may take major financial decisions, such as approving a budget, levying taxes and borrowing. Actual day to day control of a local government may be by an executive mayor, or by an elected or appointed chief executive. There normally is a chief financial officer, often - though not necessarily - an accountant in charge of other qualified accountants.

It is the responsibility of the accountants of the local government to produce the annual and other financial statements. It is not the responsibility of the auditors whose obligation is to report to the local elected council on the credibility and legality of the financial statements.

The council may appoint an audit committee to review the audit reports on their behalf, or they may ask the finance committee to do this.

However, it is quite common, in many countries, for local government financial statements to be audited by properly authorized public officials. Auditors should be qualified, independent, experienced, and competent. Audits should be regular and comprehensive. It is unclear whether or not public official auditors always fulfill these conditions.

In the United Kingdom, for example, there is a Local Government Audit Commission which employs qualified accountants either on its own staff or from hired accountancy firms. Thus, it clearly follows high standards.

Q: How did the worldwide trend of devolution affect municipal finance? A: Outside of the former Soviet Union and Eastern Europe, municipal finance was not significantly affected by devolution, though there has been a tendency for decentralization. Central governments hold the purse- strings and almost all local governments operate under legislation engendered by the national, or - in federal systems - state, governments. Local governments rarely have separate constitutional authority, although there are varying degrees of local autonomy.

In the former Soviet Empire, changes of systems and of attitudes were much more dramatic. Local

government units, unlike under the former Soviet system, are not branches of the general government. They are separate corporate bodies, or legal persons. But in Russia, and in other former socialist countries, they have often been granted "de jure" (legal) independence but not full "de facto" (practical) autonomy.

There seems to be an unwillingness to accept that the two systems are intended to operate quite differently. What is good for a central government is not necessarily equally good for a local government unit. For example, the main purpose of local government is to provide public services, with only enough authority to perform them effectively. It is almost always the responsibility of a central or state government to enact and enforce the criminal and civil law. Local by-laws or ordinances are usually concerned only with minor matters and are subject to an enabling legislation. Moreover, they may prove to be "ultra vires" (beyond their powers) and, therefore, unconstitutional, or at least unenforceable.

It may be appropriate, under certain circumstances, for a central government to run budgetary deficits, whether caused by current or capital transactions. In local government units, there is almost always a necessity to distinguish between such transactions. Moreover, in most countries, local government units are required by law to have balanced budgets, without resort to borrowing to cover current deficits.

A corporate body (legal person), whether a private or a public sector entity, has a separate legal identity from the central government and from the members, shareholders, or electorate who own and manage it. It has its own corporate name. Typically, its formal decisions are by resolution of its managing body (board or council). Written documents are authenticated by its common seal. It may contract, sue and be sued in its own name. Indeed, unless specifically prevented by law, it may even sue the central government! It may also have legal relationships with its own individual members or with its staff. It is often said to have perpetual succession, meaning that it lives on, even though the individual members may die, resign or otherwise cease their membership.

While a corporation owes its existence to legislation, a local government unit is established, typically, under something like a "Local Government Organic Law".

Corporate status differs fundamentally from that of (say) government departments in a system of de-concentration.

Permanent closure or abolition of a municipal council, or indeed any change in its powers and duties, would almost always require formal legal action, typically national parliamentary legislation.

A local government unit makes its own policy decisions, some of which, especially the financial ones, often require approval by a central government authority. Still, the central government rarely runs, or manages, a local government unit on a daily basis. The relationship is at arms length and not hands on. A local government unit usually is empowered to own land and real estate. Sometimes, public assets - such as with roads or drainage systems - are deemed to be "vested in" the local authority because they cannot be owned in the same way as buildings are.

Q: Local authorities issue bonds, partake in joint ventures, lend to SME's - in short, encroach on turf previously exclusively occupied by banks, the capital markets, and business. Is this a good or a bad thing? A: Local governments are established to provide services and perform activities required or allowed by law! Normally, they won't seek or be permitted to engage in commercial activities, best left to the private sector.

However, there have always been natural monopolies (such as water supply), coping with negative economic externalities (such as sewerage and solid waste management), the provision of whole or partial public goods (such as street lighting, or roads) and merit goods (such as education, health, and welfare), and services that the community, for economic or social reasons, seeks to subsidize (such as urban transport). Left to the private marketplace, these services would be absent, or under- supplied, or over-charged for.

Such services are wholly or partially financed by local taxation, either imposed by local governments, or by central (or state) taxation, through a grant or revenue- sharing system. What has changed in recent years is that local governments have been encouraged and empowered to outsource these services to the private sector, or to "public-private" partnerships.

Charges for services, and revenues from taxation cover current operating expenditures with a small operating surplus used to partly fund capital expenditure or to service long, or medium term debt, such as bond issues secured against future revenues. Commercial banks, because of their tendency to lend only for relatively short periods of time, usually have a relatively minor role in such funding, except perhaps as fiscal agents or bond issue managers.

Other funding is obtained via direct - and dependence- forming - capital grants from the central or state government. Alternatively, the central government can establish a quasi-autonomous local government loans authority, which it may wholly or partially fund. The authority may also seek to raise additional funds from commercial sources and make loans on reasonable terms to the local governments.

Third, the central government may lend directly to local governments, or guarantee their borrowing. Finally, local governments are left to their own devices to raise loans as and when they can, on whatever terms are available. This usually leaves them in a precarious position, because the market for this kind of long and medium term credit is thin and costly.

Commercial banks make short term loans to local governments to cover temporary shortages of working capital. If not properly controlled, such short-term loans are rolled over and accumulate unsustainably. That is what happened in New York City, in the seventies.

Q: In the age of the Internet and the car, isn't the added layer of municipal bureaucracy superfluous or even counterproductive? Can't the center - at least in smallish countries - administer things at least as well?

A: I am quite sure that they can. There are many glaring examples of mismatches of sizes, shapes and responsibilities of local government units. For example, New York, Moscow and Bombay are each single local government units. Yet, they each have much bigger populations than many countries, such as New Zealand, the republics of former Yugoslavia, and the Baltic states.

On the other hand, the Greater Washington Metropolitan Area comprises a federal district, four counties and several small cities. The local government systems are under the jurisdictions of two states and the federal government. Each of the two states has a completely different traditions and systems of local governance, emanating from pre-independence times. Accordingly, the local government systems north and east of the Potomac River (which flows through the Washington area) are substantially different from those to the south and west.

Finally, the Boston area, a cradle of U.S. democracy, is governed by a conglomerate of over 40 local government jurisdictions. Even its most famous college, Harvard, is in Cambridge and not in Boston itself. Many of the jurisdictions are so small (Boston is not very big by U.S. standards) that common services are run by agencies of the State of Massachusetts.

The problem of centralizing financial records would, indeed, be relatively simple to solve. If credit card companies can maintain linkages world-wide, there is no practical reason why local government accounts for (say) a city in Macedonia could not be kept in China. The issue here is quite different. It revolves around democracy, tradition, living in community, service delivery at a local level, civil society, and the common wealth. It really has very little to do with accountancy, which is just one tool of management, albeit an important one.

XXIX. Competition Laws

A. THE PHILOSOPHY OF COMPETITION The aims of competition (anti-trust) laws are to ensure that consumers pay the lowest possible price (=the most efficient price) coupled with the highest quality of the goods and services which they consume. This, according to current economic theories, can be achieved only through effective competition. Competition not only reduces particular prices of specific goods and services - it also tends to have a deflationary effect by reducing the general price level. It pits consumers against producers, producers against other producers (in the battle to win the heart of consumers) and even consumers against consumers (for example in the healthcare sector in the USA). This everlasting conflict does the miracle of increasing quality with lower prices. Think about the vast improvement on both scores in electrical appliances. The VCR and PC of yesteryear cost thrice as much and provided one third the functions at one tenth the speed.

Competition has innumerable advantages: a. It encourages manufacturers and service providers to be more efficient, to better respond to the needs of their customers, to innovate, to initiate, to venture. In professional words: it optimizes the allocation of resources at the firm level and, as a result, throughout the national economy.

More simply: producers do not waste resources (capital), consumers and businesses pay less for the same goods and services and, as a result, consumption grows to the benefit of all involved. b. The other beneficial effect seems, at first sight, to be an adverse one: competition weeds out the failures, the incompetents, the inefficient, the fat and slow to respond. Competitors pressure one another to be more efficient, leaner and meaner.

This is the very essence of capitalism. It is wrong to say that only the consumer benefits. If a firm improves itself, re-engineers its production processes, introduces new management techniques, modernizes - in order to fight the competition, it stands to reason that it will reap the rewards. Competition benefits the economy, as a whole, the consumers and other producers by a process of natural economic selection where only the fittest survive. Those who are not fit to survive die out and cease to waste the rare resources of humanity.

Thus, paradoxically, the poorer the country, the less resources it has - the more it is in need of competition.

Only competition can secure the proper and most efficient use of its scarce resources, a maximization of its output and the maximal welfare of its citizens (consumers).

Moreover, we tend to forget that the biggest consumers are businesses (firms). If the local phone company is inefficient (because no one competes with it, being a monopoly) - firms will suffer the most: higher charges, bad connections, lost time, effort, money and business. If the banks are dysfunctional (because there is no foreign competition), they will not properly service their clients and firms will collapse because of lack of liquidity. It is the business sector in poor countries which should head the crusade to open the country to competition.

Unfortunately, the first discernible results of the introduction of free marketry are unemployment and business closures. People and firms lack the vision, the knowledge and the wherewithal needed to support competition. They fiercely oppose it and governments throughout the world bow to protectionist measures. To no avail. Closing a country to competition will only exacerbate the very conditions which necessitate its opening up. At the end of such a wrong path awaits economic disaster and the forced entry of competitors. A country which closes itself to the world - will be forced to sell itself cheaply as its economy will become more and more inefficient, less and less competitive.

The Competition Laws aim to establish fairness of commercial conduct among entrepreneurs and competitors which are the sources of said competition and innovation.

Experience - later buttressed by research - helped to establish the following four principles: 1. There should be no barriers to the entry of new market players (barring criminal and moral barriers to certain types of activities and to certain goods and services offered). 2. A larger scale of operation does introduce economies of scale (and thus lowers prices).

This, however, is not infinitely true. There is a Minimum Efficient Scale - MES - beyond which prices will begin to rise due to monopolization of the markets. This MES was empirically fixed at 10% of the market in any one good or service. In other words: companies should be encouraged to capture up to 10% of their market (=to lower prices) and discouraged to cross this barrier, lest prices tend to rise again. 3. Efficient competition does not exist when a market is controlled by less than 10 firms with big size differences. An oligopoly should be declared whenever 4 firms control more than 40% of the market and the biggest of them controls more than 12% of it. 4. A competitive price will be comprised of a minimal cost plus an equilibrium profit which does not encourage either an exit of firms (because it is too low), nor their entry (because it is too high).

Left to their own devices, firms tend to liquidate competitors (predation), buy them out or collude with them to raise prices. The 1890 Sherman Antitrust Act in the USA forbade the latter (section 1) and prohibited monopolization or dumping as a method to eliminate competitors. Later acts (Clayton, 1914 and the Federal Trade Commission Act of the same year) added forbidden activities: tying arrangements, boycotts, territorial divisions, non-competitive mergers, price discrimination, exclusive dealing, unfair acts, practices and methods.

Both consumers and producers who felt offended were given access to the Justice Department and to the FTC or the right to sue in a federal court and be eligible to receive treble damages.

It is only fair to mention the "intellectual competition", which opposes the above premises. Many important economists thought (and still do) that competition laws represent an unwarranted and harmful intervention of the State in the markets. Some believed that the State should own important industries (J.K. Galbraith), others - that industries should be encouraged to grow because only size guarantees survival, lower prices and innovation (Ellis Hawley). Yet others supported the cause of laissez faire (Marc Eisner).

These three antithetical approaches are, by no means, new. One led to socialism and communism, the other to corporatism and monopolies and the third to jungle-ization of the market (what the Europeans derisively call: the Anglo-Saxon model).

B. HISTORICAL AND LEGAL CONSIDERATIONS Why does the State involve itself in the machinations of the free market? Because often markets fail or are unable or unwilling to provide goods, services, or competition.

The purpose of competition laws is to secure a competitive marketplace and thus protect the consumer from unfair, anti-competitive practices. The latter tend to increase prices and reduce the availability and quality of goods and services offered to the consumer.

Such state intervention is usually done by establishing a governmental Authority with full powers to regulate the markets and ensure their fairness and accessibility to new entrants. Lately, international collaboration between such authorities yielded a measure of harmonization and coordinated action (especially in cases of trusts which are the results of mergers and acquisitions).

Yet, competition law embodies an inherent conflict: while protecting local consumers from monopolies, cartels and oligopolies - it ignores the very same practices when directed at foreign consumers. Cartels related to the country's foreign trade are allowed even under GATT/WTO rules (in cases of dumping or excessive export subsidies). Put simply: governments regard acts which are criminal as legal if they are directed at foreign consumers or are part of the process of foreign trade.

A country such as Macedonia - poor and in need of establishing its export sector - should include in its competition law at least two protective measures against these discriminatory practices: 1. Blocking Statutes - which prohibit its legal entities from collaborating with legal procedures in other countries to the extent that this collaboration adversely affects the local export industry. 2. Clawback Provisions - which will enable the local courts to order the refund of any penalty payment decreed or imposed by a foreign court on a local legal entity and which exceeds actual damage inflicted by unfair trade practices of said local legal entity. US courts, for instance, are allowed to impose treble damages on infringing foreign entities. The clawback provisions are used to battle this judicial aggression.

Competition policy is the antithesis of industrial policy.

The former wishes to ensure the conditions and the rules of the game - the latter to recruit the players, train them and win the game. The origin of the former is in the 19th century USA and from there it spread to (really was imposed on) Germany and Japan, the defeated countries in the 2nd World War. The European Community (EC) incorporated a competition policy in articles 85 and 86 of the Rome Convention and in Regulation 17 of the Council of Ministers, 1962.

Still, the two most important economic blocks of our time have different goals in mind when implementing competition policies. The USA is more interested in economic (and econometric) results while the EU emphasizes social, regional development and political consequences. The EU also protects the rights of small businesses more vigorously and, to some extent, sacrifices intellectual property rights on the altar of fairness and the free movement of goods and services.

Put differently: the USA protects the producers and the EU shields the consumer. The USA is interested in the maximization of output at whatever social cost - the EU is interested in the creation of a just society, a liveable community, even if the economic results will be less than optimal.

There is little doubt that Macedonia should follow the EU example. Geographically, it is a part of Europe and, one day, will be integrated in the EU. It is socially sensitive, export oriented, its economy is negligible and its consumers are poor, it is besieged by monopolies and oligopolies.

In my view, its competition laws should already incorporate the important elements of the EU (Community) legislation and even explicitly state so in the preamble to the law. Other, mightier, countries have done so. Italy, for instance, modelled its Law number 287 dated 10/10/90 "Competition and Fair Trading Act" after the EC legislation. The law explicitly says so.

The first serious attempt at international harmonization of national antitrust laws was the Havana Charter of 1947. It called for the creation of an umbrella operating organization (the International Trade Organization or "ITO") and incorporated an extensive body of universal antitrust rules in nine of its articles. Members were required to "prevent business practices affecting international trade which restrained competition, limited access to markets, or fostered monopolistic control whenever such practices had harmful effects on the expansion of production or trade". The latter included: a. Fixing prices, terms, or conditions to be observed in dealing with others in the purchase, sale, or lease of any product; b. Excluding enterprises from, or allocating or dividing, any territorial market or field of business activity, or allocating customers, or fixing sales quotas or purchase quotas; c. Discriminating against particular enterprises; d. Limiting production or fixing production quotas; e. Preventing by agreement the development or application of technology or invention, whether patented or non-patented; and f. Extending the use of rights under intellectual property protections to matters which, according to a member's laws and regulations, are not within the scope of such grants, or to products or conditions of production, use, or sale which are not likewise the subject of such grants.

GATT 1947 was a mere bridging agreement but the Havana Charter languished and died due to the objections of a protectionist US Senate.

There are no antitrust/competition rules either in GATT 1947 or in GATT/WTO 1994, but their provisions on antidumping and countervailing duty actions and government subsidies constitute some elements of a more general antitrust/competition law.

GATT, though, has an International Antitrust Code Writing Group which produced a "Draft International Antitrust Code" (10/7/93). It is reprinted in II, 64 Antitrust & Trade Regulation Reporter (BNA), Special Supplement at S-3 (19/8/93).

Four principles guided the (mostly German) authors: 1. National laws should be applied to solve international competition problems; 2. Parties, regardless of origin, should be treated as locals; 3. A minimum standard for national antitrust rules should be set (stricter measures would be welcome); and 4. The establishment of an international authority to settle disputes between parties over antitrust issues.

The 29 (well-off) members of the Organization for Economic Cooperation and Development (OECD) formed rules governing the harmonization and coordination of international antitrust/competition regulation among its member nations ("The Revised Recommendation of the OECD Council Concerning Cooperation between Member Countries on Restrictive Business Practices Affecting International Trade," OECD Doc. No. C(86)44 (Final) (June 5, 1986), also in 25 International Legal Materials 1629 (1986). A revised version was reissued. According to it, ".Enterprises should refrain from abuses of a dominant market position; permit purchasers, distributors, and suppliers to freely conduct their businesses; refrain from cartels or restrictive agreements; and consult and cooperate with competent authorities of interested countries".

An agency in one of the member countries tackling an antitrust case, usually notifies another member country whenever an antitrust enforcement action may affect important interests of that country or its nationals (see: OECD Recommendations on Predatory Pricing, 1989).

The United States has bilateral antitrust agreements with Australia, Canada, and Germany, which was followed by a bilateral agreement with the EU in 1991. These provide for coordinated antitrust investigations and prosecutions.

The United States thus reduced the legal and political obstacles which faced its extraterritorial prosecutions and enforcement. The agreements require one party to notify the other of imminent antitrust actions, to share relevant information, and to consult on potential policy changes.

The EU-U.S. Agreement contains a "comity" principle under which each side promises to take into consideration the other's interests when considering antitrust prosecutions. A similar principle is at the basis of Chapter 15 of the North American Free Trade Agreement (NAFTA) - cooperation on antitrust matters.

The United Nations Conference on Restrictive Business Practices adopted a code of conduct in 1979/1980 that was later integrated as a U.N. General Assembly Resolution [U.N. Doc. TD/RBP/10 (1980)]: "The Set of Multilaterally Agreed Equitable Principles and Rules".

According to its provisions, "independent enterprises should refrain from certain practices when they would limit access to markets or otherwise unduly restrain competition".

The following business practices are prohibited: 1. Agreements to fix prices (including export and import prices); 2. Collusive tendering; 3. Market or customer allocation (division) arrangements; 4. Allocation of sales or production by quota; 5. Collective action to enforce arrangements, e.g., by concerted refusals to deal; 6. Concerted refusal to sell to potential importers; and 7. Collective denial of access to an arrangement, or association, where such access is crucial to competition and such denial might hamper it. In addition,

businesses are forbidden to engage in the abuse of a dominant position in the market by limiting access to it or by otherwise restraining competition by: a. Predatory behaviour towards competitors; b. Discriminatory pricing or terms or conditions in the supply or purchase of goods or services; c. Mergers, takeovers, joint ventures, or other acquisitions of control; d. Fixing prices for exported goods or resold imported goods; e. Import restrictions on legitimately- marked trademarked goods; f. Unjustifiably - whether partially or completely - refusing to deal on an enterprise's customary commercial terms, making the supply of goods or services dependent on restrictions on the distribution or manufacturer of other goods, imposing restrictions on the resale or exportation of the same or other goods, and purchase "tie-ins".

C. ANTI - COMPETITIVE STRATEGIES Any Competition Law in Macedonia should, in my view, explicitly include strict prohibitions of the following practices (further details can be found in Porter's book - "Competitive Strategy").

These practices characterize the Macedonian market.

They influence the Macedonian economy by discouraging foreign investors, encouraging inefficiencies and mismanagement, sustaining artificially high prices, misallocating very scarce resources, increasing unemployment, fostering corrupt and criminal practices and, in general, preventing the growth that Macedonia could have attained.

Strategies for Monopolization Exclude competitors from distribution channels. - This is common practice in many countries. Open threats are made by the manufacturers of popular products: "If you distribute my competitor's products - you cannot distribute mine. So, choose." Naturally, retail outlets, dealers and distributors will always prefer the popular product to the new. This practice not only blocks competition - but also innovation, trade and choice or variety.

Buy up competitors and potential competitors. - There is nothing wrong with that. Under certain circumstances, this is even desirable. Think about the Banking System: it is always better to have fewer banks with bigger capital than many small banks with capital inadequacy (remember the TAT affair). So, consolidation is sometimes welcome, especially where scale represents viability and a higher degree of consumer protection. The line is thin and is composed of both quantitative and qualitative criteria.

One way to measure the desirability of such mergers and acquisitions (M&A) is the level of market concentration following the M&A. Is a new monopoly created? Will the new entity be able to set prices unperturbed? stamp out its other competitors? If so, it is not desirable and should be prevented.

Every merger in the USA must be approved by the antitrust authorities. When multinationals merge, they must get the approval of all the competition authorities in all the territories in which they operate. The purchase of "Intuit" by "Microsoft" was prevented by the antitrust department (the "Trust-busters"). A host of airlines was conducting a drawn out battle with competition authorities in the EU, UK and the USA lately.

Use predatory [below-cost] pricing (also known as dumping) to eliminate competitors. - This tactic is mostly used by manufacturers in developing or emerging economies and in Japan. It consists of "pricing the competition out of the markets". The predator sells his products at a price which is lower even than the costs of production. The result is that he swamps the market, driving out all other competitors. Once he is left alone - he raises his prices back to normal and, often, above normal.

The dumper loses money in the dumping operation and compensates for these losses by charging inflated prices after having the competition eliminated.

Raise scale-economy barriers. - Take unfair advantage of size and the resulting scale economies to force conditions upon the competition or upon the distribution channels. In many countries Big Industry lobbies for a legislation which will fit its purposes and exclude its (smaller) competitors.

Increase "market power (share) and hence profit potential".

Study the industry's "potential" structure and ways it can be made less competitive. - Even thinking about sin or planning it should be prohibited. Many industries have "think tanks" and experts whose sole function is to show the firm the way to minimize competition and to increase its market shares. Admittedly, the line is very thin: when does a Marketing Plan become criminal? Arrange for a "rise in entry barriers to block later entrants" and "inflict losses on the entrant". - This could be done by imposing bureaucratic obstacles (of licencing, permits and taxation), scale hindrances (no possibility to distribute small quantities), "old boy networks" which share political clout and research and development, using intellectual property right to block new entrants and other methods too numerous to recount.

An effective law should block any action which prevents new entry to a market.

Buy up firms in other industries "as a base from which to change industry structures" there. - This is a way of securing exclusive sources of supply of raw materials, services and complementing products. If a company owns its suppliers and they are single or almost single sources of supply - in effect it has monopolized the market. If a software company owns another software company with a product which can be incorporated in its own products - and the two have substantial market shares in their markets - then their dominant positions will reinforce each other's. "Find ways to encourage particular competitors out of the industry". - If you can't intimidate your competitors you might wish to "make them an offer that they cannot refuse". One way is to buy them, to bribe the key personnel, to offer tempting opportunities in other markets, to swap markets (I will give you my market share in a market which I do not really care about and you will give me your market share in a market in which we are competitors). Other ways are to give the competitors assets, distribution channels and so on providing that they collude in a cartel. "Send signals to encourage competition to exit" the industry. - Such signals could be threats, promises, policy measures, attacks on the integrity and quality of the competitor, announcement that the company has set a certain market share as its

goal (and will, therefore, not tolerate anyone trying to prevent it from attaining this market share) and any action which directly or indirectly intimidates or convinces competitors to leave the industry.

Such an action need not be positive - it can be negative, need not be done by the company - can be done by its political proxies, need not be planned - could be accidental. The results are what matters.

Macedonia's Competition Law should outlaw the following, as well: 'Intimidate' Competitors Raise "mobility" barriers to keep competitors in the least-profitable segments of the industry. - This is a tactic which preserves the appearance of competition while subverting it. Certain segments, usually less profitable or too small to be of interest, or with dim growth prospects, or which are likely to be opened to fierce domestic and foreign competition are left to the competition. The more lucrative parts of the markets are zealously guarded by the company. Through legislation, policy measures, withholding of technology and know-how - the firm prevents its competitors from crossing the river into its protected turf.

Let little firms "develop" an industry and then come in and take it over. - This is precisely what Netscape is saying that Microsoft is doing to it. Netscape developed the now lucrative Browser Application market. Microsoft was wrong in discarding the Internet as a fad. When it was found to be wrong - Microsoft reversed its position and came up with its own (then, technologically inferior) browser (the Internet Explorer). It offered it free (sound suspiciously like dumping) to buyers of its operating system, "Windows". Inevitably it captured more than 30% of the market, crowding out Netscape. It is the view of the antitrust authorities in the USA that Microsoft utilized its dominant position in one market (that of the Operating Systems) to annihilate a competitor in another (that of the browsers).

Engage in "promotional warfare" by "attacking shares of others". - This is when the gist of a marketing, lobbying, or advertising campaign is to capture the market share of the competition. Direct attack is then made on the competition just in order to abolish it. To sell more in order to maximize profits, is allowed and meritorious - to sell more in order to eliminate the competition is wrong and should be disallowed.

Use price retaliation to "discipline" competitors. - Through dumping or even unreasonable and excessive discounting. This could be achieved not only through the price itself. An exceedingly long credit term offered to a distributor or to a buyer is a way of reducing the price.

The same applies to sales, promotions, vouchers, gifts.

They are all ways to reduce the effective price. The customer calculates the money value of these benefits and deducts them from the price.

Establish a "pattern" of severe retaliation against challengers to "communicate commitment" to resist efforts to win market share. - Again, this retaliation can take a myriad of forms: malicious advertising, a media campaign, adverse legislation, blocking distribution channels, staging a hostile bid in the stock exchange just in order to disrupt the proper and orderly management of the competitor. Anything which derails the competitor whenever he makes a headway, gains a larger market share, launches a new product - can be construed as a "pattern of retaliation".

Maintain excess capacity to be used for "fighting" purposes to discipline ambitious rivals. - Such excess capacity could belong to the offending firm or - through cartel or other arrangements - to a group of offending firms.

Publicize one's "commitment to resist entry" into the market.

Publicize the fact that one has a "monitoring system" to detect any aggressive acts of competitors.

Announce in advance "market share targets" to intimidate competitors into yielding their market share.

Proliferate Brand Names Contract with customers to "meet or match all price cuts (offered by the competition)" thus denying rivals any hope of growth through price competition.

Secure a big enough market share to "corner" the "learning curve," thus denying rivals an opportunity to become efficient. - Efficiency is gained by an increase in market share. Such an increase leads to new demands imposed by the market, to modernization, innovation, the introduction of new management techniques (example: Just In Time inventory management), joint ventures, training of personnel, technology transfers, development of proprietary intellectual property and so on. Deprived of a growing market share - the competitor will not feel pressurized to learn and to better itself. In due time, it will dwindle and die.

Acquire a wall of "defensive" patents to deny competitors access to the latest technology. "Harvest" market position in a no-growth industry by raising prices, lowering quality, and stopping all investment and advertising in it.

Create or encourage capital scarcity. - By colluding with sources of financing (e.g., regional, national, or investment banks), by absorbing any capital offered by the State, by the capital markets, through the banks, by spreading malicious news which serve to lower the credit-worthiness of the competition, by legislating special tax and financing loopholes and so on.

Introduce high advertising-intensity. - This is very difficult to measure. There could be no objective criteria which will not go against the grain of the fundamental right to freedom of expression. However, truth in advertising should be strictly imposed. Practices such as dragging a competitor through the mud or derogatorily referring to its products or services in advertising campaigns should be banned and the ban should be enforced.

Proliferate "brand names" to make it too expensive for small firms to grow. - By creating and maintaining a host of absolutely unnecessary brandnames, the competition's brandnames are crowded out. Again, this

cannot be legislated against. A firm has the right to create and maintain as many brandnames as it wishes. The market will exact a price and thus punish such a company because, ultimately, its own brandname will suffer from the proliferation.

Get a "corner" (control, manipulate and regulate) on raw materials, government licenses, contracts, subsidies, and patents (and, of course, prevent the competition from having access to them).

Build up "political capital" with government bodies; overseas, get "protection" from "the host government". 'Vertical' Barriers Practice a "preemptive strategy" by capturing all capacity expansion in the industry (simply buying it, leasing it or taking over the companies that own or develop it).

This serves to "deny competitors enough residual demand". Residual demand, as we previously explained, causes firms to be efficient. Once efficient, they develop enough power to "credibly retaliate" and thereby "enforce an orderly expansion process" to prevent overcapacity. Create "switching" costs. - Through legislation, bureaucracy, control of the media, cornering advertising space in the media, controlling infrastructure, owning intellectual property, owning, controlling or intimidating distribution channels and suppliers and so on.

Impose vertical "price squeezes". - By owning, controlling, colluding with, or intimidating suppliers and distributors, marketing channels and wholesale and retail outlets into not collaborating with the competition.

Practice vertical integration (buying suppliers and distribution and marketing channels).

This has the following effects: The firm gains a "tap (access) into technology" and marketing information in an adjacent industry. It defends itself against a supplier's too-high or even realistic prices.

It defends itself against foreclosure, bankruptcy and restructuring or reorganization. Owning suppliers means that the supplies do not cease even when payment is not affected, for instance.

It "protects proprietary information from suppliers" - otherwise the firm might have to give outsiders access to its technology, processes, formulas and other intellectual property.

It raises entry and mobility barriers against competitors.

This is why the State should legislate and act against any purchase, or other types of control of suppliers and marketing channels which service competitors and thus enhance competition.

It serves to "prove that a threat of full integration is credible" and thus intimidate competitors.

Finally, it gets "detailed cost information" in an adjacent industry (but doesn't integrate it into a "highly competitive industry"). "Capture distribution outlets" by vertical integration to "increase barriers". 'Consolidate' the Industry Send "signals" to threaten, bluff, preempt, or collude with competitors.

Use a "fighting brand" (a low-price brand used only for price-cutting).

Use "cross parry" (retaliate in another part of a competitor's market).

Harass competitors with antitrust suits and other litigious techniques.

Use "brute force" ("massed resources" applied "with finesse") to attack competitors or use "focal points" of pressure to collude with competitors on price. "Load up customers" at cut-rate prices to "deny new entrants a base" and force them to "withdraw" from market.

Practice "buyer selection," focusing on those that are the most "vulnerable" (easiest to overcharge) and discriminating against and for certain types of consumers. "Consolidate" the industry so as to "overcome industry fragmentation".

This arguments is highly successful with US federal courts in the last decade. There is an intuitive feeling that few is better and that a consolidated industry is bound to be more efficient, better able to compete and to survive and, ultimately, better positioned to lower prices, to conduct costly research and development and to increase quality. In the words of Porter: "(The) pay-off to consolidating a fragmented industry can be high because... small and weak competitors offer little threat of retaliation".

Time one's own capacity additions; never sell old capacity "to anyone who will use it in the same industry" and buy out "and retire competitors' capacity".

A Note on the Spiteful Application of Competition Laws In many developing countries and countries in transition from Communism to capitalism, competition laws are used to reward cronies or to damage opponents. The discriminatory and partial application of such laws and regulations sustains networks of patronage and cements political-economic alliances.

This abuse of the rule of Law and the regulatory regime is further compounded by the seething pathological envy that is typical of erstwhile egalitarian societies now exposed to growing income inequalities. The mob, business rivals, political parties, and the populace at large leverage competition laws to tear down businesses and humiliate entrepreneurs whose success grates on their nerves and provokes their unbridled jealousy.

XXX. The Benefits of Oligopolies

The Wall Street Journal has recently published an elegiac list: "Twenty years ago, cable television was dominated by a patchwork of thousands of tiny, family-operated companies. Today, a pending deal would leave three companies in control of nearly two-thirds of the market."

In 1990, three big publishers of college textbooks accounted for 35% of industry sales. Today they have 62% ... Five titans dominate the (defense) industry, and one of them, Northrop Grumman ... made a surprise (successful) \$5.9 billion bid for (another) TRW ... In 1996, when Congress deregulated telecommunications, there were eight Baby Bells. Today there are four, and dozens of small rivals are dead. In 1999, more than 10 significant firms offered help-wanted Web sites. Today, three firms dominate".

Mergers, business failures, deregulation, globalization, technology, dwindling and more cautious venture capital, avaricious managers and investors out to increase share prices through a spree of often ill-thought acquisitions - all lead inexorably to the congealing of industries into a few suppliers. Such market formations are known as oligopolies. Oligopolies encourage customers to collaborate in oligopsonies and these, in turn, foster further consolidation among suppliers, service providers, and manufacturers.

Market purists consider oligopolies - not to mention cartels - to be as villainous as monopolies. Oligopolies, they intone, restrict competition unfairly, retard innovation, charge rent and price their products higher than they could have in a perfect competition free market with multiple participants. Worse still, oligopolies are going global.

But how does one determine market concentration to start with? The Herfindahl-Hirschmann index squares the market shares of firms in the industry and adds up the total. But the number of firms in a market does not necessarily impart how low - or high - are barriers to entry. These are determined by the structure of the market, legal and bureaucratic hurdles, the existence, or lack thereof of functioning institutions, and by the possibility to turn an excess profit.

The index suffers from other shortcomings. Often the market is difficult to define. Mergers do not always drive prices higher. University of Chicago economists studying Industrial Organization - the branch of economics that deals with competition - have long advocated a shift of emphasis from market share to - usually temporary - market power. Influential antitrust thinkers, such as Robert Bork, recommended to revise the law to focus solely on consumer welfare.

These - and other insights - were incorporated in a theory of market contestability. Contrary to classical economic thinking, monopolies and oligopolies rarely raise prices for fear of attracting new competitors, went the new school. This is especially true in a "contestable" market - where entry is easy and cheap.

An Oligopolistic firm also fears the price-cutting reaction of its rivals if it reduces prices, goes the Hall, Hitch, and Sweezy theory of the Kinked Demand Curve. If it were to raise prices, its rivals may not follow suit, thus undermining its market share. Stackleberg's amendments to Cournot's Competition model, on the other hand, demonstrate the advantages to a price setter of being a first mover.

In "Economic assessment of oligopolies under the Community Merger Control Regulation, in European Competition law Review (Vol 4, Issue 3), Juan Briones Alonso writes: "At first sight, it seems that ... oligopolists will sooner or later find a way of avoiding competition among themselves, since they are aware that their overall profits are maximized with this strategy. However, the question is much more complex. First of all, collusion without explicit agreements is not easy to achieve. Each supplier might have different views on the level of prices which the demand would sustain, or might have different price preferences according to its cost conditions and market share. A company might think it has certain advantages which its competitors do not have, and would perhaps perceive a conflict between maximising its own profits and maximizing industry profits.

Moreover, if collusive strategies are implemented, and oligopolists manage to raise prices significantly above their competitive level, each oligopolist will be confronted with a conflict between sticking to the tacitly agreed behaviour and increasing its individual profits by 'cheating' on its competitors. Therefore, the question of mutual monitoring and control is a key issue in collusive oligopolies".

Monopolies and oligopolies, went the contestability theory, also refrain from restricting output, lest their market share be snatched by new entrants. In other words, even monopolists behave as though their market was fully competitive, their production and pricing decisions and actions constrained by the "ghosts" of potential and threatening newcomers.

In a CRIEFF Discussion Paper titled "From Walrasian Oligopolies to Natural Monopoly - An Evolutionary Model of Market Structure", the authors argue that: "Under decreasing returns and some fixed cost, the market grows to 'full capacity' at Walrasian equilibrium (oligopolies); on the other hand, if returns are increasing, the unique long run outcome involves a profit-maximising monopolist".

While intellectually tempting, contestability theory has little to do with the rough and tumble world of business.

Contestable markets simply do not exist. Entering a market is never cheap, nor easy. Huge sunk costs are required to counter the network effects of more veteran products as well as the competitors' brand recognition and ability and inclination to collude to set prices.

Victory is not guaranteed, losses loom constantly, investors are forever edgy, customers are fickle, bankers itchy, capital markets gloomy, suppliers beholden to the competition. Barriers to entry are almost always formidable and often insurmountable.

In the real world, tacit and implicit understandings regarding prices and competitive behavior prevail among competitors within oligopolies. Establishing a reputation for collusive predatory pricing deters

potential entrants.

And a dominant position in one market can be leveraged into another, connected or derivative, market.

But not everyone agrees. Ellis Hawley believed that industries should be encouraged to grow because only size guarantees survival, lower prices, and innovation. Louis Galambos, a business historian at Johns Hopkins University, published a 1994 paper titled "The Triumph of Oligopoly". In it, he strove to explain why firms and managers - and even consumers - prefer oligopolies to both monopolies and completely free markets with numerous entrants.

Oligopolies, as opposed to monopolies, attract less attention from trustbusters. Quoted in the Wall Street Journal on March 8, 1999, Galambos wrote: "Oligopolistic competition proved to be beneficial ... because it prevented ossification, ensuring that managements would keep their organizations innovative and efficient over the long run".

In his recently published tome "The Free-Market Innovation Machine - Analysing the Growth Miracle of Capitalism", William Baumol of Princeton University, concurs. He daringly argues that productive innovation is at its most prolific and qualitative in oligopolistic markets.

Because firms in an oligopoly characteristically charge above-equilibrium (i.e., high) prices - the only way to compete is through product differentiation. This is achieved by constant innovation - and by incessant advertising.

Baumol maintains that oligopolies are the real engines of growth and higher living standards and urges antitrust authorities to leave them be. Lower regulatory costs, economies of scale and of scope, excess profits due to the ability to set prices in a less competitive market - allow firms in an oligopoly to invest heavily in research and development. A new drug costs c. \$800 million to develop and get approved, according to Joseph DiMasi of Tufts University's Center for the Study of Drug Development, quoted in The wall Street Journal.

In a paper titled "If Cartels Were Legal, Would Firms Fix Prices", implausibly published by the Antitrust Division of the US Department of Justice in 1997, Andrew Dick demonstrated, counterintuitively, that cartels are more likely to form in industries and sectors with many producers. The more concentrated the industry - i.e., the more oligopolistic it is - the less likely were cartels to emerge.

Cartels are conceived in order to cut members' costs of sales. Small firms are motivated to pool their purchasing and thus secure discounts. Dick draws attention to a paradox: mergers provoke the competitors of the merging firms to complain. Why do they act this way? Mergers and acquisitions enhance market concentration.

According to conventional wisdom, the more concentrated the industry, the higher the prices every producer or supplier can charge. Why would anyone complain about being able to raise prices in a post-merger market? Apparently, conventional wisdom is wrong. Market concentration leads to price wars, to the great benefit of the consumer. This is why firms find the mergers and acquisitions of their competitors worrisome. America's soft drink market is ruled by two firms - Pepsi and Coca-Cola. Yet, it has been the scene of ferocious price competition for decades. "The Economist", in its review of the paper, summed it up neatly: "The story of America's export cartels suggests that when firms decide to co-operate, rather than compete, they do not always have price increases in mind. Sometimes, they get together simply in order to cut costs, which can be of benefit to consumers".

The very atom of antitrust thinking - the firm - has changed in the last two decades. No longer hierarchical and rigid, business resembles self-assembling, nimble, ad-hoc networks of entrepreneurship superimposed on ever-shifting product groups and profit and loss centers.

Competition used to be extraneous to the firm - now it is commonly an internal affair among autonomous units within a loose overall structure. This is how Jack "neutron" Welsh deliberately structured General Electric.

AOL-Time Warner hosts many competing units, yet no one ever instructs them either to curb this internecine competition, to stop cannibalizing each other, or to start collaborating synergistically. The few mammoth agencies that rule the world of advertising now host a clutch of creative boutiques comfortably ensconced behind Chinese walls. Such outfits often manage the accounts of competitors under the same corporate umbrella.

Most firms act as intermediaries. They consume inputs, process them, and sell them as inputs to other firms. Thus, many firms are concomitantly consumers, producers, and suppliers. In a paper published last year and titled "Productive Differentiation in Successive Vertical Oligopolies", that authors studied: "An oligopoly model with two brands. Each downstream firm chooses one brand to sell on a final market. The upstream firms specialize in the production of one input specifically designed for the production of one brand, but they also produce the input for the other brand at an extra cost. (They concluded that) when more downstream brands choose one brand, more upstream firms will specialize in the input specific to that brand, and vice versa. Hence, multiple equilibria are possible and the softening effect of brand differentiation on competition might not be strong enough to induce maximal differentiation" (and, thus, minimal competition).

Both scholars and laymen often mix their terms.

Competition does not necessarily translate either to variety or to lower prices. Many consumers are turned off by too much choice. Lower prices sometimes deter competition and new entrants. A multiplicity of vendors, retail outlets, producers, or suppliers does not always foster competition. And many products have unpteen substitutes. Consider films - cable TV, satellite, the Internet, cinemas, video rental shops, all offer

the same service: visual content delivery.

And then there is the issue of technological standards. It is incalculably easier to adopt a single worldwide or industry-wide standard in an oligopolistic environment.

Standards are known to decrease prices by cutting down R&D expenditures and systematizing components.

Or, take innovation. It is used not only to differentiate one's products from the competitors' - but to introduce new generations and classes of products. Only firms with a dominant market share have both the incentive and the wherewithal to invest in R&D and in subsequent branding and marketing.

But oligopolies in deregulated markets have sometimes substituted price fixing, extended intellectual property rights, and competitive restraint for market regulation.

Still, Schumpeter believed in the faculty of "disruptive technologies" and "destructive creation" to check the power of oligopolies to set extortionate prices, lower customer care standards, or inhibit competition.

Linux threatens Windows. Opera nibbles at Microsoft's Internet Explorer. Amazon drubbed traditional booksellers. eBay thrashes Amazon. Bell was forced by Covad Communications to implement its own technology, the DSL broadband phone line.

Barring criminal behavior, there is little that oligopolies can do to defend themselves against these forces. They can acquire innovative firms, intellectual property, and talent. They can form strategic partnerships. But the supply of innovators and new technologies is infinite - and the resources of oligopolies, however mighty, are finite.

The market is stronger than any of its participants, regardless of the hubris of some, or the paranoia of others.

XXXI. Anarchy as an Organizing Principle

The recent spate of accounting fraud scandals signals the end of an era. Disillusionment and disenchantment with American capitalism may yet lead to a tectonic ideological shift from laissez faire and self regulation to state intervention and regulation. This would be the reversal of a trend dating back to Thatcher in Britain and Reagan in the USA. It would also cast some fundamental - and way more ancient - tenets of free-marketry in grave doubt.

Markets are perceived as self-organizing, self-assembling, exchanges of information, goods, and services. Adam Smith's "invisible hand" is the sum of all the mechanisms whose interaction gives rise to the optimal allocation of economic resources. The market's great advantages over central planning are precisely its randomness and its lack of self-awareness.

Market participants go about their egoistic business, trying to maximize their utility, oblivious of the interests and action of all, bar those they interact with directly.

Somehow, out of the chaos and clamor, a structure emerges of order and efficiency unmatched. Man is incapable of intentionally producing better outcomes.

Thus, any intervention and interference are deemed to be detrimental to the proper functioning of the economy.

It is a minor step from this idealized worldview back to the Physiocrats, who preceded Adam Smith, and who propounded the doctrine of "laissez faire, laissez passer" - the hands-off battle cry. Theirs was a natural religion. The market, as an agglomeration of individuals, they thundered, was surely entitled to enjoy the rights and freedoms accorded to each and every person. John Stuart Mill weighed against the state's involvement in the economy in his influential and exquisitely-timed "Principles of Political Economy", published in 1848.

Undaunted by mounting evidence of market failures - for instance to provide affordable and plentiful public goods - this flawed theory returned with a vengeance in the last two decades of the past century. Privatization, deregulation, and self-regulation became faddish buzzwords and part of a global consensus propagated by both commercial banks and multilateral lenders.

As applied to the professions - to accountants, stock brokers, lawyers, bankers, insurers, and so on - self-regulation was premised on the belief in long-term self-preservation. Rational economic players and moral agents are supposed to maximize their utility in the long-run by observing the rules and regulations of a level playing field.

This noble propensity seemed, alas, to have been tampered by avarice and narcissism and by the immature inability to postpone gratification. Self-regulation failed so spectacularly to conquer human nature that its demise gave rise to the most intrusive statal stratagems ever devised. In both the UK and the USA, the government is much more heavily and pervasively involved in the minutia of accountancy, stock dealing, and banking than it was only two years ago.

But the ethos and myth of "order out of chaos" - with its proponents in the exact sciences as well - ran deeper than that. The very culture of commerce was thoroughly permeated and transformed. It is not

surprising that the Internet - a chaotic network with an anarchic modus operandi - flourished at these times.

The dotcom revolution was less about technology than about new ways of doing business - mixing umpteen irreconcilable ingredients, stirring well, and hoping for the best. No one, for instance, offered a linear revenue model of how to translate "eyeballs" - i.e., the number of visitors to a Web site - to money ("monetizing"). It was dogmatically held to be true that, miraculously, traffic - a chaotic phenomenon - will translate to profit - hitherto the outcome of painstaking labour.

Privatization itself was such a leap of faith. State owned assets - including utilities and suppliers of public goods such as health and education - were transferred wholesale to the hands of profit maximizers. The implicit belief was that the price mechanism will provide the missing planning and regulation. In other words, higher prices were supposed to guarantee an uninterrupted service.

Predictably, failure ensued - from electricity utilities in California to railway operators in Britain.

The simultaneous crumbling of these urban legends - the liberating power of the Net, the self-regulating markets, the unbridled merits of privatization - inevitably gave rise to a backlash.

The state has acquired monstrous proportions in the decades since the Second world War. It is about to grow further and to digest the few sectors hitherto left untouched. To say the least, these are not good news. But we libertarians - proponents of both individual freedom and individual responsibility - have brought it on ourselves by thwarting the work of that invisible regulator - the market.

XXXII. Narcissism in the Boardroom

The perpetrators of the recent spate of financial frauds in the USA acted with callous disregard for both their employees and shareholders - not to mention other stakeholders. Psychologists have often remote-diagnosed them as "malignant, pathological narcissists".

Narcissists are driven by the need to uphold and maintain a false self - a concocted, grandiose, and demanding psychological construct typical of the narcissistic personality disorder. The false self is projected to the world in order to garner "narcissistic supply" - adulation, admiration, or even notoriety and infamy. Any kind of attention is usually deemed by narcissists to be preferable to obscurity.

The false self is suffused with fantasies of perfection, grandeur, brilliance, infallibility, immunity, significance, omnipotence, omnipresence, and omniscience. To be a narcissist is to be convinced of a great, inevitable personal destiny. The narcissist is preoccupied with ideal love, the construction of brilliant, revolutionary scientific theories, the composition or authoring or painting of the greatest work of art, the founding of a new school of thought, the attainment of fabulous wealth, the reshaping of a nation or a conglomerate, and so on. The narcissist never sets realistic goals to himself. He is forever preoccupied with fantasies of uniqueness, record breaking, or breathtaking achievements. His verbosity reflects this propensity.

Reality is, naturally, quite different and this gives rise to a "grandiosity gap". The demands of the false self are never satisfied by the narcissist's accomplishments, standing, wealth, clout, sexual prowess, or knowledge. The narcissist's grandiosity and sense of entitlement are equally incommensurate with his achievements.

To bridge the grandiosity gap, the malignant (pathological) narcissist resorts to shortcuts. These very often lead to fraud.

The narcissist cares only about appearances. What matters to him are the facade of wealth and its attendant social status and narcissistic supply. Witness the travestied extravagance of Tyco's Denis Kozlowski. Media attention only exacerbates the narcissist's addiction and makes it incumbent on him to go to ever-wilder extremes to secure uninterrupted supply from this source.

The narcissist lacks empathy - the ability to put himself in other people's shoes. He does not recognize boundaries - personal, corporate, or legal. Everything and everyone are to him mere instruments, extensions, objects unconditionally and uncomplainingly available in his pursuit of narcissistic gratification.

This makes the narcissist perniciously exploitative. He uses, abuses, devalues, and discards even his nearest and dearest in the most chilling manner. The narcissist is utility-driven, obsessed with his overwhelming need to reduce his anxiety and regulate his labile sense of self-worth by securing a constant supply of his drug - attention. American executives acted without compunction when they raided their employees' pension funds - as did Robert Maxwell a generation earlier in Britain.

The narcissist is convinced of his superiority - cerebral or physical. To his mind, he is a Gulliver hamstrung by a horde of narrow-minded and envious Lilliputians. The dotcom "new economy" was infested with "visionaries" with a contemptuous attitude towards the mundane: profits, business cycles, conservative economists, doubtful journalists, and cautious analysts.

Yet, deep inside, the narcissist is painfully aware of his addiction to others - their attention, admiration, applause, and affirmation. He despises himself for being thus dependent. He hates people the same way a drug addict hates his pusher. He wishes to "put them in their place", humiliate them, demonstrate to them how inadequate and imperfect they are in comparison to his regal self and how little he craves or needs them.

The narcissist regards himself as one would an expensive present, a gift to his company, to his family, to his neighbours, to his colleagues, to his country. This firm conviction of his inflated importance makes him feel entitled to special treatment, special favors, special outcomes, concessions, subservience, immediate gratification, obsequiousness, and lenience. It also makes him feel immune to mortal laws and somehow divinely protected and insulated from the inevitable consequences of his deeds and misdeeds.

The self-destructive narcissist plays the role of the "bad guy" (or "bad girl"). But even this is within the traditional social roles cartoonishly exaggerated by the narcissist to attract attention. Men are likely to emphasise intellect, power, aggression, money, or social status. Narcissistic women are likely to emphasise body, looks, charm, sexuality, feminine "traits", homemaking, children and childrearing.

Punishing the wayward narcissist is a veritable catch-22.

A jail term is useless as a deterrent if it only serves to focus attention on the narcissist. Being infamous is second best to being famous - and far preferable to being ignored.

The only way to effectively punish a narcissist is to withhold narcissistic supply from him and thus to prevent him from becoming a notorious celebrity.

Given a sufficient amount of media exposure, book contracts, talk shows, lectures, and public attention - the narcissist may even consider the whole grisly affair to be emotionally rewarding. To the narcissist, freedom, wealth, social status, family, vocation - are all means to an end.

And the end is attention. If he can secure attention by being the big bad wolf - the narcissist unhesitatingly transforms himself into one. Lord Archer, for instance, seems to be positively basking in the media circus provoked by his prison diaries.

The narcissist does not victimise, plunder, terrorise and abuse others in a cold, calculating manner. He does so offhandedly, as a manifestation of his genuine character.

To be truly "guilty" one needs to intend, to deliberate, to contemplate one's choices and then to choose one's acts.

The narcissist does none of these.

Thus, punishment breeds in him surprise, hurt and seething anger. The narcissist is stunned by society's insistence that he should be held accountable for his deeds and penalized accordingly. He feels wronged, baffled, injured, the victim of bias, discrimination and injustice.

He rebels and rages.

Depending upon the pervasiveness of his magical thinking, the narcissist may feel besieged by overwhelming powers, forces cosmic and intrinsically ominous. He may develop compulsive rites to fend off this "bad", unwarranted, persecutory influences.

The narcissist, very much the infantile outcome of stunted personal development, engages in magical thinking. He feels omnipotent, that there is nothing he couldn't do or achieve if only he sets his mind to it. He feels omniscient - he rarely admits to ignorance and regards his intuitions and intellect as founts of objective data.

Thus, narcissists are haughtily convinced that introspection is a more important and more efficient (not to mention easier to accomplish) method of obtaining knowledge than the systematic study of outside sources of information in accordance with strict and tedious curricula. Narcissists are "inspired" and they despise hamstrung technocrats.

To some extent, they feel omnipresent because they are either famous or about to become famous or because their product is selling or is being manufactured globally.

Deeply immersed in their delusions of grandeur, they firmly believe that their acts have - or will have - a great influence not only on their firm, but on their country, or even on Mankind. Having mastered the manipulation of their human environment - they are convinced that they will always "get away with it". They develop hubris and a false sense of immunity.

Narcissistic immunity is the (erroneous) feeling, harboured by the narcissist, that he is impervious to the consequences of his actions, that he will never be effected by the results of his own decisions, opinions, beliefs, deeds and misdeeds, acts, inaction, or membership of certain groups, that he is above reproach and punishment, that, magically, he is protected and will miraculously be saved at the last moment. Hence the audacity, simplicity, and transparency of some of the fraud and corporate looting in the 1990's. Narcissists rarely bother to cover their traces, so great is their disdain and conviction that they are above mortal laws and wherewithal.

What are the sources of this unrealistic appraisal of situations and events? The false self is a childish response to abuse and trauma.

Abuse is not limited to sexual molestation or beatings.

Smothering, doting, pampering, over-indulgence, treating the child as an extension of the parent, not respecting the child's boundaries, and burdening the child with excessive expectations are also forms of abuse.

The child reacts by constructing false self that is possessed of everything it needs in order to prevail: unlimited and instantaneously available Harry Potter-like powers and wisdom. The false self, this Superman,

is indifferent to abuse and punishment. This way, the child's true self is shielded from the toddler's harsh reality.

This artificial, maladaptive separation between a vulnerable (but not punishable) true self and a punishable (but invulnerable) false self is an effective mechanism. It isolates the child from the unjust, capricious, emotionally dangerous world that he occupies. But, at the same time, it fosters in him a false sense of "nothing can happen to me, because I am not here, I am not available to be punished, hence I am immune to punishment".

The comfort of false immunity is also yielded by the narcissist's sense of entitlement. In his grandiose delusions, the narcissist is *sui generis*, a gift to humanity, a precious, fragile, object. Moreover, the narcissist is convinced both that this uniqueness is immediately discernible - and that it gives him special rights. The narcissist feels that he is protected by some cosmological law pertaining to "endangered species".

He is convinced that his future contribution to others - his firm, his country, humanity - should and does exempt him from the mundane: daily chores, boring jobs, recurrent tasks, personal exertion, orderly investment of resources and efforts, laws and regulations, social conventions, and so on.

The narcissist is entitled to a "special treatment": high living standards, constant and immediate catering to his needs, the eradication of any friction with the humdrum and the routine, an all-engulfing absolution of his sins, fast track privileges (to higher education, or in his encounters with bureaucracies, for instance). Punishment, trusts the narcissist, is for ordinary people, where no great loss to humanity is involved.

Narcissists are possessed of inordinate abilities to charm, to convince, to seduce, and to persuade. Many of them are gifted orators and intellectually endowed. Many of them work in politics, the media, fashion, show business, the arts, medicine, or business, and serve as religious leaders.

By virtue of their standing in the community, their charisma, or their ability to find the willing scapegoats, they do get exempted many times. Having recurrently "got away with it" - they develop a theory of personal immunity, founded upon some kind of societal and even cosmic "order" in which certain people are above punishment.

But there is a fourth, simpler, explanation. The narcissist lacks self-awareness. Divorced from his true self, unable to empathise (to understand what it is like to be someone else), unwilling to constrain his actions to cater to the feelings and needs of others - the narcissist is in a constant dreamlike state.

To the narcissist, his life is unreal, like watching an autonomously unfolding movie. The narcissist is a mere spectator, mildly interested, greatly entertained at times.

He does not "own" his actions. He, therefore, cannot understand why he should be punished and when he is, he feels grossly wronged.

So convinced is the narcissist that he is destined to great things - that he refuses to accept setbacks, failures and punishments. He regards them as temporary, as the outcomes of someone else's errors, as part of the future mythology of his rise to power/brilliance/wealth/ideal love, etc. Being punished is a diversion of his precious energy and resources from the all-important task of fulfilling his mission in life.

The narcissist is pathologically envious of people and believes that they are equally envious of him. He is paranoid, on guard, ready to fend off an imminent attack.

A punishment to the narcissist is a major surprise and a nuisance but it also validates his suspicion that he is being persecuted. It proves to him that strong forces are arrayed against him.

He tells himself that people, envious of his achievements and humiliated by them, are out to get him. He constitutes a threat to the accepted order. When required to pay for his misdeeds, the narcissist is always disdainful and bitter and feels misunderstood by his inferiors.

Cooked books, corporate fraud, bending the (GAAP or other) rules, sweeping problems under the carpet, over-promising, making grandiose claims (the "vision thing") - are hallmarks of a narcissist in action. When social cues and norms encourage such behaviour rather than inhibit it - in other words, when such behaviour elicits abundant narcissistic supply - the pattern is reinforced and become entrenched and rigid. Even when circumstances change, the narcissist finds it difficult to adapt, shed his routines, and replace them with new ones. He is trapped in his past success. He becomes a swindler.

But pathological narcissism is not an isolated phenomenon. It is embedded in our contemporary culture.

The West's is a narcissistic civilization. It upholds narcissistic values and penalizes alternative value-systems. From an early age, children are taught to avoid self-criticism, to deceive themselves regarding their capacities and attainments, to feel entitled, and to exploit others.

As Lilian Katz observed in her important paper, "Distinctions between Self-Esteem and Narcissism: Implications for Practice", published by the Educational Resources Information Center, the line between enhancing self-esteem and fostering narcissism is often blurred by educators and parents.

Both Christopher Lasch in "The Culture of Narcissism" and Theodore Millon in his books about personality disorders, singled out American society as narcissistic.

Litigiousness may be the flip side of an inane sense of entitlement. Consumerism is built on this common and communal lie of "I can do anything I want and possess everything I desire if I only apply myself to it" and on the pathological envy it fosters.

Not surprisingly, narcissistic disorders are more common among men than among women. This may be

because narcissism conforms to masculine social mores and to the prevailing ethos of capitalism. Ambition, achievements, hierarchy, ruthlessness, drive - are both social values and narcissistic male traits. Social thinkers like the aforementioned Lasch speculated that modern American culture - a self-centred one - increases the rate of incidence of the narcissistic personality disorder.

Otto Kernberg, a notable scholar of personality disorders, confirmed Lasch's intuition: "Society can make serious psychological abnormalities, which already exist in some percentage of the population, seem to be at least superficially appropriate".

In their book "Personality Disorders in Modern Life", Theodore Millon and Roger Davis state, as a matter of fact, that pathological narcissism was once the preserve of "the royal and the wealthy" and that it "seems to have gained prominence only in the late twentieth century".

Narcissism, according to them, may be associated with "higher levels of Maslow's hierarchy of needs ...

Individuals in less advantaged nations .. are too busy trying (to survive) ... to be arrogant and grandiose".

They - like Lasch before them - attribute pathological narcissism to "a society that stresses individualism and self-gratification at the expense of community, namely the United States." They assert that the disorder is more prevalent among certain professions with "star power" or respect. "In an individualistic culture, the narcissist is 'God's gift to the world'. In a collectivist society, the narcissist is 'God's gift to the collective'".

Millon quotes Warren and Caponi's "The Role of Culture in the Development of Narcissistic Personality Disorders in America, Japan and Denmark": "Individualistic narcissistic structures of self-regard (in individualistic societies) ... are rather self-contained and independent ... (In collectivist cultures) narcissistic configurations of the we-self ... denote self-esteem derived from strong identification with the reputation and honor of the family, groups, and others in hierarchical relationships".

Still, there are malignant narcissists among subsistence farmers in Africa, nomads in the Sinai desert, day laborers in east Europe, and intellectuals and socialites in Manhattan. Malignant narcissism is all-pervasive and independent of culture and society. It is true, though, that the way pathological narcissism manifests and is experienced is dependent on the particulars of societies and cultures.

In some cultures, it is encouraged, in others suppressed. In some societies it is channeled against minorities - in others it is tainted with paranoia. In collectivist societies, it may be projected onto the collective, in individualistic societies, it is an individual's trait.

Yet, can families, organizations, ethnic groups, churches, and even whole nations be safely described as "narcissistic" or "pathologically self-absorbed"? Can we talk about a "corporate culture of narcissism"? Human collectives - states, firms, households, institutions, political parties, cliques, bands - acquire a life and a character all their own. The longer the association or affiliation of the members, the more cohesive and conformist the inner dynamics of the group, the more persecutory or numerous its enemies, competitors, or adversaries, the more intensive the physical and emotional experiences of the individuals it is comprised of, the stronger the bonds of locale, language, and history - the more rigorous might an assertion of a common pathology be.

Such an all-pervasive and extensive pathology manifests itself in the behavior of each and every member. It is a defining - though often implicit or underlying - mental structure. It has explanatory and predictive powers. It is recurrent and invariable - a pattern of conduct melding distorted cognition and stunted emotions. And it is often vehemently denied.

XXXIII. The Revolt of the Poor

The Demise of Intellectual Property?

In 1997, I published a book of short stories in Israel. The publishing house belongs to Israel's leading (and exceedingly wealthy) newspaper. I signed a contract which stated that I am entitled to receive 8% of the income from the sales of the book after commissions payable to distributors, shops, etc. A few months later (1997), I won the coveted Prize of the Ministry of Education (for short prose). The prize money (a few thousand DMs) was snatched by the publishing house on the legal grounds that all the money generated by the book belongs to them because they own the copyright.

In the mythology generated by capitalism to pacify the masses, the myth of intellectual property stands out. It goes like this: if the rights to intellectual property were not defined and enforced, commercial entrepreneurs would not have taken on the risks associated with publishing books, recording records, and preparing multimedia products. As a result, creative people will have suffered because they will have found no way to make their works accessible to the public. Ultimately, it is the public which pays the price of piracy, goes the refrain.

But this is factually untrue. In the USA there is a very limited group of authors who actually live by their pen.

Only select musicians eke out a living from their noisy vocation (most of them rock stars who own their labels - George Michael had to fight Sony to do just that) and very few actors come close to deriving subsistence level income from their profession. All these can no longer be thought of as mostly creative

people. Forced to defend their intellectual property rights and the interests of Big Money, Madonna, Michael Jackson, Schwarzenegger and Grisham are businessmen at least as much as they are artists.

Economically and rationally, we should expect that the costlier a work of art is to produce and the narrower its market - the more emphasized its intellectual property rights.

Consider a publishing house.

A book which costs 50,000 DM to produce with a potential audience of 1000 purchasers (certain academic texts are like this) - would have to be priced at a minimum of 100 DM to recoup only the direct costs. If illegally copied (thereby shrinking the potential market as some people will prefer to buy the cheaper illegal copies) - its price would have to go up prohibitively to recoup costs, thus driving out potential buyers. The story is different if a book costs 10,000 DM to produce and is priced at 20 DM a copy with a potential readership of 1,000,000 readers. Piracy (illegal copying) should in this case be more readily tolerated as a marginal phenomenon.

This is the theory. But the facts are tellingly different. The less the cost of production (brought down by digital technologies) - the fiercer the battle against piracy. The bigger the market - the more pressure is applied to clamp down on samizdat entrepreneurs.

Governments, from China to Macedonia, are introducing intellectual property laws (under pressure from rich world countries) and enforcing them belatedly. But where one factory is closed on shore (as has been the case in mainland China) - two sprout off shore (as is the case in Hong Kong and in Bulgaria).

But this defies logic: the market today is global, the costs of production are lower (with the exception of the music and film industries), the marketing channels more numerous (half of the income of movie studios emanates from video cassette sales), the speedy recouping of the investment virtually guaranteed. Moreover, piracy thrives in very poor markets in which the population would anyhow not have paid the legal price. The illegal product is inferior to the legal copy (it comes with no literature, warranties or support). So why should the big manufacturers, publishing houses, record companies, software companies and fashion houses worry? The answer lurks in history. Intellectual property is a relatively new notion. In the near past, no one considered knowledge or the fruits of creativity (art, design) as "patentable", or as someone's "property". The artist was but a mere channel through which divine grace flowed.

Texts, discoveries, inventions, works of art and music, designs - all belonged to the community and could be replicated freely. True, the chosen ones, the conduits, were honoured but were rarely financially rewarded. They were commissioned to produce their works of art and were salaried, in most cases. Only with the advent of the Industrial Revolution were the embryonic precursors of intellectual property introduced but they were still limited to industrial designs and processes, mainly as embedded in machinery. The patent was born. The more massive the market, the more sophisticated the sales and marketing techniques, the bigger the financial stakes - the larger loomed the issue of intellectual property. It spread from machinery to designs, processes, books, newspapers, any printed matter, works of art and music, films (which, at their beginning were not considered art), software, software embedded in hardware, processes, business methods, and even unto genetic material.

Intellectual property rights - despite their noble title - are less about the intellect and more about property. This is Big Money: the markets in intellectual property outweigh the total industrial production in the world. The aim is to secure a monopoly on a specific work. This is an especially grave matter in academic publishing where small-circulation magazines do not allow their content to be quoted or published even for non-commercial purposes. The monopolists of knowledge and intellectual products cannot allow competition anywhere in the world - because theirs is a world market. A pirate in Skopje is in direct competition with Bill Gates. When he sells a pirated Microsoft product - he is depriving Microsoft not only of its income, but of a client (=future income), of its monopolistic status (cheap copies can be smuggled into other markets), and of its competition-detering image (a major monopoly preserving asset). This is a threat which Microsoft cannot tolerate. Hence its efforts to eradicate piracy - successful in China and an utter failure in legally-relaxed Russia.

But what Microsoft fails to understand is that the problem lies with its pricing policy - not with the pirates. When faced with a global marketplace, a company can adopt one of two policies: either to adjust the price of its products to a world average of purchasing power - or to use discretionary differential pricing (as pharmaceutical companies were forced to do in Brazil and South Africa).

A Macedonian with an average monthly income of 160 USD clearly cannot afford to buy the Encyclopaedia Encarta Deluxe. In America, 50 USD is the income generated in 4 hours of an average job. In Macedonian terms, therefore, the Encarta is 20 times more expensive.

Either the price should be lowered in the Macedonian market - or an average world price should be fixed which will reflect an average global purchasing power.

Something must be done about it not only from the economic point of view. Intellectual products are very price sensitive and highly elastic. Lower prices will be more than compensated for by a much higher sales volume. There is no other way to explain the pirate industries: evidently, at the right price a lot of people are willing to buy these products. High prices are an implicit trade-off favouring small, elite, select, rich world clientele. This raises a moral issue: are the children of Macedonia less worthy of education and access to the latest in human knowledge and creation? Two developments threaten the future of intellectual property rights. One is the Internet. Academics, fed up with the monopolistic practices of professional publications - already publish on the web in big numbers.

I published a few books on the Internet and they can be freely downloaded by anyone who has a computer or

a modem. The full text of electronic magazines, trade journals, billboards, professional publications, and thousands of books is available online. Hackers even made sites available from which it is possible to download whole software and multimedia products. It is very easy and cheap to publish on the Internet, the barriers to entry are virtually nil. Web pages are hosted free of charge, and authoring and publishing software tools are incorporated in most word processors and browser applications. As the Internet acquires more impressive sound and video capabilities it will proceed to threaten the monopoly of the record companies, the movie studios and so on.

The second development is also technological. The oft-vindicated Moore's law predicts the doubling of computer memory capacity every 18 months. But memory is only one aspect of computing power. Another is the rapid simultaneous advance on all technological fronts.

Miniaturization and concurrent empowerment by software tools have made it possible for individuals to emulate much larger scale organizations successfully. A single person, sitting at home with 5000 USD worth of equipment can fully compete with the best products of the best printing houses anywhere. CD-ROMs can be written on, stamped and copied in house. A complete music studio with the latest in digital technology has been condensed to the dimensions of a single chip. This will lead to personal publishing, personal music recording, and the to the digitization of plastic art. But this is only one side of the story.

The relative advantage of the intellectual property corporation does not consist exclusively in its technological prowess. Rather it lies in its vast pool of capital, its marketing clout, market positioning, sales organization, and distribution network.

Nowadays, anyone can print a visually impressive book, using the above-mentioned cheap equipment. But in an age of information glut, it is the marketing, the media campaign, the distribution, and the sales that determine the economic outcome.

This advantage, however, is also being eroded.

First, there is a psychological shift, a reaction to the commercialization of intellect and spirit. Creative people are repelled by what they regard as an oligarchic establishment of institutionalized, lowest common denominator art and they are fighting back.

Secondly, the Internet is a huge (200 million people), truly cosmopolitan market, with its own marketing channels freely available to all. Even by default, with a minimum investment, the likelihood of being seen by surprisingly large numbers of consumers is high.

I published one book the traditional way - and another on the Internet. In 50 months, I have received 6500 written responses regarding my electronic book. Well over 500,000 people read it (my Link Exchange meter registered c. 2,000,000 impressions since November 1998). It is a textbook (in psychopathology) - and 500,000 readers is a lot for this kind of publication. I am so satisfied that I am not sure that I will ever consider a traditional publisher again. Indeed, my last book was published in the very same way.

The demise of intellectual property has lately become abundantly clear. The old intellectual property industries are fighting tooth and nail to preserve their monopolies (patents, trademarks, copyright) and their cost advantages in manufacturing and marketing.

But they are faced with three inexorable processes which are likely to render their efforts vain: The Newspaper Packaging Print newspapers offer package deals of cheap content subsidized by advertising. In other words, the advertisers pay for content formation and generation and the reader has no choice but be exposed to commercial messages as he or she studies the content.

This model - adopted earlier by radio and television - rules the internet now and will rule the wireless internet in the future. Content will be made available free of all pecuniary charges. The consumer will pay by providing his personal data (demographic data, consumption patterns and preferences and so on) and by being exposed to advertising. Subscription based models are bound to fail.

Thus, content creators will benefit only by sharing in the advertising cake. They will find it increasingly difficult to implement the old models of royalties paid for access or of ownership of intellectual property.

Disintermediation A lot of ink has been spilt regarding this important trend.

The removal of layers of brokering and intermediation - mainly on the manufacturing and marketing levels - is a historic development (though the continuation of a long term trend).

Consider music for instance. Streaming audio on the internet or downloadable MP3 files will render the CD obsolete. The internet also provides a venue for the marketing of niche products and reduces the barriers to entry previously imposed by the need to engage in costly marketing ("branding") campaigns and manufacturing activities.

This trend is also likely to restore the balance between artist and the commercial exploiters of his product. The very definition of "artist" will expand to include all creative people. One will seek to distinguish oneself, to "brand" oneself and to auction off one's services, ideas, products, designs, experience, etc. This is a return to pre-industrial times when artisans ruled the economic scene.

Work stability will vanish and work mobility will increase in a landscape of shifting allegiances, head hunting, remote collaboration and similar labour market trends.

Market Fragmentation In a fragmented market with a myriad of mutually exclusive market niches, consumer preferences and marketing and sales channels - economies of scale in manufacturing and distribution are meaningless.

Narrowcasting replaces broadcasting, mass customization replaces mass production, a network of shifting affiliations replaces the rigid owned-branch system. The decentralized, intrapreneurship-based corporation is a late response to these trends. The mega-corporation of the future is more likely to act as a collective of start-ups than as a homogeneous, uniform (and, to conspiracy theorists, sinister) juggernaut it once was.

XXXIV. The Kidnapping of Content

<http://www.plagiarism.org> and <http://www.Turnitin.com>

Latin kidnapped the word "plagion" from ancient Greek and it ended up in English as "plagiarism". It literally means "to kidnap" - most commonly, to misappropriate content and wrongly attribute it to oneself. It is a close kin of piracy. But while the software or content pirate does not bother to hide or alter the identity of the content's creator or the software's author - the plagiarist does.

Plagiarism is, therefore, more pernicious than piracy.

Enter Turnit.com. An off-shoot of www.iparadigms.com, it was established by a group of concerned (and commercially minded) scientists from UC Berkeley.

Whereas digital rights and asset management systems are geared to prevent piracy - [plagiarism.org](http://www.plagiarism.org) and its commercial arm, [Turnitin.com](http://www.Turnitin.com), are the cyber equivalent of a law enforcement agency, acting after the fact to discover the culprits and uncover their misdeeds. This, they claim, is a first stage on the way to a plagiarism-free Internet-based academic community of both teachers and students, in which the educational potential of the Internet can be fully realized.

The problem is especially severe in academia. Various surveys have discovered that a staggering 80%(!!) of US students cheat and that at least 30% plagiarize written material. The Internet only exacerbated this problem.

More than 200 cheat-sites have sprung up, with thousands of papers available on-line and tens of thousands of satisfied plagiarists the world over. Some of these hubs - like cheater.com, [cheatweb](http://cheatweb.com) or cheathouse.com - make no bones about their offerings. Many of them are located outside the USA (in Germany, or Asia) and at least one offers papers in a few languages, Hebrew included.

The problem, though, is not limited to the ivory towers. E-zines plagiarize. The print media plagiarize. Individual journalists plagiarize, many with abandon. Even advertising agencies and financial institutions plagiarize.

The amount of material out there is so overwhelming that the plagiarist develops a (fairly justified) sense of immunity. The temptation is irresistible, the rewards big and the pressures of modern life great.

Some of the plagiarists are straightforward copiers. Others substitute words, add sentences, or combine two or more sources. This raises the question: "when should content be considered original and when - plagiarized?". Should the test for plagiarism be more stringent than the one applied by the Copyright Office? And what rights are implicitly granted by the material's genuine authors or publishers once they place the content on the Internet? Is the Web a public domain and, if yes, to what extent? These questions are not easily answered. Consider reports generated by users from a database. Are these reports copyrighted - and if so, by whom - by the database compiler or by the user who defined the parameters, without which the reports in question would have never been generated? What about "fair use" of text and works of art? In the USA, the backlash against digital content piracy and plagiarism has reached preposterous legal, litigious and technological nadirs.

[Plagiarism.org](http://www.plagiarism.org) has developed a statistics-based technology (the "Document Source Analysis") which creates a "digital fingerprint" of every document in its database. Web crawlers are then unleashed to scour the Internet and find documents with the same fingerprint and a colour-coded report is generated. An instructor, teacher, or professor can then use the report to prove plagiarism and cheating.

Piracy is often considered to be a form of viral marketing (even by software developers and publishers). The author's, publisher's, or software house's data are preserved intact in the cracked copy. Pirated copies of e-books often contribute to increased sales of the print versions. Crippled versions of software or pirated copies of software without its manuals, updates and support - often lead to the purchase of a licence. Not so with plagiarism. The identities of the author, editor, publisher and illustrator are deleted and replaced by the details of the plagiarist. And while piracy is discussed freely and fought vigorously - the discussion of plagiarism is still taboo and actively suppressed by image-conscious and endowment-weary academic institutions and media. It is an uphill struggle but [plagiarism.org](http://www.plagiarism.org) has taken the first resolute step.

XXXV. The Economics of Spam

Tennessee resident K. C. "Khan" Smith owes the internet service provider EarthLink \$24 million. According

to the CNN, in August 2001 he was slapped with a lawsuit accusing him of violating federal and state Racketeering Influenced and Corrupt Organizations (RICO) statutes, the federal Computer Fraud and Abuse Act of 1984, the federal Electronic Communications Privacy Act of 1986 and numerous other state laws. On July 19, 2002 - having failed to appear in court - the judge ruled against him. Mr.

Smith is a spammer.

Brightmail, a vendor of e-mail filters and anti-spam applications warned that close to 5 million spam "attacks" or "bursts" occurred in June 2002 and that spam has mushroomed 450 percent since June 2001. This pace continued unabated well into the beginning of 2004 when the introduction of spam filters began to take effect. PC World concurs.

Between one half and three quarters of all e-mail messages are spam or UCE (Unsolicited Commercial Email) - unsolicited and intrusive commercial ads, mostly concerned with sex, scams, get rich quick schemes, financial services and products, and health articles of dubious provenance. The messages are sent from spoofed or fake e-mail addresses. Some spammers hack into unsecured servers - mainly in China and Korea - to relay their missives anonymously.

Starting in 2003, malicious hackers began using spam to install malware - such as viruses, adware, spyware, and Trojans - on the unprotected personal computers of less savvy users. They thus transform these computers into "zombies", organize them into spam-spewing "bots" (networks), and sell access to them to criminals on penumbral boards and forums all over the Net.

Spam is an industry. Mass e-mailers maintain lists of e-mail addresses, often "harvested" by spamware bots - specialized computer applications - from Web sites. These lists are rented out or sold to marketers who use bulk mail services. They come cheap - c. \$100 for 10 million addresses. Bulk mailers provide servers and bandwidth, charging c. \$300 per million messages sent.

As spam recipients become more inured, ISPs less tolerant, and both more litigious - spammers multiply their efforts in order to maintain the same response rate. Spam works. It is not universally unwanted - which makes it tricky to outlaw. It elicits between 0.1 and 1 percent in positive follow ups, depending on the message. Many messages now include HTML, JavaScript, and ActiveX coding and thus resemble (or actually contain) viruses and Trojans.

Jupiter Media Matrix predicted in 2001 that the number of spam messages annually received by a typical Internet user will double to 1400 and spending on legitimate e-mail marketing will reach \$9.4 billion by 2006 - compared to \$1 billion in 2001. Forrester Research pegs the number at \$4.8 billion in 2003.

More than 2.3-5 billion spam messages are sent daily. eMarketer puts the figures a lot lower at 76 billion messages in 2002. By 2006, daily spam output will soar to c. 15 billion missives, says Radicati Group. Jupiter projects a more modest 268 billion annual messages this year (2005). An average communication costs the spammer 0.00032 cents.

PC World quotes the European Union as pegging the bandwidth costs of spam worldwide in 2002 at \$8-10 billion annually. Other damages include server crashes, time spent purging unwanted messages, lower productivity, aggravation, and increased cost of Internet access.

Inevitably, the spam industry gave rise to an anti-spam industry. According to a Radicati Group report titled "Anti-virus, anti-spam, and content filtering market trends 2002-2006", anti-spam revenues were projected to exceed \$88 million in 2002 - and more than double by 2006. List blockers, report and complaint generators, advocacy groups, registers of known spammers, and spam filters all proliferate. The Wall Street Journal reported in its June 25, 2002 issue about a resurgence of anti-spam startups financed by eager venture capital.

ISPs are bent on preventing abuse - reported by victims - by expunging the accounts of spammers. But the latter simply switch ISPs or sign on with free services like Hotmail and Yahoo! Barriers to entry are getting lower by the day as the costs of hardware, software, and communications plummet.

The use of e-mail and broadband connections by the general population is spreading. Hundreds of thousands of technologically-savvy operators have joined the market in the last five years, as the dotcom bubble burst. Still, Steve Linford of the UK-based Spamhaus.org insists that most spam emanates from c. 80 large operators.

Now, according to Jupiter Media, ISPs and portals are poised to begin to charge advertisers in a tier-based system, replete with premium services. Writing back in 1998, Bill Gates described a solution also espoused by Esther Dyson, chair of the Electronic Frontier Foundation: "As I first described in my book 'The Road Ahead' in 1995, I expect that eventually you'll be paid to read unsolicited e-mail. You'll tell your e-mail program to discard all unsolicited messages that don't offer an amount of money that you'll choose. If you open a paid message and discover it's from a long-lost friend or somebody else who has a legitimate reason to contact you, you'll be able to cancel the payment. Otherwise, you'll be paid for your time".

Subscribers may not be appreciative of the joint ventures between gatekeepers and inbox clutterers. Moreover, dominant ISPs, such as AT&T and PSINet have recurrently been accused of knowingly collaborating with spammers. ISPs rely on the data traffic that spam generates for their revenues in an ever-harsher business environment.

The Financial Times and others described how WorldCom refuses to ban the sale of spamware over its network, claiming that it does not regulate content. When "pink" (the color of canned spam) contracts came to light, the implicated ISPs blame the whole affair on rogue employees.

PC World begs to differ: "Ronnie Scelson, a self-described spammer who signed such a contract with PSInet, (says) that backbone providers are more than happy to do business with bulk e-mailers. 'I've signed up with the biggest 50 carriers two or three times', says Scelson ... The Louisiana-based spammer claims to send 84 million commercial e-mail messages a day over his three 45-megabit-per-second DS3 circuits. 'If you were getting \$40,000 a month for each circuit', Scelson asks, 'would you want to shut me down?'" The line between permission-based or "opt-in" e-mail marketing and spam is getting thinner by the day. Some list resellers guarantee the consensual nature of their wares. According to the Direct Marketing Association's guidelines, quoted by PC World, not responding to an unsolicited e-mail amounts to "opting-in" - a marketing strategy known as "opting out". Most experts, though, strongly urge spam victims not to respond to spammers, lest their e-mail address is confirmed.

But spam is crossing technological boundaries. Japan has just legislated against wireless SMS spam targeted at hapless mobile phone users. Many states in the USA as well as the European parliament have followed suit. Ideas regarding a "do not spam" list akin to the "do not call" list in telemarketing have been floated. Mobile phone users will place their phone numbers on the list to avoid receiving UCE (spam). Email subscribers enjoy the benefits of a similar list under the CAN-Spam Act of 2003.

Expensive and slow connections make mobile phone spam and spim (instant messaging spam) particularly resented. Still, according to Britain's Mobile Channel, a mobile advertising company quoted by "The Economist", SMS advertising - a novelty - attracts a 10-20 percent response rate - compared to direct mail's 1-3 percent.

Net identification systems - like Microsoft's Passport and the one proposed by Liberty Alliance - will make it even easier for marketers to target prospects.

The reaction to spam can be described only as mass hysteria. Reporting someone as a spammer - even when he is not - has become a favorite pastime of vengeful, self-appointed, vigilante "cyber-cops". Perfectly legitimate, opt-in, email marketing businesses and discussion forums often find themselves in one or more black lists - their reputation and business ruined.

In January 2002, CMGI-owned Yesmail was awarded a temporary restraining order against MAPS - Mail Abuse Prevention System - forbidding it to place the reputable e-mail marketer on its Real-time Blackhole list. The case was settled out of court.

Harris Interactive, a large online opinion polling company, sued not only MAPS, but ISPs who blocked its email messages when it found itself included in MAPS' Blackhole. Their CEO accused one of their competitors for the allegations that led to Harris' inclusion in the list.

Coupled with other pernicious phenomena - such as viruses, Trojans, and spyware - the very foundation of the Internet as a fun, relatively safe, mode of communication and data acquisition is at stake.

Spammers, it emerges, have their own organizations.

NOIC - the National Organization of Internet Commerce threatened to post to its Web site the e-mail addresses of millions of AOL members. AOL has aggressive anti-spamming policies. "AOL is blocking bulk email because it wants the advertising revenues for itself (by selling pop-up ads)" the president of NOIC, Damien Melle, complained to CNET.

Spam is a classic "free rider" problem. For any given individual, the cost of blocking a spammer far outweighs the benefits. It is cheaper and easier to hit the "delete" key. Individuals, therefore, prefer to let others do the job and enjoy the outcome - the public good of a spam-free Internet. They cannot be left out of the benefits of such an aftermath - public goods are, by definition, "non-excludable". Nor is a public good diminished by a growing number of "non-rival" users.

Such a situation resembles a market failure and requires government intervention through legislation and enforcement. The FTC - the US Federal Trade Commission - has taken legal action against more than 100 spammers for promoting scams and fraudulent goods and services. "Project Mailbox" is an anti-spam collaboration between American law enforcement agencies and the private sector. Non government organizations have entered the fray, as have lobbying groups, such as CAUCE - the Coalition Against Unsolicited Commercial E-mail.

But, a few recent anti-spam and anti-spyware Acts notwithstanding, Congress is curiously reluctant to enact stringent laws against spam. Reasons cited are free speech, limits on state powers to regulate commerce, avoiding unfair restrictions on trade, and the interests of small business. The courts equivocate as well. In some cases - e.g., Missouri vs. American Blast Fax - US courts found "that the provision prohibiting the sending of unsolicited advertisements is unconstitutional".

According to Spamlaws.com, the 107th Congress, for instance, discussed these laws but never enacted them: Unsolicited Commercial Electronic Mail Act of 2001 (H.R. 95), Wireless Telephone Spam Protection Act (H.R. 113), Anti-Spamming Act of 2001 (H.R. 718), Anti-Spamming Act of 2001 (H.R. 1017), Who Is E-Mailing Our Kids Act (H.R. 1846), Protect Children From E-Mail Smut Act of 2001 (H.R. 2472), Netizens Protection Act of 2001 (H.R. 3146), "CAN SPAM" Act of 2001 (S. 630).

Anti-spam laws fared no better in the 106th Congress.

Some of the states have picked up the slack. Arkansas, California, Colorado, Connecticut, Delaware, Idaho, Illinois, Iowa, Kansas, Louisiana, Maryland, Minnesota, Missouri, Nevada, North Carolina, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Tennessee, Utah, Virginia, Washington, West Virginia, and Wisconsin.

The situation is no better across the pond. The European parliament decided in 2001 to allow each member country to enact its own spam laws, thus avoiding a continent-wide directive and directly confronting the communications ministers of the union. Paradoxically, it also decided, in March 2002, to restrict SMS spam.

Confusion clearly reigns. Finally, in May 2002, it adopted strong anti-spam provisions as part of a Directive on Data Protection.

Responding to this unfavorable legal environment, spam is relocating to developing countries, such as Malaysia, Nepal, and Nigeria. In a May 2005 report, the OECD (Organization for Economic Cooperation and Development) warned that these countries lack the technical know-how and financial resources (let alone the will) to combat spam. Their users, anyhow deprived of bandwidth, endure, as a result, a less reliable service and an intermittent access to the Internet; "Spam is a much more serious issue in developing countries...as it is a heavy drain on resources that are scarcer and costlier in developing countries than elsewhere" - writes the report's author, Suresh Ramasubramanian, an OECD advisor and postmaster for Outblaze.com.

ISPs, spam monitoring services, and governments in the rich industrialized world react by placing entire countries - such as Macedonia and Costa Rica - on black lists and, thus denying access to their users en bloc.

International collaboration against the looming destruction of the Internet by crime organizations is budding. The FTC had just announced that it will work with its counterparts abroad to cut zombie computers off the network. A welcome step - but about three years late.

Spammers the world over are still six steps ahead and are having the upper hand.

The Content Downloader's Profile Interview granted to Tim Emmerling, a student at Eastern Illinois University.

Q. What do you know about people illegally downloading files over the internet? A. I know what everyone knows from being exposed to the news media and to lawsuits filed by publishers: the phenomenon is widespread and most of the millions of exchanged files are music tracks and films (though book rip-offs are not unknown as well).

Q. Why do you think people are taking part in these electronic transactions? Does the cost of purchasing the media come into play? A. It's a complex canvass of motivations, I guess. Many media products (especially in developing and poor countries) are overpriced in terms of the local purchasing power. Illegally downloading them is often an act of protest or defiance against what disgruntled consumers perceive as excessive profiteering. It may also be the only realistic way to gain ownership of coveted content.

The fact that everything - from text to images - is digital makes replication facile and enticing. Illegal downloading also probably confers an aura of daring and mystique on the "pirates" involved (whose life may otherwise be a lot drearier and mundane).

Additionally, these products resemble public goods in that they are nonrivalrous (the cost of extending the service or providing the good to another person is (close to) zero) and largely nonexcludable.

Most products are rivalrous (scarce) - zero sum games.

Having been consumed, they are gone and are not available to others. Public goods, in contrast, are accessible to growing numbers of people without any additional marginal cost. This wide dispersion of benefits renders them unsuitable for private entrepreneurship. It is impossible to recapture the full returns they engender. As Samuelson observed, they are extreme forms of positive externalities (spillover effects).

Moreover, it is impossible to exclude anyone from enjoying the benefits of a public good, or from defraying its costs (positive and negative externalities). Neither can anyone willingly exclude himself from their remit.

Needless to emphasize that media products are not public goods at all! They only superficially resemble public goods. Still, the fact that many books, music, and some films are, indeed, in the public domain further exacerbates the consumer's confusion. "Why can I (legally) download certain books and music tracks free of charge - but not others?" - wonders the baffled surfer, who is rarely versed in the intricacies of copyright laws.

Q. Do you think this leads to a feeling of disrespect toward the various pieces of media by the person that steals it so frequently? (If I download music all the time, will I lose interest in it?)

A. I am not sure that the word "respect" is relevant here.

People don't respect or disrespect music - they enjoy it, like it, or dislike it. But frequent illegal downloading of media products is, probably, the outcome of disrespect towards content intermediaries such as publishers, producers, and retail outlets. I don't know for sure because there is no research to guide us in this matter, but I would imagine that these people (wrongly) perceive content intermediaries as parasitic and avaricious.

Q. Downloading is still a widespread act today. The threats of lawsuits and legal action against downloaders hasn't stopped the problem. What, in your opinion, needs to be done to stop this behavior?

A. Law enforcement activities and lawsuits are already having an effect. But you cannot prosecute thousands of people on a regular basis without suffering a commensurate drop in popularity and a tarnished image.

People do not perceive these acts as self-defense but as David vs. Goliath bullying. Sooner or later, the efficacy of such measures is bound to decline.

Media companies would do better to adopt new technologies rather than fight them. They must come forth with new business models and new venues of dissemination of content. They have to show more generosity in the management of digital rights. They have to adopt differential pricing of their products across the board, to reflect disparities in earnings and purchasing power in the global marketplace. They have to transform themselves rather than try to coerce the world into their antiquated and Procrustean ways of doing things.

Q. Psychologically speaking, is there a certain kind of person who is more likely to take part in this behavior? Do you feel that this is a generational issue?

A. I cannot but speculate. There is a dearth of data at this early stage. I would imagine that illegal downloaders are hoarders. They are into owning things rather than into using or consuming them. They are into building libraries and collections. They are young and intelligent, but not affluent. They are irreverent, rebellious, and non-conformist. They may be loners who network socially only online. Some of them love culture and its artifacts but they need not be particularly computer-savvy.

XXXVII. The Fabric of Economic Trust

Economics acquired its dismal reputation by pretending to be an exact science rather than a branch of mass psychology. In truth it is a narrative struggling to describe the aggregate behavior of humans. It seeks to cloak its uncertainties and shifting fashions with mathematical formulae and elaborate econometric computerized models.

So much is certain, though - that people operate within markets, free or regulated, patchy or organized. They attach numerical (and emotional) values to their inputs (work, capital) and to their possessions (assets, natural endowments). They communicate these values to each other by sending out signals known as prices.

Yet, this entire edifice - the market and its price mechanism - critically depends on trust. If people do not trust each other, or the economic "envelope" within which they interact - economic activity gradually grinds to a halt.

There is a strong correlation between the general level of trust and the extent and intensity of economic activity.

Francis Fukuyama, the political scientist, distinguishes between high-trust and prosperous societies and low-trust and, therefore, impoverished collectives. Trust underlies economic success, he argued in a 1995 tome.

Trust is not a monolithic quantity. There are a few categories of economic trust. Some forms of trust are akin to a public good and are closely related to governmental action or inaction, the reputation of the state and its institutions, and its pronounced agenda. Other types of trust are the outcomes of kinship, ethnic origin, personal standing and goodwill, corporate brands and other data generated by individuals, households, and firms.

I. Trust in the playing field To transact, people have to maintain faith in a relevant economic horizon and in the immutability of the economic playing field or "envelope". Put less obscurely, a few hidden assumptions underlie the continued economic activity of market players.

They assume, for instance, that the market will continue to exist for the foreseeable future in its current form. That it will remain inert - unhindered by externalities like government intervention, geopolitical upheavals, crises, abrupt changes in accounting policies and tax laws, hyperinflation, institutional and structural reform and other market-deflecting events and processes.

They further assume that their price signals will not be distorted or thwarted on a consistent basis thus skewing the efficient and rational allocation of risks and rewards.

Insider trading, stock manipulation, monopolies, hoarding - all tend to consistently but unpredictably distort price signals and, thus, deter market participation.

Market players take for granted the existence and continuous operation of institutions - financial intermediaries, law enforcement agencies, courts. It is important to note that market players prefer continuity and certainty to evolution, however gradual and ultimately beneficial. A venal bureaucrat is a known quantity and can be tackled effectively. A period of transition to good and equitable governance can be more stifling than any level of corruption and malfeasance. This is why economic activity drops sharply whenever institutions are reformed.

II. Trust in other players Market players assume that other players are (generally) rational, that they have intentions, that they intend to maximize their benefits and that they are likely to act on their intentions in a legal (or rule-based), rational manner.

III. Trust in market liquidity Market players assume that other players possess or have access to the liquid means they need in order to act on their intentions and obligations. They know, from personal experience, that idle capital tends to dwindle and that the only way to, perhaps, maintain or increase it is to transact with others, directly or through intermediaries, such as banks.

IV. Trust in others' knowledge and ability Market players assume that other players possess or have access

to the intellectual property, technology, and knowledge they need in order to realize their intentions and obligations. This implicitly presupposes that all other market players are physically, mentally, legally and financially able and willing to act their parts as stipulated, for instance, in contracts they sign.

The emotional dimensions of contracting are often neglected in economics. Players assume that their counterparts maintain a realistic and stable sense of self-worth based on intimate knowledge of their own strengths and weaknesses. Market participants are presumed to harbor realistic expectations, commensurate with their skills and accomplishments. Allowance is made for exaggeration, disinformation, even outright deception - but these are supposed to be marginal phenomena.

When trust breaks down - often the result of an external or internal systemic shock - people react expectedly. The number of voluntary interactions and transactions decreases sharply. With a collapsed investment horizon, individuals and firms become corrupt in an effort to shortcut their way into economic benefits, not knowing how long will the system survive. Criminal activity increases.

People compensate with fantasies and grandiose delusions for their growing sense of uncertainty, helplessness, and fears. This is a self-reinforcing mechanism, a vicious cycle which results in under-confidence and a fluctuating self-esteem. They develop psychological defence mechanisms.

Cognitive dissonance ("I really choose to be poor rather than heartless"), pathological envy (seeks to deprive others and thus gain emotional reward), rigidity ("I am like that, my family or ethnic group has been like that for generations, there is nothing I can do"), passive-aggressive behavior (obstructing the work flow, absenteeism, stealing from the employer, adhering strictly to arcane regulations) - are all reactions to a breakdown in one or more of the four aforementioned types of trust.

Furthermore, people in a trust crisis are unable to postpone gratification. They often become frustrated, aggressive, and deceitful if denied. They resort to reckless behavior and stopgap economic activities.

In economic environments with compromised and impaired trust, loyalty decreases and mobility increases.

People switch jobs, renege on obligations, fail to repay debts, relocate often. Concepts like exclusivity, the sanctity of contracts, workplace loyalty, or a career path - all get eroded. As a result, little is invested in the future, in the acquisition of skills, in long term savings. Short-termism and bottom line mentality rule.

The outcomes of a crisis of trust are, usually, catastrophic: Economic activity is much reduced, human capital is corroded and wasted, brain drain increases, illegal and extra-legal activities rise, society is polarized between haves and have-nots, interethnic and inter-racial tensions increase. To rebuild trust in such circumstances is a daunting task. The loss of trust is contagious and, finally, it infects every institution and profession in the land. It is the stuff revolutions are made of.

XXXVIII. The Distributive Justice of the Market

The public outcry against executive pay and compensation followed disclosures of insider trading, double dealing, and outright fraud. But even honest and productive entrepreneurs often earn more money in one year than Albert Einstein did in his entire life. This strikes many - especially academics - as unfair. Surely Einstein's contributions to human knowledge and welfare far exceed anything ever accomplished by sundry businessmen? Fortunately, this discrepancy is cause for constructive jealousy, emulation, and imitation. It can, however, lead to an orgy of destructive and self-ruinous envy.

Such envy is reinforced by declining social mobility in the United States. Recent (2006-7) studies by the OECD (Organization for Economic Cooperation and Development) clearly demonstrate that the American Dream is a myth. In an editorial dated July 13, 2007, the New-York Times described the rapidly deteriorating situation thus: "... (M)obility between generations - people doing better or worse than their parents - is weaker in America than in Denmark, Austria, Norway, Finland, Canada, Sweden, Germany, Spain and France. In America, there is more than a 40 percent chance that if a father is in the bottom fifth of the earnings' distribution, his son will end up there, too. In Denmark, the equivalent odds are under 25 percent, and they are less than 30 percent in Britain.

America's sluggish mobility is ultimately unsurprising.

Wealthy parents not only pass on that wealth in inheritances, they can pay for better education, nutrition and health care for their children. The poor cannot afford this investment in their children's development - and the government doesn't provide nearly enough help.

In a speech earlier this year, the Federal Reserve chairman, Ben Bernanke, argued that while the inequality of rewards fuels the economy by making people exert themselves, opportunity should be "as widely distributed and as equal as possible." The problem is that the have-nots don't have many opportunities either".

Still, entrepreneurs recombine natural and human resources in novel ways. They do so to respond to forecasts of future needs, or to observations of failures and shortcomings of current products or services.

Entrepreneurs are professional - though usually intuitive - futurologists. This is a valuable service and it is financed by systematic risk takers, such as venture capitalists.

Surely they all deserve compensation for their efforts and the hazards they assume? Exclusive ownership is the most ancient type of such remuneration. First movers, entrepreneurs, risk takers, owners of the wealth they generated, exploiters of resources - are allowed to exclude others from owning or exploiting the same things. Mineral concessions, patents, copyright, trademarks - are all forms of monopoly ownership. What moral right to exclude others is gained from being the first? Nozick advanced Locke's Proviso. An exclusive ownership of property is just only if "enough and as good is left in common for others". If it does not worsen other people's lot, exclusivity is morally permissible. It can be argued, though, that all modes of exclusive ownership aggravate other people's situation. As far as everyone, bar the entrepreneur, are concerned, exclusivity also prevents a more advantageous distribution of income and wealth.

Exclusive ownership reflects real-life irreversibility. A first mover has the advantage of excess information and of irreversibly invested work, time, and effort. Economic enterprise is subject to information asymmetry: we know nothing about the future and everything about the past.

This asymmetry is known as "investment risk". Society compensates the entrepreneur with one type of asymmetry - exclusive ownership - for assuming another, the investment risk.

One way of looking at it is that all others are worse off by the amount of profits and rents accruing to owner- entrepreneurs. Profits and rents reflect an intrinsic inefficiency. Another is to recall that ownership is the result of adding value to the world. It is only reasonable to expect it to yield to the entrepreneur at least this value added now and in the future.

In a "Theory of Justice" (published 1971, p. 302), John Rawls described an ideal society thus: "(1) Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all. (2) Social and economic inequalities are to be arranged so that they are both: (a) to the greatest benefit of the least advantaged, consistent with the just savings principle, and (b) attached to offices and positions open to all under conditions of fair equality of opportunity".

It all harks back to scarcity of resources - land, money, raw materials, manpower, creative brains. Those who can afford to do so, hoard resources to offset anxiety regarding future uncertainty. Others wallow in paucity.

The distribution of means is thus skewed. "Distributive justice" deals with the just allocation of scarce resources.

Yet, even the basic terminology is somewhat fuzzy. What constitutes a resource? what is meant by allocation? Who should allocate resources - Adam Smith's "invisible hand", the government, the consumer, or business? Should it reflect differences in power, in intelligence, in knowledge, or in heredity? Should resource allocation be subject to a principle of entitlement? Is it reasonable to demand that it be just - or merely efficient? Are justice and efficiency antonyms? Justice is concerned with equal access to opportunities.

Equal access does not guarantee equal outcomes, invariably determined by idiosyncrasies and differences between people. Access leveraged by the application of natural or acquired capacities - translates into accrued wealth. Disparities in these capacities lead to discrepancies in accrued wealth.

The doctrine of equal access is founded on the equivalence of Men. That all men are created equal and deserve the same respect and, therefore, equal treatment is not self evident. European aristocracy well into this century would have probably found this notion abhorrent.

Jose Ortega Y Gasset, writing in the 1930's, preached that access to educational and economic opportunities should be premised on one's lineage, up bringing, wealth, and social responsibilities.

A succession of societies and cultures discriminated against the ignorant, criminals, atheists, females, homosexuals, members of ethnic, religious, or racial groups, the old, the immigrant, and the poor. Communism - ostensibly a strict egalitarian idea - foundered because it failed to reconcile strict equality with economic and psychological realities within an impatient timetable.

Philosophers tried to specify a "bundle" or "package" of goods, services, and intangibles (like information, or skills, or knowledge). Justice - though not necessarily happiness - is when everyone possesses an identical bundle. Happiness - though not necessarily justice - is when each one of us possesses a "bundle" which reflects his or her preferences, priorities, and predilections. None of us will be too happy with a standardized bundle, selected by a committee of philosophers - or bureaucrats, as was the case under communism.

The market allows for the exchange of goods and services between holders of identical bundles. If I seek books, but detest oranges - I can swap them with someone in return for his books. That way both of us are rendered better off than under the strict egalitarian version.

Still, there is no guarantee that I will find my exact match - a person who is interested in swapping his books for my oranges. Illiquid, small, or imperfect markets thus inhibit the scope of these exchanges. Additionally, exchange participants have to agree on an index: how many books for how many oranges? This is the price of oranges in terms of books.

Money - the obvious "index" - does not solve this problem, merely simplifies it and facilitates exchanges. It does not eliminate the necessity to negotiate an "exchange rate". It does not prevent market failures. In other words: money is not an index. It is merely a medium of exchange and a store of value. The index - as expressed in terms of money - is the underlying agreement regarding the values of resources in terms of other resources (i.e., their relative values).

The market - and the price mechanism - increase happiness and welfare by allowing people to alter the composition of their bundles. The invisible hand is just and benevolent. But money is imperfect. The

aforementioned Rawles demonstrated (1971), that we need to combine money with other measures in order to place a value on intangibles.

The prevailing market theories postulate that everyone has the same resources at some initial point (the "starting gate"). It is up to them to deploy these endowments and, thus, to ravage or increase their wealth. While the initial distribution is equal - the end distribution depends on how wisely - or imprudently - the initial distribution was used.

Egalitarian thinkers proposed to equate everyone's income in each time frame (e.g., annually). But identical incomes do not automatically yield the same accrued wealth. The latter depends on how the income is used - saved, invested, or squandered. Relative disparities of wealth are bound to emerge, regardless of the nature of income distribution.

Some say that excess wealth should be confiscated and redistributed. Progressive taxation and the welfare state aim to secure this outcome. Redistributive mechanisms reset the "wealth clock" periodically (at the end of every month, or fiscal year). In many countries, the law dictates which portion of one's income must be saved and, by implication, how much can be consumed. This conflicts with basic rights like the freedom to make economic choices.

The legalized expropriation of income (i.e., taxes) is morally dubious. Anti-tax movements have sprung all over the world and their philosophy permeates the ideology of political parties in many countries, not least the USA. Taxes are punitive: they penalize enterprise, success, entrepreneurship, foresight, and risk assumption.

Welfare, on the other hand, rewards dependence and parasitism.

According to Rawles' Difference Principle, all tenets of justice are either redistributive or retributive. This ignores non-economic activities and human inherent variance.

Moreover, conflict and inequality are the engines of growth and innovation - which mostly benefit the least advantaged in the long run. Experience shows that unmitigated equality results in atrophy, corruption and stagnation. Thermodynamics teaches us that life and motion are engendered by an irregular distribution of energy. Entropy - an even distribution of energy - equals death and stasis.

What about the disadvantaged and challenged - the mentally retarded, the mentally insane, the paralyzed, the chronically ill? For that matter, what about the less talented, less skilled, less daring? Dworkin (1981) proposed a compensation scheme. He suggested a model of fair distribution in which every person is given the same purchasing power and uses it to bid, in a fair auction, for resources that best fit that person's life plan, goals and preferences.

Having thus acquired these resources, we are then permitted to use them as we see fit. Obviously, we end up with disparate economic results. But we cannot complain - we were given the same purchasing power and the freedom to bid for a bundle of our choice.

Dworkin assumes that prior to the hypothetical auction, people are unaware of their own natural endowments but are willing and able to insure against being naturally disadvantaged. Their payments create an insurance pool to compensate the less fortunate for their misfortune.

This, of course, is highly unrealistic. We are usually very much aware of natural endowments and liabilities - both ours and others'. Therefore, the demand for such insurance is not universal, nor uniform. Some of us badly need and want it - others not at all. It is morally acceptable to let willing buyers and sellers to trade in such coverage (e.g., by offering charity or alms) - but may be immoral to make it compulsory.

Most of the modern welfare programs are involuntary Dworkin schemes. Worse yet, they often measure differences in natural endowments arbitrarily, compensate for lack of acquired skills, and discriminate between types of endowments in accordance with cultural biases and fads.

Libertarians limit themselves to ensuring a level playing field of just exchanges, where just actions always result in just outcomes. Justice is not dependent on a particular distribution pattern, whether as a starting point, or as an outcome. Robert Nozick "Entitlement Theory" proposed in 1974 is based on this approach.

That the market is wiser than any of its participants is a pillar of the philosophy of capitalism. In its pure form, the theory claims that markets yield patterns of merited distribution - i.e., reward and punish justly. Capitalism generate just deserts. Market failures - for instance, in the provision of public goods - should be tackled by governments. But a just distribution of income and wealth does not constitute a market failure and, therefore, should not be tampered with.

XXXIX. The Agent-Principal Conundrum

In the catechism of capitalism, shares represent the part- ownership of an economic enterprise, usually a firm. The value of shares is determined by the replacement value of the assets of the firm, including intangibles such as goodwill. The price of the share is determined by transactions among arm's length buyers and sellers in an efficient and liquid market. The price reflects expectations regarding the future value of the firm and the stock's future stream of income - i.e., dividends.

Alas, none of these oft-recited dogmas bears any resemblance to reality. Shares rarely represent ownership.

The float - the number of shares available to the public - is frequently marginal. Shareholders meet once a year to vent and disperse. Boards of directors are appointed by management - as are auditors. Shareholders are not represented in any decision making process - small or big.

The dismal truth is that shares reify the expectation to find future buyers at a higher price and thus incur capital gains.

In the Ponzi scheme known as the stock exchange, this expectation is proportional to liquidity - new suckers - and volatility. Thus, the price of any given stock reflects merely the consensus as to how easy it would be to offload one's holdings and at what price.

Another myth has to do with the role of managers. They are supposed to generate higher returns to shareholders by increasing the value of the firm's assets and, therefore, of the firm. If they fail to do so, goes the moral tale, they are booted out mercilessly. This is one manifestation of the "Principal-Agent Problem". It is defined thus by the Oxford Dictionary of Economics: "The problem of how a person A can motivate person B to act for A's benefit rather than following (his) self-interest".

The obvious answer is that A can never motivate B not to follow B's self-interest - never mind what the incentives are. That economists pretend otherwise - in "optimal contracting theory" - just serves to demonstrate how divorced economics is from human psychology and, thus, from reality.

Managers will always rob blind the companies they run.

They will always manipulate boards to collude in their shenanigans. They will always bribe auditors to bend the rules. In other words, they will always act in their self-interest. In their defense, they can say that the damage from such actions to each shareholder is minuscule while the benefits to the manager are enormous. In other words, this is the rational, self-interested, thing to do.

But why do shareholders cooperate with such corporate brigandage? In an important Chicago Law Review article whose preprint was posted to the Web a few weeks ago - titled "Managerial Power and Rent Extraction in the Design of Executive Compensation" - the authors demonstrate how the typical stock option granted to managers as part of their remuneration rewards mediocrity rather than encourages excellence.

But everything falls into place if we realize that shareholders and managers are allied against the firm - not pitted against each other. The paramount interest of both shareholders and managers is to increase the value of the stock - regardless of the true value of the firm. Both are concerned with the performance of the share - rather than the performance of the firm. Both are preoccupied with boosting the share's price - rather than the company's business.

Hence the inflationary executive pay packets.

Shareholders hire stock manipulators - euphemistically known as "managers" - to generate expectations regarding the future prices of their shares. These snake oil salesmen and snake charmers - the corporate executives - are allowed by shareholders to loot the company providing they generate consistent capital gains to their masters by provoking persistent interest and excitement around the business. Shareholders, in other words, do not behave as owners of the firm - they behave as free-riders.

The Principal-Agent Problem arises in other social interactions and is equally misunderstood there. Consider taxpayers and their government. Contrary to conservative lore, the former want the government to tax them providing they share in the spoils. They tolerate corruption in high places, cronyism, nepotism, inaptitude and worse - on condition that the government and the legislature redistribute the wealth they confiscate. Such redistribution often comes in the form of pork barrel projects and benefits to the middle-class.

This is why the tax burden and the government's share of GDP have been soaring inexorably with the consent of the citizenry. People adore government spending precisely because it is inefficient and distorts the proper allocation of economic resources. The vast majority of people are rent-seekers. Witness the mass demonstrations that erupt whenever governments try to slash expenditures, privatize, and eliminate their gaping deficits. This is one reason the IMF with its austerity measures is universally unpopular.

Employers and employees, producers and consumers - these are all instances of the Principal-Agent Problem.

Economists would do well to discard their models and go back to basics. They could start by asking: Why do shareholders acquiesce with executive malfeasance as long as share prices are rising? Why do citizens protest against a smaller government - even though it means lower taxes? Could it mean that the interests of shareholders and managers are identical? Does it imply that people prefer tax-and-spend governments and pork barrel politics to the Thatcherite alternative? Nothing happens by accident or by coercion. Shareholders aided and abetted the current crop of corporate executives enthusiastically. They knew well what was happening.

They may not have been aware of the exact nature and extent of the rot - but they witnessed approvingly the public relations antics, insider trading, stock option resetting, unwinding, and unloading, share price manipulation, opaque transactions, and outlandish pay packages. Investors remained mum throughout the corruption of corporate America. It is time for the hangover.

XL. The Green-Eyed Capitalist

Conservative sociologists self-servingly marvel at the peaceful proximity of abject poverty and ostentatious affluence in American - or, for that matter, Western - cities. Devastating riots do erupt, but these are reactions either to perceived social injustice (Los Angeles 1965) or to political oppression (Paris 1968). The French Revolution may have been the last time the urban sans-culotte raised a fuss against the economically enfranchised.

This pacific co-existence conceals a maelstrom of envy.

Behold the rampant Schadenfreude which accompanied the antitrust case against the predatory but loaded Microsoft. Observe the glee which engulfed many destitute countries in the wake of the September 11 atrocities against America, the epitome of triumphant prosperity. Witness the post-World.com orgiastic castigation of avaricious CEO's.

Envy - a pathological manifestation of destructive aggressiveness - is distinct from jealousy.

The New Oxford Dictionary of English defines envy as: "A feeling of discontented or resentful longing aroused by someone else's possessions, qualities, or luck ...

Mortification and ill-will occasioned by the contemplation of another's superior advantages".

Pathological envy - the fourth deadly sin - is engendered by the realization of some lack, deficiency, or inadequacy in oneself. The envious begrudge others their success, brilliance, happiness, beauty, good fortune, or wealth.

Envy provokes misery, humiliation, and impotent rage.

The envious copes with his pernicious emotions in five ways: 1. They attack the perceived source of frustration in an attempt to destroy it, or "reduce it" to their "size". Such destructive impulses often assume the disguise of championing social causes, fighting injustice, touting reform, or promoting an ideology. 2. They seek to subsume the object of envy by imitating it. In extreme cases, they strive to get rich quick through criminal scams, or corruption.

They endeavor to out-smart the system and shortcut their way to fortune and celebrity. 3. They resort to self-deprecation. They idealize the successful, the rich, the mighty, and the lucky and attribute to them super-human, almost divine, qualities. At the same time, they humble themselves. Indeed, most of this strain of the envious end up disenchanting and bitter, driving the objects of their own erstwhile devotion and adulation to destruction and decrepitude. 4. They experience cognitive dissonance. These people devalue the source of their frustration and envy by finding faults in everything they most desire and in everyone they envy. 5. They avoid the envied person and thus the agonizing pangs of envy.

Envy is not a new phenomenon. Belisarius, the general who conquered the world for Emperor Justinian, was blinded and stripped of his assets by his envious peers. I - and many others - have written extensively about envy in command economies. Nor is envy likely to diminish.

In his book, "Facial Justice", Hartley describes a post-apocalyptic dystopia, New State, in which envy is forbidden and equality extolled and everything enviable is obliterated. Women are modified to look like men and given identical "beta faces". Tall buildings are razed.

Joseph Schumpeter, the prophetic Austrian-American economist, believed that socialism will disinherit capitalism. In "Capitalism, Socialism, and Democracy" he foresaw a conflict between a class of refined but dirt-poor intellectuals and the vulgar but filthy rich businessmen and managers they virulently envy and resent. Samuel Johnson wrote: "He was dull in a new way, and that made many people think him great." The literati seek to tear down the market economy which they feel has so disenfranchised and undervalued them.

Hitler, who fancied himself an artist, labeled the British a "nation of shopkeepers" in one of his bouts of raging envy. Ralph Reiland, the Kenneth Simon professor of free enterprise at Robert Morris University, quotes David Brooks of the "weekly Standard", who christened this phenomenon "bourgeoisophobia": "The hatred of the bourgeoisie is the beginning of all virtue" - wrote Gustav Flaubert. He signed his letters 'Bourgeoisophobus' to show how much he despised 'stupid grocers and their ilk ... Through some screw-up in the great scheme of the universe, their narrow-minded greed had brought them vast wealth, unstoppable power and growing social prestige".

Reiland also quotes from Ludwig van Mises's "The Anti-Capitalist Mentality": "Many people, and especially intellectuals, passionately loathe capitalism. In a society based on caste and status, the individual can ascribe adverse fate to conditions beyond his control. In ... capitalism ... everybody's station in life depends on his doing ... (what makes a man rich is) not the evaluation of his contribution from any 'absolute' principle of justice but the evaluation on the part of his fellow men who exclusively apply the yardstick of their personal wants, desires and ends ... Everybody knows very well that there are people like himself who succeeded where he himself failed. Everybody knows that many of those he envies are self-made men who started from the same point from which he himself started. Everybody is aware of his own defeat. In order to console himself and to restore his self-assertion, such a man is in search of a scapegoat. He tries to persuade himself that he failed through no fault of his own. He was too decent to resort to the base tricks to which his successful rivals owe their ascendancy. The nefarious social order does not accord the prizes to the most meritorious men; it crowns the dishonest, unscrupulous scoundrel, the swindler, the exploiter, the 'rugged individualist'."

In "The Virtue of Prosperity", Dinesh D'Souza accuses prosperity and capitalism of inspiring vice and temptation.

Inevitably, it provokes envy in the poor and depravity in the rich.

With only a modicum of overstatement, capitalism can be depicted as the sublimation of jealousy. As opposed to destructive envy - jealousy induces emulation. Consumers - responsible for two thirds of America's GDP - ape role models and vie with neighbors, colleagues, and family members for possessions and the social status they endow.

Productive and constructive competition - among scientists, innovators, managers, actors, lawyers, politicians, and the members of just about every other profession - is driven by jealousy.

The eminent Nobel prize winning British economist and philosopher of Austrian descent, Friedrich Hayek, suggested in "The Constitution of Liberty" that innovation and progress in living standards are the outcomes of class envy. The wealthy are early adopters of expensive and unproven technologies. The rich finance with their conspicuous consumption the research and development phase of new products. The poor, driven by jealousy, imitate them and thus create a mass market which allows manufacturers to lower prices.

But jealousy is premised on the twin beliefs of equality and a level playing field. "I am as good, as skilled, and as talented as the object of my jealousy." - goes the subtext - "Given equal opportunities, equitable treatment, and a bit of luck, I can accomplish the same or more".

Jealousy is easily transformed to outrage when its presumptions - equality, honesty, and fairness - prove wrong. In a paper recently published by Harvard University's John M. Olin Center for Law and titled "Executive Compensation in America: Optimal Contracting or Extraction of Rents?", the authors argue that executive malfeasance is most effectively regulated by this "outrage constraint": "Directors (and non-executive directors) would be reluctant to approve, and executives would be hesitant to seek, compensation arrangements that might be viewed by observers as outrageous".

Notes on the Economics of

Game Theory

Consider this: Could Western management techniques be successfully implemented in the countries of Central and Eastern Europe (CEE)? Granted, they have to be adapted, modified and cannot be imported in their entirety. But their crux, their inalienable nucleus - can this be transported and transplanted in CEE? Theory provides us with a positive answer. Human agents are the same everywhere and are mostly rational. Practice begs to differ. Basic concepts such as the money value of time or the moral and legal meaning of property are non-existent.

The legal, political and economic environments are all unpredictable. As a result, economic players will prefer to maximize their utility immediately (steal from the workplace, for instance) - than to wait for longer term (potentially, larger) benefits. Warrants (stock options) convertible to the company's shares constitute a strong workplace incentive in the West (because there is an horizon and they increase the employee's welfare in the long term). Where the future is speculation - speculation withers. Stock options or a small stake in his firm, will only encourage the employee to blackmail the other shareholders by paralysing the firm, to abuse his new position and will be interpreted as immunity, conferred from above, from the consequences of illegal activities.

The very allocation of options or shares will be interpreted as a sign of weakness, dependence and need, to be exploited. Hierarchy is equated with slavery and employees will rather harm their long term interests than follow instructions or be subjected to criticism - never mind how constructive. The employees in CEE regard the corporate environment as a conflict zone, a zero sum game (in which the gains by some equal the losses to others). In the West, the employees participate in the increase in the firm's value. The difference between these attitudes is irreconcilable.

Now, let us consider this: An entrepreneur is a person who is gifted at identifying the unsatisfied needs of a market, at mobilizing and organizing the resources required to satisfy those needs and at defining a long-term strategy of development and marketing. As the enterprise grows, two processes combine to denude the entrepreneur of some of his initial functions. The firm has ever growing needs for capital: financial, human, assets and so on. Additionally, the company begins (or should begin) to interface and interact with older, better established firms. Thus, the company is forced to create its first management team: a general manager with the right doses of respectability, connections and skills, a chief financial officer, a host of consultants and so on. In theory - if all our properly motivated financially - all these players (entrepreneurs and managers) will seek to maximize the value of the firm. What happens, in reality, is that both work to minimize it, each for its own reasons. The managers seek to maximize their short-term utility by securing enormous pay packages and other forms of company-dilapidating compensation. The entrepreneurs feel that they are "strangled", "shackled", "held back" by bureaucracy and they "rebel". They oust the management, or undermine it, turning it into an ineffective representative relic. They assume real, though informal, control of the firm. They do so by defining a new set of strategic goals for the firm, which call for the institution of an entrepreneurial rather than a bureaucratic type of management. These cycles of initiative-consolidation-new initiative-revolution-consolidation are the dynamos of company growth.

Growth leads to maximization of value. However, the players don't know or do not fully believe that they are in the process of maximizing the company's worth. On the contrary, consciously, the managers say: "Let's maximize the benefits that we derive from this company, as long as we are still here." The entrepreneurs-owners say: "We cannot tolerate this stifling bureaucracy any longer. We prefer to have a smaller company - but all ours." The growth cycles forces the entrepreneurs to dilute their holdings (in order to raise the capital necessary to finance their initiatives). This dilution (the fracturing of the ownership structure) is what brings the last cycle to its end. The holdings of the entrepreneurs are too small to materialize a coup against the management. The management then prevails and the entrepreneurs are neutralized and move on to establish another start-up. The only thing that they leave behind them is their names and their heirs.

We can use Game Theory methods to analyse both these situations. Wherever we have economic players bargaining for the allocation of scarce resources in order to attain their utility functions, to secure the outcomes and consequences (the value, the preference, that the player attaches to his outcomes) which are right for them - we can use Game Theory (GT).

A short recap of the basic tenets of the theory might be in order.

GT deals with interactions between agents, whether conscious and intelligent - or Dennettic. A Dennettic Agent (DA) is an agent that acts so as to influence the future allocation of resources, but does not need to be either conscious or deliberative to do so. A Game is the set of acts committed by 1 to n rational DA and one a-rational (not irrational but devoid of rationality) DA (nature, a random mechanism). At least 1 DA in a Game must control the result of the set of acts and the DAs must be (at least potentially) at conflict, whole or partial. This is not to say that all the DAs aspire to the same things.

They have different priorities and preferences. They rank the likely outcomes of their acts differently. They engage Strategies to obtain their highest ranked outcome. A Strategy is a vector, which details the acts, with which the DA will react in response to all the (possible) acts by the other DAs. An agent is said to be rational if his Strategy does guarantee the attainment of his most preferred goal.

Nature is involved by assigning probabilities to the outcomes. An outcome, therefore, is an allocation of resources resulting from the acts of the agents. An agent is said to control the situation if its acts matter to others to the extent that at least one of them is forced to alter at least one vector (Strategy). The Consequence to the agent is the value of a function that assigns real numbers to each of the outcomes. The consequence represents a list of outcomes, prioritized, ranked. It is also known as an ordinal utility function. If the function includes relative numerical importance measures (not only real numbers) - we call it a Cardinal Utility Function.

Games, naturally, can consist of one player, two players and more than two players (n-players). They can be zero (or fixed) - sum (the sum of benefits is fixed and whatever gains made by one of the players are lost by the others).

They can be nonzero-sum (the amount of benefits to all players can increase or decrease). Games can be cooperative (where some of the players or all of them form coalitions) - or non-cooperative (competitive). For some of the games, the solutions are called Nash equilibria. They are sets of strategies constructed so that an agent which adopts them (and, as a result, secures a certain outcome) will have no incentive to switch over to other strategies (given the strategies of all other players).

Nash equilibria (solutions) are the most stable (it is where the system "settles down", to borrow from Chaos Theory) - but they are not guaranteed to be the most desirable.

Consider the famous "Prisoners' Dilemma" in which both players play rationally and reach the Nash equilibrium only to discover that they could have done much better by collaborating (that is, by playing irrationally). Instead, they adopt the "Paretto-dominated", or the "Paretto- optimal", sub-optimal solution. Any outside interference with the game (for instance, legislation) will be construed as creating a NEW game, not as pushing the players to adopt a "Paretto-superior" solution.

The behaviour of the players reveals to us their order of preferences. This is called "Preference Ordering" or "Revealed Preference Theory". Agents are faced with sets of possible states of the world (=allocations of resources, to be more economically inclined). These are called "Bundles". In certain cases they can trade their bundles, swap them with others. The evidence of these swaps will inevitably reveal to us the order of priorities of the agent.

All the bundles that enjoy the same ranking by a given agent - are this agent's "Indifference Sets". The construction of an Ordinal Utility Function is, thus, made simple. The indifference sets are numbered from 1 to n.

These ordinals do not reveal the INTENSITY or the RELATIVE INTENSITY of a preference - merely its location in a list. However, techniques are available to transform the ordinal utility function - into a cardinal one.

A Stable Strategy is similar to a Nash solution - though not identical mathematically. There is currently no comprehensive theory of Information Dynamics. Game Theory is limited to the aspects of competition and exchange of information (cooperation). Strategies that lead to better results (independently of other agents) are dominant and where all the agents have dominant strategies - a solution is established. Thus, the Nash equilibrium is applicable to games that are repeated and wherein each agent reacts to the acts of other agents. The agent is influenced by others - but does not influence them (he is negligible). The agent continues to adapt in this way - until no longer able to improve his position.

The Nash solution is less available in cases of cooperation and is not unique as a solution. In most cases, the players will adopt a minimax strategy (in zero-sum games) or maximin strategies (in nonzero-sum games).

These strategies guarantee that the loser will not lose more than the value of the game and that the winner will gain at least this value. The solution is the "Saddle Point".

The distinction between zero-sum games (ZSG) and nonzero-sum games (NZSG) is not trivial. A player playing a ZSG cannot gain if prohibited to use certain strategies. This is not the case in NZSGs. In ZSG, the player does not benefit from exposing his strategy to his rival and is never harmed by having foreknowledge of his rival's strategy. Not so in NZSGs: at times, a player stands to gain by revealing his plans to the "enemy". A player can actually be harmed by NOT declaring his strategy or by gaining acquaintance with the enemy's stratagems. The very ability to communicate, the level of communication and the order of communication - are important in cooperative cases. A Nash solution: 1. Is not dependent upon any utility function; 2. It is impossible for two players to improve the Nash solution (=their position) simultaneously (=the Pareto optimality); 3. Is not influenced by the introduction of irrelevant (not very gainful) alternatives; and 4. Is symmetric (reversing the roles of the players does not affect the solution).

The limitations of this approach are immediately evident.

It is definitely not geared to cope well with more complex, multi-player, semi-cooperative (semi-competitive), imperfect information situations.

Von Neumann proved that there is a solution for every ZSG with 2 players, though it might require the implementation of mixed strategies (strategies with probabilities attached to every move and outcome).

Together with the economist Morgenstern, he developed an approach to coalitions (cooperative efforts of one or more players - a coalition of one player is possible).

Every coalition has a value - a minimal amount that the coalition can secure using solely its own efforts and resources. The function describing this value is super-additive (the value of a coalition which is comprised of two sub-coalitions equals, at least, the sum of the values of the two sub-coalitions). Coalitions can be epiphenomenal: their value can be higher than the combined values of their constituents. The amounts paid to the players equal the value of the coalition and each player stands to get an amount no smaller than any amount that he would have made on his own. A set of payments to the players, describing the division of the coalition's value amongst them, is the "imputation", a single outcome of a strategy. A strategy is, therefore, dominant, if: (1) each player is getting more under the strategy than under any other strategy and (2) the players in the coalition receive a total payment that does not exceed the value of the coalition. Rational players are likely to prefer the dominant strategy and to enforce it.

Thus, the solution to an n-players game is a set of imputations. No single imputation in the solution must be dominant (=better). They should all lead to equally desirable results. On the other hand, all the imputations outside the solution should be dominated. Some games are without solution (Lucas, 1967).

Aumann and Maschler tried to establish what is the right payoff to the members of a coalition. They went about it by enlarging upon the concept of bargaining (threats, bluffs, offers and counter-offers). Every imputation was examined, separately, whether it belongs in the solution (=yields the highest ranked outcome) or not, regardless of the other imputations in the solution. But in their theory, every member had the right to "object" to the inclusion of other members in the coalition by suggesting a different, exclusionary, coalition in which the members stand to gain a larger payoff. The player about to be excluded can "counter-argue" by demonstrating the existence of yet another coalition in which the members will get at least as much as in the first coalition and in the coalition proposed by his adversary, the "objector". Each coalition has, at least, one solution.

The Game in GT is an idealized concept. Some of the assumptions can - and should be argued against. The number of agents in any game is assumed to be finite and a finite number of steps is mostly incorporated into the assumptions. Omissions are not treated as acts (though negative ones). All agents are negligible in their relationship to others (have no discernible influence on them) - yet are influenced by them (their strategies are not - but the specific moves that they select - are). The comparison of utilities is not the result of any ranking - because no universal ranking is possible. Actually, no ranking common to two or n players is possible (rankings are bound to differ among players). Many of the problems are linked to the variant of rationality used in GT. It is comprised of a clarity of preferences on behalf of the rational agent and relies on the people's tendency to converge and cluster around the right answer / move.

This, however, is only a tendency. Some of the time, players select the wrong moves. It would have been much wiser to assume that there are no pure strategies, that all of them are mixed. Game Theory would have done well to borrow mathematical techniques from quantum mechanics. For instance: strategies could have been described as wave functions with probability distributions.

The same treatment could be accorded to the cardinal utility function. Obviously, the highest ranking (smallest ordinal) preference should have had the biggest probability attached to it - or could be treated as the collapse event. But these are more or less known, even trivial, objections. Some of them cannot be overcome. We must idealize the world in order to be able to relate to it scientifically at all. The idealization process entails the incorporation of gross inaccuracies into the model and the ignorance of other elements. The surprise is that the approximation yields results, which tally closely with reality - in view of its mutilation, affected by the model.

There are more serious problems, philosophical in nature.

It is generally agreed that "changing" the game can - and very often does - move the players from a non-cooperative mode (leading to Pareto-dominated results, which are never desirable) - to a cooperative one. A government can force its citizens to cooperate and to obey the law. It can enforce this cooperation. This is often called a Hobbesian dilemma. It arises even in a population made up entirely of altruists. Different utility

functions and the process of bargaining are likely to drive these good souls to threaten to become egoists unless other altruists adopt their utility function (their preferences, their bundles). Nash proved that there is an allocation of possible utility functions to these agents so that the equilibrium strategy for each one of them will be this kind of threat. This is a clear social Hobbesian dilemma: the equilibrium is absolute egoism despite the fact that all the players are altruists. This implies that we can learn very little about the outcomes of competitive situations from acquainting ourselves with the psychological facts pertaining to the players. The agents, in this example, are not selfish or irrational - and, still, they deteriorate in their behaviour, to utter egotism. A complete set of utility functions - including details regarding how much they know about one another's utility functions - defines the available equilibrium strategies. The altruists in our example are prisoners of the logic of the game. Only an "outside" power can release them from their predicament and permit them to materialize their true nature. Gauthier said that morally-constrained agents are more likely to evade Pareto-dominated outcomes in competitive games - than agents who are constrained only rationally. But this is unconvincing without the existence of an Hobbesian enforcement mechanism (a state is the most common one). Players would do better to avoid Pareto dominated outcomes by imposing the constraints of such a mechanism upon their available strategies. Pareto optimality is defined as efficiency, when there is no state of things (a different distribution of resources) in which at least one player is better off - with all the other no worse off. "Better off" read: "with his preference satisfied". This definitely could lead to cooperation (to avoid a bad outcome) - but it cannot be shown to lead to the formation of morality, however basic. Criminals can achieve their goals in splendid cooperation and be content, but that does not make it more moral. Game theory is agent neutral, it is utilitarianism at its apex. It does not prescribe to the agent what is "good" - only what is "right". It is the ultimate proof that effort at reconciling utilitarianism with more deontological, agent relative, approaches are dubious, in the best of cases. Teleology, in other words, in no guarantee of morality.

Acts are either means to an end or ends in themselves.

This is no infinite regression. There is bound to be an holy grail (happiness?) in the role of the ultimate end. A more commonsense view would be to regard acts as means and states of affairs as ends. This, in turn, leads to a teleological outlook: acts are right or wrong in accordance with their effectiveness at securing the achievement of the right goals. Deontology (and its stronger version, absolutism) constrain the means. It states that there is a permitted subset of means, all the other being immoral and, in effect, forbidden. Game Theory is out to shatter both the notion of a finite chain of means and ends culminating in an ultimate end - and of the deontological view. It is consequentialist but devoid of any value judgement.

Game Theory pretends that human actions are breakable into much smaller "molecules" called games. Human acts within these games are means to achieving ends but the ends are improbable in their finality. The means are segments of "strategies": prescient and omniscient renditions of the possible moves of all the players. Aside from the fact that it involves mnemonic causation (direct and deterministic influence by past events) and a similar influence by the utility function (which really pertains to the future) - it is highly implausible. Additionally, Game Theory is mired in an internal contradiction: on the one hand it solemnly teaches us that the psychology of the players is absolutely of no consequence. On the other, it hastens to explicitly and axiomatically postulate their rationality and implicitly (and no less axiomatically) their benefit-seeking behaviour (though this aspect is much more muted). This leads to absolutely outlandish results: irrational behaviour leads to total cooperation, bounded rationality leads to more realistic patterns of cooperation and competition (cooperation) and an unmitigated rational behaviour leads to disaster (also known as Pareto dominated outcomes).

Moreover, Game Theory refuses to acknowledge that real games are dynamic, not static. The very concepts of strategy, utility function and extensive (tree like) representation are static. The dynamic is retrospective, not prospective. To be dynamic, the game must include all the information about all the actors, all their strategies, all their utility functions. Each game is a subset of a higher level game, a private case of an implicit game which is constantly played in the background, so to say. This is a hyper-game of which all games are but derivatives. It incorporates all the physically possible moves of all the players. An outside agency with enforcement powers (the state, the police, the courts, the law) are introduced by the players. In this sense, they are not really an outside event which has the effect of altering the game fundamentally.

They are part and parcel of the strategies available to the players and cannot be arbitrarily ruled out. On the contrary, their introduction as part of a dominant strategy will simplify Game theory and make it much more applicable. In other words: players can choose to compete, to cooperate and to cooperate in the formation of an outside agency. There is no logical or mathematical reason to exclude the latter possibility. The ability to thus influence the game is a legitimate part of any real life strategy. Game Theory assumes that the game is a given - and the players have to optimize their results within it. It should open itself to the inclusion of game altering or redefining moves by the players as an integral part of their strategies. After all, games entail the existence of some agreement to play and this means that the players accept some rules (this is the role of the prosecutor in the Prisoners' Dilemma). If some outside rules (of the game) are permissible - why not allow the "risk" that all the players will agree to form an outside, lawfully binding, arbitration and enforcement agency - as part of the game? Such an agency will be nothing if not the embodiment, the materialization of one of the rules, a move in the players' strategies, leading them to more optimal or superior outcomes as far as their utility functions are concerned.

Bargaining inevitably leads to an agreement regarding a decision making procedure. An outside agency, which enforces cooperation and some moral code, is such a decision making procedure. It is not an "outside" agency in the true, physical, sense. It does not "alter" the game (not to mention its rules). It IS the game, it is a procedure, a way to resolve conflicts, an integral part of any solution and imputation, the herald of cooperation, a representative of some of the will of all the players and, therefore, a part both of their utility functions and of their strategies to obtain their preferred outcomes. Really, these outside agencies ARE the desired outcomes. Once Game Theory digests this observation, it could tackle reality rather than its own

idealized contraptions.

XLII. Market Impeders and Market Inefficiencies

Even the most devout proponents of free marketry and hidden hand theories acknowledge the existence of market failures, market imperfections and inefficiencies in the allocation of economic resources. Some of these are the results of structural problems, others of an accumulation of historical liabilities. But, strikingly, some of the inefficiencies are the direct outcomes of the activities of "non bona fide" market participants. These "players" (individuals, corporations, even larger economic bodies, such as states) act either irrationally or egotistically (too rationally).

What characterizes all those "market impeders" is that they are value subtractors rather than value adders. Their activities generate a reduction, rather than an increase, in the total benefits (utilities) of all the other market players (themselves included). Some of them do it because they are after a self interest which is not economic (or, more strictly, financial). They sacrifice some economic benefits in order to satisfy that self interest (or, else, they could never have attained these benefits, in the first place).

Others refuse to accept the self interest of other players as their limit. They try to maximize their benefits at any cost, as long as it is a cost to others. Some do so legally and some adopt shadier varieties of behaviour. And there is a group of parasites - participants in the market who feed off its very inefficiencies and imperfections and, by their very actions, enhance them. A vicious cycle ensues: the body economic gives rise to parasitic agents who thrive on its imperfections and lead to the amplification of the very impurities that they prosper on.

We can distinguish six classes of market impeders: 1. Crooks and other illegal operators. These take advantage of ignorance, superstition, greed, avarice, emotional states of mind of their victims - to strike. They re-allocate resources from (potentially or actually) productive agents to themselves. Because they reduce the level of trust in the marketplace - they create negative added value. (See: "The Shadowy World of International Finance" and "The Fabric of Economic Trust") 2. Illegitimate operators include those treading the thin line between legally permissible and ethically inadmissible. They engage in petty cheating through misrepresentations, half-truths, semi-rumours and the like. They are full of pretensions to the point of becoming impostors. They are wheeler-dealers, sharp-cookies, Daymon Ranyon characters, lurking in the shadows cast by the sun of the market. Their impact is to slow down the economic process through disinformation and the resulting misallocation of resources. They are the sand in the wheels of the economic machine. 3. The "not serious" operators. These are people too hesitant, or phobic to commit themselves to the assumption of any kind of risk. Risk is the coal in the various locomotives of the economy, whether local, national, or global. Risk is being assumed, traded, diversified out of, avoided, insured against.

It gives rise to visions and hopes and it is the most efficient "economic natural selection" mechanism.

To be a market participant one must assume risk, it is an inseparable part of economic activity.

Without it the wheels of commerce and finance, investments and technological innovation will immediately grind to a halt. But many operators are so risk averse that, in effect, they increase the inefficiency of the market in order to avoid it.

They act as though they are resolute, risk assuming operators. They make all the right moves, utter all the right sentences and emit the perfect noises. But when push comes to shove - they recoil, retreat, defeated before staging a fight. Thus, they waste the collective resources of all that the operators that they get involved with. They are known to endlessly review projects, often change their minds, act in fits and starts, have the wrong priorities (for an efficient economic functioning, that is), behave in a self-defeating manner, be horrified by any hint of risk, saddled and surrounded by every conceivable consultant, glutted by information. They are the stick in the spinning wheel of the modern marketplace. 4. The former kind of operators obviously has a character problem. Yet, there is a more problematic species: those suffering from serious psychological problems, personality disorders, clinical phobias, psychoneuroses and the like. This human aspect of the economic realm has, to the best of my knowledge, been neglected before.

Enormous amounts of time, efforts, money and energy are expended by the more "normal" - because of the "less normal" and the "eccentric".

These operators are likely to regard the maintaining of their internal emotional balance as paramount, far over-riding economic considerations. They will sacrifice economic advantages and benefits and adversely affect their utility outcome in the name of principles, to quell psychological tensions and pressures, as part of obsessive-compulsive rituals, to maintain a false grandiose image, to go on living in a land of fantasy, to resolve a psychodynamic conflict and, generally, to cope with personal problems which have nothing to do with the idealized rational economic player of the theories. If quantified, the amounts of resources wasted in these coping manoeuvres is, probably, mind numbing. Many deals clinched are revoked, many businesses started end, many detrimental policy decisions adopted and many potentially beneficial situations avoided because of these personal upheavals. 5. Speculators and middlemen are yet another species of parasites. In a theoretically totally efficient marketplace - there would have been no niche for them. They both thrive on information failures. The first kind engages in arbitrage (differences in pricing in two markets of an identical good - the result of inefficient dissemination of information) and in gambling.

These are important and blessed functions in an imperfect world because they make it more perfect. The

speculative activity equates prices and, therefore, sends the right signals to market operators as to how and where to most efficiently allocate their resources. But this is the passive speculator. The "active" speculator is really a market rigger. He corners the market by the dubious virtue of his reputation and size. He influences the market (even creates it) rather than merely exploit its imperfections. Soros and Buffet have such an influence though their effect is likely to be considered beneficial by unbiased observers.

Middlemen are a different story because most of them belong to the active subcategory. This means that they, on purpose, generate market inconsistencies, inefficiencies and problems - only to solve them later at a cost extracted and paid to them, the perpetrators of the problem. Leaving ethical questions aside, this is a highly wasteful process. Middlemen use privileged information and access - whereas speculators use information of a more public nature. Speculators normally work within closely monitored, full disclosure, transparent markets. Middlemen thrive of disinformation, misinformation and lack of information. Middlemen monopolize their information - speculators share it, willingly or not.

The more information becomes available to more users - the greater the deterioration in the resources consumed by brokers of information.

The same process will likely apply to middlemen of goods and services. We are likely to witness the death of the car dealer, the classical retail outlet, the music records shop. For that matter, inventions like the internet is likely to short-circuit the whole distribution process in a matter of a few years. 6. The last type of market impeder is well known and is the only one to have been tackled - with varying degrees of success by governments and by legislators worldwide. These are the trade restricting arrangements: monopolies, cartels, trusts and other illegal organizations. Rivers of inks were spilled over forests of paper to explain the pernicious effects of these anti-competitive practices (see: "Competition Laws"). The short and the long of it is that competition enhances and increases efficiency and that, therefore, anything that restricts competition, weakens and lessens efficiency.

What could anyone do about these inefficiencies? The world goes in circles of increasing and decreasing free marketry. The globe was a more open, competitive and, in certain respects, efficient place at the beginning of the 20th century than it is now. Capital flowed more freely and so did labour. Foreign Direct Investment was bigger. The more efficient, "friction free" the dissemination of information (the ultimate resource) - the less waste and the smaller the lebensraum for parasites. The more adherence to market, price driven, open auction based, meritocratic mechanisms - the less middlemen, speculators, bribers, monopolies, cartels and trusts. The less political involvement in the workings of the market and, in general, in what consenting adults conspire to do that is not harmful to others - the more efficient and flowing the economic ambience is likely to become.

This picture of "laissez faire, laissez aller" should be complimented by even stricter legislation coupled with effective and draconian law enforcement agents and measures. The illegal and the illegitimate should be stamped out, cruelly. Freedom to all - is also freedom from being conned or hassled. Only when the righteous freely prosper and the less righteous excessively suffer - only then will we have entered the efficient kingdom of the free market.

This still does not deal with the "not serious" and the "personality disordered". What about the inefficient havoc that they wreak? This, after all, is part of what is known, in legal parlance as: "force majeure".

Note There is a raging debate between the "rational expectations" theory and the "prospect theory". The former - the cornerstone of rational economics - assumes that economic (human) players are rational and out to maximize their utility (see: "The Happiness of Others", "The Egotistic Friend" and "The Distributive Justice of the Market"). Even ignoring the fuzzy logic behind the ill-defined philosophical term "utility" - rational economics has very little to do with real human being and a lot to do with sterile (though mildly useful) abstractions. Prospect theory builds on behavioural research in modern psychology which demonstrates that people are more loss averse than gain seekers (utility maximizers). Other economists have succeeded to demonstrate irrational behaviours of economic actors (heuristics, dissonances, biases, magical thinking and so on).

The apparent chasm between the rational theories (efficient markets, hidden hands and so on) and behavioural economics is the result of two philosophical fallacies which, in turn, are based on the misapplication and misinterpretation of philosophical terms.

The first fallacy is to assume that all forms of utility are reducible to one another or to money terms. Thus, the values attached to all utilities are expressed in monetary terms. This is wrong. Some people prefer leisure, or freedom, or predictability to expected money. This is the very essence of risk aversion: a trade off between the utility of predictability (absence or minimization of risk) and the expected utility of money. In other words, people have many utility functions running simultaneously - or, at best, one utility function with many variables and coefficients. This is why taxi drivers in New York cease working in a busy day, having reached a pre-determined income target: the utility function of their money equals the utility function of their leisure.

How can these coefficients (and the values of these variables) be determined? Only by engaging in extensive empirical research. There is no way for any theory or "explanation" to predict these values. We have yet to reach the stage of being able to quantify, measure and numerically predict human behaviour and personality (=the set of adaptive traits and their interactions with changing circumstances). That economics is a branch of psychology is becoming more evident by the day. It would do well to lose its mathematical pretensions and adopt the statistical methods of its humbler relative.

The second fallacy is the assumption underlying both rational and behavioural economics that human nature is an "object" to be analysed and "studied", that it is static and unchanged. But, of course, humans change inexorably. This is the only fixed feature of being human: change. Some changes are unpredictable,

even in deterministic principle. Other changes are well documented. An example of the latter class of changes in the learning curve. Humans learn and the more they learn the more they alter their behaviour. So, to obtain any meaningful data, one has to observe behaviour in time, to obtain a sequence of reactions and actions. To isolate, observe and manipulate environmental variables and study human interactions. No snapshot can approximate a video sequence where humans are concerned.

XLIII. The Pettifogger Procurators

Diplomats in Post-Communist Countries

In 2001, the most unusual event has gone unnoticed in the international press. A former minister of finance has accused the more prominent members of the diplomatic corps in his country of corruption. He insisted that these paragons of indignant righteousness and hectoring morality have tried to blackmail him into paying them hefty commissions from money allotted to exigent humanitarian aid. This was immediately and from afar - and, therefore, without proper investigation - denied by their superiors in no uncertain terms.

The facts are these: most (though by no means all) Western diplomats in the nightmarish wasteland that is East Europe and the Balkan, the unctuously fulsome and the frowzily wizened alike, are ageing and sybaritic basket cases. They have often failed miserably in their bootless previous posts - or have insufficiently submerged in the Byzantine culture of their employers. Thus emotionally injured and cast into the frigorific outer darkness of a ravaged continent, they adopt the imperial patina of Roman procurators in narcissistic compensation. Their long suffering wives - bored to distraction in the impassibly catatonic societies of post communism - impose upon a reluctant and flummoxed population the nescient folderol of their distaff voluntary urges or exiguous artistic talents. Ever more crapulous, they aestivate and hibernate, the queens of tatty courts and shabby courtiers.

The cold war having ebbed, these emissaries of questionable provenance engage in the promotion of the narrow interests of specific industries or companies. They lobby the local administration, deploying bare threats and obloquies where veiled charm fails. They exert subtle or brutal pressure through the press. They co-opt name-dropping bureaucrats and bribe pivotal politicians. They get fired those who won't collaborate or threaten to expose their less defensible misdeeds. They are glorified delivery boys, carrying apocryphal messages to and fro. They are bloviating PR campaigners, seeking to aggrandize their meagre role and, incidentally, that of their country. They wine and dine and banter endlessly with the provincial somnolent variety of public figures, members of the venal and pinchbeck elites that now rule these tortured territories. In short - forced to deal with the bedizened miscreants that pass for businessmen and politicians in this nether world - they are transformed, assuming in the process the identity of their obdurately corrupted hosts.

Thus, they help to sway elections and hasten to endorse their results, however disputed and patently fraudulent.

They intimidate the opposition, negotiate with businessmen, prod favoured politicians, spread roorbacks and perambulate their fiefdom to gather intelligence.

More often than not, they cross the limpid lines between promotion and extortion, lagniappe and pelf, friendship and collusion, diplomacy and protectorate, the kosher and the criminal.

They are the target and the address of a legion of pressures and demands. Their government may ask them to help depose one coalition and help install another.

Their secret services - disguised as intrusive NGOs or workers at the embassy - often get them involved in shady acts and unscrupulous practices. Real NGOs ask for their assiduous assistance and protection. Their hosts - and centuries old protocol - expect them to surreptitiously provide support while openly refrain from intervening, maintaining equipoise. Other countries protest, compete, or leak damaging reports to an often hostile media. The torpid common folk resent them for their colonial ways and hypocritical demarches. Lacking compunction, they are nobody's favourites and everybody's scapegoats at one time or another.

And they are ill-equipped to deal with these subtleties.

Not of intelligence, they end where they now are and wish they weren't. Ignorant of business and entrepreneurship, they occupy the dead end, otiose and pension-orientated jobs they do. Devoid of the charm, negotiating skills and human relations required by the intricacies of their profession - they are relegated to the Augean outskirts of civilization. Dishonest and mountebank, they persist in their mortifying positions, inured to the conniving they require.

This blatantly discernible ineptitude provokes the "natives" into a wholesale rejection of the West, its values and its culture. The envoys are perceived as the cormorant reification of their remote controllers. Their voluptuary decadence is a distant echo of the West's decay, their nonage greed - a shadow of its avarice, their effrontery and hidebound peremptory nature - its mien. They are in no position to preach or teach.

The diplomats of the West are not evil. Some of them mean well. To the best of their oft limited abilities, they cadge and beg and press and convince their governments to show goodwill and to contribute to their hosts. But soon their mettle is desiccated by the vexatious realities of their new habitation. Reduced to susurrus cynicism and sardonic contempt, they perfunctorily perform their functions, a distant look in their now empty eyes. They have been assimilated, rendered useless to their dispatchers and to their hosts alike.

XLIV. Microsoft's Third Front

The Intellectual Property Wars

Elated investors greeted chairman Bill Gates and chief executive officer Steve Ballmer for Microsoft's victory in the titanic antitrust lawsuit brought against it by the Department of Justice and assorted state attorneys general.

They also demanded that Microsoft distribute its pile of cash - \$40 billion in monopoly profits - as dividends.

But Microsoft may need that hoard. The battle is far from over. The European Commission, though much weakened by recent European Court of First Instance rulings against its competition commissioner, Mario Monti, can fine the company up to one tenth its worldwide turnover if it finds against it. Microsoft is being investigated by the European watchdog for anti-competitive practices now threatening to spread into the high-end server software and digital media markets.

But the software colossus faces an even more daunting third front in central and eastern Europe and Asia. It is the war against piracy. Both its operating system, Windows, and its office productivity suite, Office, are widely cracked and replicated throughout these regions.

Three years ago, Microsoft negotiated a \$3 million settlement with the government of Macedonia, one of the single largest abusers of intellectual property rights in this tiny country. More than 1 percent of Macedonia's GDP is said by various observers to be derived from software and digital content piracy.

According to Yugoslavia's news agency, Tanjug, The governments of Serbia and Yugoslavia purchased, last month, 30,000 software licenses from the Redmond giant.

Another 10-15,000 are in the pipeline. Aleksandar Bojovic, public relations manager of Microsoft's representative office in Belgrade was ebullient: "Before the signing of an agreement on a strategic partnership with authorities of Yugoslavia and Serbia, the percentage of legal software used by the citizens and industry of Serbia and Montenegro was only a few percents. Presently it is about 20 percents. Microsoft is more than surprised at the interest for legalization that exists in Yugoslavia".

According to the Yugoslav newspaper Danas, Microsoft Yugoslavia has developed versions of Windows and Office in Serbian, replete with a spell-checker. There are c. 1 million computers in Yugoslavia. The company undertook, last year, to revamp the Yugoslav labyrinthine health, education, customs and tax systems. It also sent representatives to a delegation of businessmen that visited Bosnia-Herzegovina in February.

Microsoft obstinately refused to price its products differentially - to charge less in poorer markets. The Office suite costs the equivalent of 6 weeks of the average wage in Macedonia and a whopping 3 months' wages in Serbia. This extortionate pricing gave rise to resentment and thriving markets in pilfered Microsoft applications.

Pirated software costs between \$1.5 per compact disk in Macedonia and \$3 in Moscow's immense open-air Gorbushka market.

According to the Russia-based Compulog Computer Consultants, quoted by USA Today, most communist states maintained large-scale hacking operations involving not only the security services, but also the computers and electrical engineering departments of universities and prestigious research institutes. American bans on the sale of certain software applications - such as computer-aided design and encryption - fostered the emergence of an officially-sanctioned subculture of crackers and pirates.

In the last few years, Russian organized crime has evolved to incorporate computer fraud, identity theft, piracy of software and digital media and other related offenses. The Russian mafia employs programmers and graduates of computer sciences. The British Daily Express reported in September that - probably Russian - hackers broke into Microsoft's computer network and absconded with invaluable source codes. These are believed to be now also in the possession of the FSB, the chief successor to Russia's notorious KGB.

The Business Software Alliance, a United States based trade group, claims that 87-92 percent of all business computer programs used in Russia are bootlegged - a piracy rate second only to China's. Microsoft sells c. \$80- 100 million a year in the Russian Federation and the CIS.

Had it not been for piracy, its revenues could have climbed well above the \$1 billion mark.

According to Moscow Times and RosBalt, Microsoft's sales in Russia almost doubled in the last 12 months and it has decided to expand into the regions outlying Moscow and into Kazakhstan and Ukraine. Yet, the company's attempts to stamp out illicit copying in the last years of Russian president Boris Yeltsin's regime - including a much publicized visit by Bill Gates and a series of televised raids on disk stamping factories - floundered and yielded a wave of xenophobic indignation.

Still, central and eastern Europe is a natural growth market for the likes of Microsoft. The region is awash with highly qualified, talented, and - by Western measure - sinfully cheap experts. Purchasing power has increased precipitously in countries like the Czech Republic, Hungary, Slovakia, Slovenia, parts of Russia, and Croatia.

Both governments and businesses are at the initial stages of investing in information technology infrastructure.

Technological leapfrogging rendered certain countries here more advanced than the West in terms of broadband and wireless networks.

XLV. NGOs - The Self-Appointed Altruists

Their arrival portends rising local prices and a culture shock. Many of them live in plush apartments, or five star hotels, drive SUV's, sport \$3000 laptops and PDA's. They earn a two figure multiple of the local average wage. They are busybodies, preachers, critics, do-gooders, and professional altruists.

Always self-appointed, they answer to no constituency.

Though unelected and ignorant of local realities, they confront the democratically chosen and those who voted them into office. A few of them are enmeshed in crime and corruption. They are the non-governmental organizations, or NGO's.

Some NGO's - like Oxfam, Human Rights Watch, Medecins Sans Frontieres, or Amnesty - genuinely contribute to enhancing welfare, to the mitigation of hunger, the furtherance of human and civil rights, or the curbing of disease. Others - usually in the guise of think tanks and lobby groups - are sometimes ideologically biased, or religiously-committed and, often, at the service of special interests.

NGO's - such as the International Crisis Group - have openly interfered on behalf of the opposition in the last parliamentary elections in Macedonia. Other NGO's have done so in Belarus and Ukraine, Zimbabwe and Israel, Nigeria and Thailand, Slovakia and Hungary - and even in Western, rich, countries including the USA, Canada, Germany, and Belgium.

The encroachment on state sovereignty of international law - enshrined in numerous treaties and conventions - allows NGO's to get involved in hitherto strictly domestic affairs like corruption, civil rights, the composition of the media, the penal and civil codes, environmental policies, or the allocation of economic resources and of natural endowments, such as land and water. No field of government activity is now exempt from the glare of NGO's. They serve as self-appointed witnesses, judges, jury and executioner rolled into one.

Regardless of their persuasion or modus operandi, all NGO's are top heavy with entrenched, well-remunerated, extravagantly-perked bureaucracies. Opacity is typical of NGO's. Amnesty's rules prevent its officials from publicly discussing the inner workings of the organization - proposals, debates, opinions - until they have become officially voted into its Mandate. Thus, dissenting views rarely get an open hearing.

Contrary to their teachings, the financing of NGO's is invariably obscure and their sponsors unknown. The bulk of the income of most non-governmental organizations, even the largest ones, comes from - usually foreign - powers. Many NGO's serve as official contractors for governments.

NGO's serve as long arms of their sponsoring states - gathering intelligence, burnishing their image, and promoting their interests. There is a revolving door between the staff of NGO's and government bureaucracies the world over. The British Foreign Office finances a host of NGO's - including the fiercely "independent" Global Witness - in troubled spots, such as Angola. Many host governments accuse NGO's of - unwittingly or knowingly - serving as hotbeds of espionage.

Very few NGO's derive some of their income from public contributions and donations. The more substantial NGO's spend one tenth of their budget on PR and solicitation of charity. In a desperate bid to attract international attention, so many of them lied about their projects in the Rwanda crisis in 1994, recounts "The Economist", that the Red Cross felt compelled to draw up a ten point mandatory NGO code of ethics. A code of conduct was adopted in 1995. But the phenomenon recurred in Kosovo.

All NGO's claim to be not for profit - yet, many of them possess sizable equity portfolios and abuse their position to increase the market share of firms they own. Conflicts of interest and unethical behavior abound.

Cafedirect is a British firm committed to "fair trade" coffee. Oxfam, an NGO, embarked, three years ago, on a campaign targeted at Cafedirect's competitors, accusing them of exploiting growers by paying them a tiny fraction of the retail price of the coffee they sell. Yet, Oxfam owns 25% of Cafedirect.

Large NGO's resemble multinational corporations in structure and operation. They are hierarchical, maintain large media, government lobbying, and PR departments, head-hunt, invest proceeds in professionally-managed portfolios, compete in government tenders, and own a variety of unrelated businesses. The Aga Khan Fund for Economic Development owns the license for second mobile phone operator in Afghanistan - among other businesses. In this respect, NGO's are more like cults than like civic organizations.

Many NGO's promote economic causes - anti- globalization, the banning of child labor, the relaxing of intellectual property rights, or fair payment for agricultural products. Many of these causes are both worthy and sound. Alas, most NGO's lack economic expertise and inflict damage on the alleged recipients of their beneficence. NGO's are at times manipulated by - or collude with - industrial groups and political parties.

It is telling that the denizens of many developing countries suspect the West and its NGO's of promoting an

agenda of trade protectionism. Stringent - and expensive - labor and environmental provisions in international treaties may well be a ploy to fend off imports based on cheap labor and the competition they wreak on well-ensconced domestic industries and their political stooges.

Take child labor - as distinct from the universally condemnable phenomena of child prostitution, child soldiering, or child slavery.

Child labor, in many destitute locales, is all that separates the family from all-pervasive, life threatening, poverty. As national income grows, child labor declines. Following the outcry provoked, in 1995, by NGO's against soccer balls stitched by children in Pakistan, both Nike and Reebok relocated their workshops and sacked countless women and 7000 children. The average family income - anyhow meager - fell by 20 percent.

This affair elicited the following wry commentary from economists Drusilla Brown, Alan Deardorif, and Robert Stern: "While Baden Sports can quite credibly claim that their soccer balls are not sewn by children, the relocation of their production facility undoubtedly did nothing for their former child workers and their families".

This is far from being a unique case. Threatened with legal reprisals and "reputation risks" (being named-and- shamed by overzealous NGO's) - multinationals engage in preemptive sacking. More than 50,000 children in Bangladesh were let go in 1993 by German garment factories in anticipation of the American never-legislated Child Labor Deterrence Act.

Former Secretary of Labor, Robert Reich, observed: "Stopping child labor without doing anything else could leave children worse off. If they are working out of necessity, as most are, stopping them could force them into prostitution or other employment with greater personal dangers. The most important thing is that they be in school and receive the education to help them leave poverty".

NGO-fostered hype notwithstanding, 70% of all children work within their family unit, in agriculture. Less than 1 percent are employed in mining and another 2 percent in construction. Again contrary to NGO-proffered panaceas, education is not a solution. Millions graduate every year in developing countries - 100,000 in Morocco alone. But unemployment reaches more than one third of the workforce in places such as Macedonia.

Children at work may be harshly treated by their supervisors but at least they are kept off the far more menacing streets. Some kids even end up with a skill and are rendered employable. "The Economist" sums up the shortsightedness, inaptitude, ignorance, and self-centeredness of NGO's neatly: "Suppose that in the remorseless search for profit, multinationals pay sweatshop wages to their workers in developing countries. Regulation forcing them to pay higher wages is demanded... The NGOs, the reformed multinationals and enlightened rich-country governments propose tough rules on third-world factory wages, backed up by trade barriers to keep out imports from countries that do not comply. Shoppers in the West pay more - but willingly, because they know it is in a good cause. The NGOs declare another victory. The companies, having shafted their third-world competition and protected their domestic markets, count their bigger profits (higher wage costs notwithstanding). And the third-world workers displaced from locally owned factories explain to their children why the West's new deal for the victims of capitalism requires them to starve".

NGO's in places like Sudan, Somalia, Myanmar, Bangladesh, Pakistan, Albania, and Zimbabwe have become the preferred venue for Western aid - both humanitarian and financial - development financing, and emergency relief. According to the Red Cross, more money goes through NGO's than through the World Bank.

Their iron grip on food, medicine, and funds rendered them an alternative government - sometimes as venal and graft-stricken as the one they replace.

Local businessmen, politicians, academics, and even journalists form NGO's to plug into the avalanche of Western largesse. In the process, they award themselves and their relatives with salaries, perks, and preferred access to Western goods and credits. NGO's have evolved into vast networks of patronage in Africa, Latin America, and Asia.

NGO's chase disasters with a relish. More than 200 of them opened shop in the aftermath of the Kosovo refugee crisis in 1999-2000. Another 50 supplanted them during the civil unrest in Macedonia a year later. Floods, elections, earthquakes, wars - constitute the cornucopia that feed the NGO's.

NGO's are proponents of Western values - women's lib, human rights, civil rights, the protection of minorities, freedom, equality. Not everyone finds this liberal menu palatable. The arrival of NGO's often provokes social polarization and cultural clashes. Traditionalists in Bangladesh, nationalists in Macedonia, religious zealots in Israel, security forces everywhere, and almost all politicians find NGO's irritating and bothersome.

The British government ploughs well over \$30 million a year into "Proshika", a Bangladeshi NGO. It started as a women's education outfit and ended up as a restive and aggressive women empowerment political lobby group with budgets to rival many ministries in this impoverished, Moslem and patriarchal country.

Other NGO's - fuelled by \$300 million of annual foreign infusion - evolved from humble origins to become mighty coalitions of full-time activists. NGO's like the Bangladesh Rural Advancement Committee (BRAC) and the Association for Social Advancement mushroomed even as their agendas have been fully implemented and their goals exceeded. It now owns and operates 30,000 schools.

This mission creep is not unique to developing countries.

As Parkinson discerned, organizations tend to self-perpetuate regardless of their proclaimed charter.

Remember NATO? Human rights organizations, like Amnesty, are now attempting to incorporate in their ever-expanding remit "economic and social rights" - such as the rights to food, housing, fair wages, potable water, sanitation, and health provision. How insolvent countries are supposed to provide such munificence is conveniently overlooked. "The Economist" reviewed a few of the more egregious cases of NGO imperialism.

Human Rights Watch lately offered this tortured argument in favor of expanding the role of human rights NGOs: "The best way to prevent famine today is to secure the right to free expression - so that misguided government policies can be brought to public attention and corrected before food shortages become acute." It blatantly ignored the fact that respect for human and political rights does not fend off natural disasters and disease. The two countries with the highest incidence of AIDS are Africa's only two true democracies - Botswana and South Africa.

The Centre for Economic and Social Rights, an American outfit, "challenges economic injustice as a violation of international human rights law". Oxfam pledges to support the "rights to a sustainable livelihood, and the rights and capacities to participate in societies and make positive changes to people's lives". In a poor attempt at emulation, the WHO published an inane titled document - "A Human Rights Approach to Tuberculosis".

NGO's are becoming not only all-pervasive but more aggressive. In their capacity as "shareholder activists", they disrupt shareholders meetings and act to actively tarnish corporate and individual reputations. Friends of the Earth worked hard four years ago to instigate a consumer boycott against Exxon Mobil - for not investing in renewable energy resources and for ignoring global warming. No one - including other shareholders - understood their demands. But it went down well with the media, with a few celebrities, and with contributors.

As "think tanks", NGO's issue partisan and biased reports.

The International Crisis Group published a rabid attack on the then incumbent government of Macedonia, days before an election, relegating the rampant corruption of its predecessors - whom it seemed to be tacitly supporting - to a few footnotes. On at least two occasions - in its reports regarding Bosnia and Zimbabwe - ICG has recommended confrontation, the imposition of sanctions, and, if all else fails, the use of force. Though the most vocal and visible, it is far from being the only NGO that advocates "just" wars.

The ICG is a repository of former heads of state and has-been politicians and is renowned (and notorious) for its prescriptive - some say meddling - philosophy and tactics. "The Economist" remarked sardonically: "To say (that ICG) is 'solving world crises' is to risk underestimating its ambitions, if overestimating its achievements".

NGO's have orchestrated the violent showdown during the trade talks in Seattle in 1999 and its repeat performances throughout the world. The World Bank was so intimidated by the riotous invasion of its premises in the NGO-choreographed "Fifty Years is Enough" campaign of 1994, that it now employs dozens of NGO activists and let NGO's determine many of its policies.

NGO activists have joined the armed - though mostly peaceful - rebels of the Chiapas region in Mexico.

Norwegian NGO's sent members to forcibly board whaling ships. In the USA, anti-abortion activists have murdered doctors. In Britain, animal rights zealots have both assassinated experimental scientists and wrecked property.

Birth control NGO's carry out mass sterilizations in poor countries, financed by rich country governments in a bid to stem immigration. NGO's buy slaves in Sudan thus encouraging the practice of slave hunting throughout sub-Saharan Africa. Other NGO's actively collaborate with "rebel" armies - a euphemism for terrorists.

NGO's lack a synoptic view and their work often undermines efforts by international organizations such as the UNHCR and by governments. Poorly-paid local officials have to contend with crumbling budgets as the funds are diverted to rich expatriates doing the same job for a multiple of the cost and with inexhaustible hubris.

This is not conducive to happy co-existence between foreign do-gooders and indigenous governments.

Sometimes NGO's seem to be an ingenious ploy to solve Western unemployment at the expense of down-trodden natives. This is a misperception driven by envy and avarice.

But it is still powerful enough to foster resentment and worse. NGO's are on the verge of provoking a ruinous backlash against them in their countries of destination.

That would be a pity. Some of them are doing indispensable work. If only they were a wee more sensitive and somewhat less ostentatious. But then they wouldn't be NGO's, would they?

Interview granted to Revista Terra, Brazil, September 2005 Q. NGOs are growing quickly in Brazil due to the discredit politicians and governmental institutions face after decades of corruption, elitism etc. The young people feel they can do something concrete working as activists in a NGOs. Isn't that a good thing? What kind of dangers someone should be aware before enlisting himself as a supporter of a NGO? A. One must clearly distinguish between NGOs in the sated, wealthy, industrialized West - and (the far more numerous) NGOs in the developing and less developed countries.

Western NGOs are the heirs to the Victorian tradition of "White Man's Burden". They are missionary and charity-orientated. They are designed to spread both aid (food, medicines, contraceptives, etc.) and Western values. They closely collaborate with Western governments and institutions against local governments and institutions.

They are powerful, rich, and care less about the welfare of the indigenous population than about "universal" principles of ethical conduct.

Their counterparts in less developed and in developing countries serve as substitutes to failed or dysfunctional state institutions and services. They are rarely concerned with the furthering of any agenda and more preoccupied with the well-being of their constituents, the people.

Q. Why do you think many NGO activists are narcissists and not altruists? What are the symptoms you identify on them? A. In both types of organizations - Western NGOs and NGOs elsewhere - there is a lot of waste and corruption, double-dealing, self-interested promotion, and, sometimes inevitably, collusion with unsavory elements of society.

Both organizations attract narcissistic opportunists who regards NGOs as venues of upward social mobility and self-enrichment. Many NGOs serve as sinecures, "manpower sinks", or "employment agencies" - they provide work to people who, otherwise, are unemployable. Some NGOs are involved in political networks of patronage, nepotism, and cronyism.

Narcissists are attracted to money, power, and glamour.

NGOs provide all three. The officers of many NGOs draw exorbitant salaries (compared to the average salary where the NGO operates) and enjoy a panoply of work-related perks. Some NGOs exert a lot of political influence and hold power over the lives of millions of aid recipients.

NGOs and their workers are, therefore, often in the limelight and many NGO activists have become minor celebrities and frequent guests in talk shows and such.

Even critics of NGOs are often interviewed by the media (laughing).

Finally, a slim minority of NGO officers and workers are simply corrupt. They collude with venal officials to enrich themselves. For instance: during the Kosovo crisis in 1999, NGO employees sold in the open market food, blankets, and medical supplies intended for the refugees.

Q. How can one choose between good and bad NGOs? A. There are a few simple tests: 1. What part of the NGO's budget is spent on salaries and perks for the NGO's officers and employees? The less the better. 2. Which part of the budget is spent on furthering the aims of the NGO and on implementing its promulgated programs? The more the better. 3. What portion of the NGOs resources is allocated to public relations and advertising? The less the better. 4. What part of the budget is contributed by governments, directly or indirectly? The less the better. 5. What do the alleged beneficiaries of the NGO's activities think of the NGO? If the NGO is feared, resented, and hated by the local denizens, then something is wrong! 6. How many of the NGO's operatives are in the field, catering to the needs of the NGO's ostensible constituents? The more the better. 7. Does the NGO own or run commercial enterprises? If it does, it is a corrupt and compromised NGO involved in conflicts of interest.

Q. The way you describe, many NGO are already more powerful and politically influential than many governments. What kind of dangers this elicits? Do you think they are a pest that need control? What kind of control would that be? A. The voluntary sector is now a cancerous phenomenon.

NGOs interfere in domestic politics and take sides in election campaigns. They disrupt local economies to the detriment of the impoverished populace. They impose alien religious or Western values. They justify military interventions. They maintain commercial interests which compete with indigenous manufacturers. They provoke unrest in many a place. And this is a partial list.

The trouble is that, as opposed to most governments in the world, NGOs are authoritarian. They are not elected institutions. They cannot be voted down. The people have no power over them. Most NGOs are ominously and tellingly secretive about their activities and finances.

Light disinfects. The solution is to force NGOs to become both democratic and accountable. All countries and multinational organizations (such as the UN) should pass laws and sign international conventions to regulate the formation and operation of NGOs.

NGOs should be forced to democratize. Elections should be introduced on every level. All NGOs should hold "annual stakeholder meetings" and include in these gatherings representatives of the target populations of the NGOs. NGO finances should be made completely transparent and publicly accessible. New accounting standards should be developed and introduced to cope with the current pecuniary opacity and operational double-speak of NGOs.

Q. It seems that many values carried by NGO are typically modern and Western. What kind of problems this creates in more traditional and culturally different countries? A. Big problems. The assumption that the West has the monopoly on ethical values is undisguised cultural chauvinism. This arrogance is the 21st century equivalent of the colonialism and racism of the 19th and 20th century. Local populations throughout the world resent this haughty presumption and imposition bitterly.

As you said, NGOs are proponents of modern Western values - democracy, women's lib, human rights, civil rights, the protection of minorities, freedom, equality. Not everyone finds this liberal menu palatable. The arrival of NGOs often provokes social polarization and cultural clashes.

XLVII. Quis Custodiet Ipsos Custodes?

Who is Guarding the Guards in Countries in Transition from Communism?

Written: August 23, 1999

Izetbegovic, the nominal president of the nominal Bosnian state, the darling of the gullible western media, denies that he and his cronies and his cronies' cronies stole 40% of all civilian aid targeted at Bosnia - a minor matter of 1 billion US dollars and change, in less than 4 years. The tribes of the Balkans stop bleeding each other to death only when they gang up to bleed another. In this, there are no races and no traces - everyone is equal under the sign of the dollar. Serbs, Bosnians and Croats divided the loot with the loftiest of egalitarian instincts. Honour among thieves transformed into honour among victims and their murderers. Mammon is the only real authority in this god forsaken, writhing rump of a country.

And not only there.

In Russia, billions (3 to 5) were transferred to secret off shore bank accounts to be "portfolio managed" by mysterious fly-by-night entities. Many paid with their jobs when the trail led to the incestuous Yeltsin clan and their byzantine court.

Convoys snake across the mountainous Kosovo, bringing smuggled goods at exorbitant prices to the inhabitants of this parched territory - all under the avuncular gaze of multinational peacekeepers.

In Romania, Hungary and Greece, UN forces have been known to take bribes to allow goods into besieged Serbia.

Oil, weapons and strategic materials, all slid across this greasy channel of the international brotherhood of cash.

A lot of the aid, ostensibly intended to ameliorate the state of refugedom imposed upon the unsuspecting, harried population of Kosovo - resurfaced in markets, white and black, across the region. Food, blankets, tents, electrical equipment, even toys - were on offer in bazaars from Skopje to Podgorica and from Sofia to Thessaloniki, replete with the stamps of the unwitting donors. Aid workers scurried back and forth in expensive utility vehicles, buzzing mobile phones in hand and latest model, officially purchased, infrared laptops humming in the air conditioned coolness of their five star hotel rooms (or fancy apartments). In their back pockets they safeguarded their first class tickets (the food is better and the stewardesses ...). The scavengers of every carnage, they descended upon this tortured land in redundant hordes, feeding off the misery, the autoimmune deficiency of the syndrome of humanism.

Ask yourselves: how could one of every 3 dollars - 50% of GNP - be stolen in a country the size of a tiny American state - without the knowledge and collaboration of the international organizations which ostensibly manage this bedlam? Why did the IMF renew the credit lines to a Russia which cheated bold-facely regarding its foreign exchange reserves? How was Serbia awash and flush with oil and other goods prohibited under the terms of the never-ending series of embargoes imposed upon it? The answer is that potent cocktail of fear and graft. First came fear - that Russia will collapse, that the Balkans will spill over, that Bosnia will disintegrate. Nuclear nightmares intermingled with Armenian and Jewish flashbacks of genocide. The west shut its eyes tight and threw money at the bad spirits of irredentism and re-emergent communism. The long arm of the USA, the "international" financial institutions, collaborated in constructing the habit forming dole house that Eastern and Southern Europe has become. This conflict-reticence, these approach-avoidance cycles led to an inevitable collusion between the ruling mob families that pass for regimes in these parts of the planet - and the unilateral institutions that pass for multilateral ones in the rest of it.

An elaborate system of winks and nods, the sign language of institutional rot and decaying governance, took over.

Greasy palms clapped one another with the eerie silence of conspiracy. The world looked away as both - international financial institutions and corrupt regimes - robbed their constituencies blind. This was perceived to be the inevitable moral cost of stability. Survival of the majority entailed the filthy enrichment of the minority.

And the west acquiesced.

But this grand design backfired. Like insidious bacteria, corruption breeds violence and hops from host to host. It does not discriminate, this plague of black conscience, between east and west. As it infected the indigenous, it also effected their guardians. They were all engulfed by raging greed, by a degradation of the inhibitions and by the intoxicating promiscuity of lawlessness. Inebriated by their newly found powers, little ceasars - natives and financial colonialists - claimed their little plots of crime and avarice, a not so secret order of disintegration of the social fabric. A ghoulish landscape, shrouded in the opaque mist of the nomenclature, the camaraderie of the omnipotent.

And corruption bred violence. The Chicago model imported lock, stock and the barrel of the gun. Former cronies disappeared mysteriously, bloated corpses in stale hotel rooms - being the only "contracts" honoured.

Territories were carved up in constant, unrelenting warfare. One billion dollars are worth a lot of blood and it was spilled with glee, with the enthusiasm of the inevitable, with the elation of gambling all on a single spin of the Russian roulette.

It is this very violence that the west tried to drown with its credits. But unbeknownst to it, this very violence thrived on these pecuniary fertilizers. A plant of horrors, it devoured its soil and its cultivators alike. And

120,000 people paid with their lives for this wrong gamble.

Counting its losses, the west is poised to spin the wheel again. More money is amassed, the dice are cast and more people cast to die.

XLVII. The Honorary Academic Higher Education for Sale

In Countries in Transition from Communism

Mira Markovic is an "Honorary Academic" of the Russian Academy of Science. It cost a lot of money to obtain this title and the Serb multi-billionaire Karic was only too glad to cough it up. Whatever else you say about Balkan cronies, they rarely bite the hand that feeds them (unless and until it is expedient to do so). And whatever else you say about Russia, it adapted remarkably to capitalism.

Everything has a price and a market. Israel had to learn this fact the hard way when Russian practical-nurse-level medical doctors and construction-worker-level civil engineers flooded its shores. Everything is for sale in this region of opportunities, instant education inclusive.

It seems that academe suffered the most during the numerous shock therapies and transition periods showered upon the impoverished inhabitants of Eastern and Central Europe. The resident of decrepit communist-era buildings, it had to cope with a flood of eager students and a deluge of anachronistic "scholars". But in Russia, the CIS and the Balkans the scenery is nothing short of Dantesque.

Unschooling in any major European language, lazily content with their tenured positions, stagnant and formal - the academics and academicians of the Balkans are both failures and a resounding indictment of the rigor mortis that was socialism. Economics textbooks stop short of mentioning Friedman or Phelps. History textbooks should better be relegated to the science fiction shelves. A brave facade of self sufficiency covers up a vast hinterland of inferiority complex fully supported by real inferiority. In antiquated libraries, shattered labs, crooked buildings and inadequate facilities, students pursue redundant careers with the wrong teachers.

Corruption seethes under this repellent surface. Teachers sell exams, take bribes, trade incestuous sex with their students. They refuse to contribute to their communities.

In all my years in the Balkans, I have yet to come across a voluntary act - a single voluntary act - by an academic.

And I have come across numerous refusals to help and to contribute. Materialism incarnate.

This sorry state of affairs has a twofold outcome. On the one hand, herds of victims of rigidly dictated lectures and the suppression of free thought. These academic products suffer from the twin afflictions of irrelevance of skills and the inability to acquire relevant ones, the latter being the result of decades of brainwashing and industrial educational methods. Unable to match their anyhow outdated knowledge with anything a modern marketplace can offer - they default on to menial jobs, rebel or pull levers to advance in life. Which leads us to the death of meritocracy and why this region's future is behind it.

In the wake of the downfall of all the major ideologies of the 20th century - Fascism, Communism, etc. the New Order, heralded by President Bush, emerged as a battle of Open Club versus Closed Club societies, at least from the economic point of view.

All modern states and societies must choose whether to be governed by merit (meritocracy) or by the privileged few (oligarchy). It is inevitable that the social and economic structures be controlled by elites. It is a complex world and only a few can master the knowledge it takes to govern effectively. What sets meritocracy apart is not the number of members of its ruling (or leading) class, usually no larger than an oligarchy. No, it is distinguished by its membership criteria and by the mode of their application.

The meritocratic elite is an open club because it satisfies three conditions: 1. The process and rules of joining up (i.e., the criteria) are transparent and widely known. 2. The application and membership procedures are uniform, equal to all and open to continuous public scrutiny and criticism. 3. The system alters its membership requirements in direct response to public feedback and to the changing social and economic environment.

To belong to a meritocracy one needs to satisfy a series of demands, whose attainment is entirely up to the individual.

And that is all that one needs to do. The rules of joining and of membership are cast in iron. The wishes and opinions of those who happen to comprise the club at any given moment are of no importance and of no consequence. Meritocracy is a "fair play" by rules of equal chance to derive benefits. Put differently, is the rule of law.

To join a meritocratic club, one needs to demonstrate that one is in possession of, or has access to, "inherent" parameters, such as intelligence, a certain level of education, a potential to contribute to society. An inherent parameter must correspond to a criterion and the latter must be applied independent of the views and predilections of those who sometimes are forced to apply it. The members of a committee or a board can disdain an applicant, or they might wish not to approve a candidate.

Or they may prefer someone else for the job because they owe her something, or because they play golf with him.

Yet, they are permitted to consider only the applicant's or the candidate's "inherent" parameters: does he have the necessary tenure, qualifications, education, experience? Does he contribute to his workplace, community, society at large? In other words: is he "worthy" or "deserving"? Not WHO he is - but WHAT he is.

Granted, these processes of selection, admission, incorporation and assimilation are administered by mere humans and are, therefore, subject to human failings. Can qualifications be always judged "objectively, unambiguously and unequivocally"? Can "the right personality traits" or "the ability to engage in teamwork" be evaluated "objectively"? These are vague and ambiguous enough to accommodate bias and bad will.

Still, at least appearances are kept in most cases - and decisions can be challenged in courts.

What characterizes oligarchy is the extensive, relentless and ruthless use of "transcendent" (in lieu of "inherent") parameters to decide who will belong where, who will get which job and, ultimately, who will enjoy which benefits.

The trouble with transcendent parameters is that there is nothing much an applicant or a candidate can do about them. Usually, they are accidents, occurrences absolutely beyond the reach or control of those most affected by them. Race is such a transcendent parameter and so are gender, familial affiliation or contacts and influence.

In many corners of the globe, to join a closed, oligarchic club, to get the right job, to enjoy excessive benefits - one must be white (racism), male (sexual discrimination), born to the right family (nepotism), or to have the right political (or other) contacts (cronyism). And often, belonging to one such club is the prerequisite for joining another.

In France, for instance, the whole country is politically and economically run by graduates of the Ecole Normale d'Administration (ENA). They are known as the ENArques (=the royal dynasty of ENA graduates).

The privatization of state enterprises in most East and Central European countries provided a glaring example of oligarchic machinations. In most of these countries (the Czech Republic, Macedonia, Serbia and Russia are notorious examples) - state companies, the nation's only assets, were "sold" to political cronies, creating in the process a pernicious amalgam of capitalism and oligarchy, known as "crony capitalism" or privateering. The national wealth was passed on to the hands of relatively few, well connected, individuals, at a ridiculously low price. The nations involved were robbed, their riches either squandered or smuggled abroad.

In the affairs of humans, not everything falls neatly into place. Take money, for instance. Is it an inherent parameter or an expressly transcendent one? Making money indicates the existence of some merit, some inherent advantageous traits of the money-making individual. To make money consistently, a person needs to be diligent, resilient, hard working, to prevail and overcome hardships, to be far sighted and to possess a host of other - universally acclaimed - traits. On the other hand, is it fair when someone who made his fortune through corruption, inheritance, or luck - be preferred to a poor genius? That is a contentious issue. In the USA money talks.

Being possessed of money means being virtuous and meritorious. To preserve a fortune inherited is as difficult a task as to make it in the first place, the thinking goes.

Thus, the source of the money is secondary.

An oligarchy tends to have long term devastating economic effects.

The reason is that the best and the brightest - when shut out by the members of the ruling elites - emigrate. In a country where one's job is determined by his family connections or by influence peddling - those best fit to do the job are likely to be disappointed, then disgusted and then to leave the place altogether.

This is the phenomenon known as "Brain Drain". It is one of the biggest migratory tidal waves in human history.

Capable, well-trained, educated, young people leave their oligarchic, arbitrary, influence peddling societies and migrate to less arbitrary meritocracies (mostly to be found in what is collectively known as "The West").

This is colonialism of the worst kind. The mercantilist definition of a colony is a territory which exports raw materials only to re-import them in the form of finished products. The Brain drain is exactly that: the poorer countries are exporting raw brains and buying back the finished products masterminded, invented and manufactured by these brains.

Yet, while in classical colonialism, the colony at least received some recompense for its goods - here the poor country is actually the poorer for its exports. The bright young people who depart (most of them never to return) carry with them an investment of the scarce resources of their homeland - and award it to their new, much richer, host countries. This is an absurd situation, a subsidy granted reluctantly by the poor to the rich. This is also one of the largest capital transfers (really capital flight) in history.

Some poor countries understood these basic, unpleasant, facts of life. They extracted an "education fee" from those emigrating. This fee was supposed to, at least partially, recapture the costs of educating and training the immigrants. Romania and the USSR imposed such levies on Jews emigrating to Israel in the 1970s. Others despairingly regard the brain drain as a natural catastrophe. Very few countries are trying to tackle the fundamental, structural and philosophical flaws of the system, the roots of the disenchantment of those who leave.

The Brain Drain is so serious that some countries lost up to a third of their total young and educated population to it (Macedonia in South-eastern Europe, some less developed countries in South East Asia and in Africa). Others were drained of almost one half of the growth in their educated workforce (for instance, Israel during the 1980s).

Brains are an ideal natural resource: they can be cultivated, directed, controlled, manipulated, regulated.

They are renewable and replicable. Brains tend to grow exponentially through interaction and they have an unparalleled economic value added. The profit margin in knowledge and information related industries far exceeds anything common to more traditional, second wave, industries (not to mention first wave agriculture and agribusiness).

What is even more important: Poor countries are uniquely positioned to take advantage of this third revolution. With cheap, educated workforce - they can monopolize basic data processing and telecommunications functions worldwide. True, this calls for massive initial investments in physical infrastructure.

But the important input is the wetware, the brains. To constrain them, to disappoint them, to make them run away, to more merit-orientated places - is to sentence oneself to a permanent disadvantage and deprivation.

This is what the countries in the Balkans are doing.

Driving away the best part of their population by encouraging the worst part. Abandoning their future by dwelling on their past. Caught in a fatal spider web of family connections and political cronyism of their own design. Their factories and universities and offices and government filled to the brim with third rate relatives of third rate professors and bureaucrats. Turning themselves into third rate countries in a self perpetuating, self feeding process of decline. And all the while eyeing the new and the foreign with the paranoia that is the result of true guilt.

XLVIII. Rasputin in Transition

Frauds and Con-men in Countries in Transition from Communism

The mad glint in his eyes is likely to be nothing more ominous than maladjusted contact lenses. If not clean shaven, he is likely to sport nothing wilder than a goatee.

More likely an atheist than a priest, this mutation of the ageless confidence artist is nonetheless the direct spiritual descendent of Rasputin, the raving maniac who governed Russia until his own execution by Russian noblemen and patriots.

They are to be found in all countries in transition. Wild and insidious weeds, the outcome of wayward pollination by mutated capitalism. They prey on their victims, at first acquiring their confidence and love, then penetrating their political, social and financial structures almost as a virus would: stealthily and treacherously. By the time their quarry wakes up to its infection and subjugation - it is already too late. By then, the invader will have become part of the invaded or its master, either through blackmail or via tempting subornation.

This region of the CEE and the Balkans provides for fertile grounds. It is a Petrie dish upon which cultures of corruption and scandalous conduct are fermented. The typical exploiter of these vulnerabilities is a foreigner.

Things foreign are held in awe and adulation by a populace so down trodden and made to feel inferior in every way, not least by foreign tutors and advisors. The craving to be loved, this gnawing urge to be accepted, to be a member of the club, to be distinguished from one's former neighbours - are irresistible. The modern Rasputin doles out this unconditional acceptance, this all encompassing affinity, the echoes of avuncularity. In doing so, he evokes in the recipients such warmth, such relief, such fervour and reciprocity - that he becomes an idol, a symbol of a paradise long lost, a golden braid.

Having thus completed the first phase of his meticulous attack - he moves on to the second chapter in this book of body snatching.

Armed with his new-fangled popularity, the crook moves on and leverages it to the hilt. He does so by feigning charity, by faking interest, by false "constructive criticism". To his slow forming army, he recruits the media, the flower children, the bleeding hearts, reformers, dissidents and the occasional freak. By holding old authority in disdain, by declaring his contempt for the methods of the "tried and true", by appearing to make war upon all rot and immorality - this creature of expediency emerges as a folk hero. It is the more cynical and world weary and "sophisticated" members of society that lead the way, succumbing to his ardour and conviction, to his child-like innocence, to his unwavering agenda. He cleverly thrusts at them the double edge of their own disillusionment and disappointment. Thus mirrored, they are transformed and converted into his camp of renewal and clean promises by this epiphany. They hand him the keys to every medium, the very codes and secrets that make him so powerful. They pledge their alliance and allegiance and render to him the access they possess to the nerve centres of society. The castle gates thus opened from inside, his victory assured, the rogue moves on to consummate this unholy marriage between himself and the deceived.

Always in fear of light, he surreptitiously and cunningly begins to interact with the foci of power and money in the land. However loathsome he is to them, however repulsive the experience, however undesirable the effects of their surrender - they are made to recognize him as their equal. With the might of the media and a large part of the people behind him, he can no longer be ignored.

Their conspiracy-prone mind, awash with superstitions and its attaching phobias, tries to comprehend his meteoric rise, the forcefulness with which he treads, his unmitigated, inane, self confidence. Is he a spy? A member of a secret order? The latent agent of a hyperpower? The heart of a world conspiracy? Has he no fear of retribution and no remorse? Before this great unknown, they kneel and yield, an atavistic reaction to atavistic fears. Now all doors are thrown open, all deals are made available, all secrets are revealed. The more he learns, the mightier he becomes - the more his might, the more he learns. To him, a virtuous cycle, to his hosts - a vicious one.

In all this tumult, he does not lose sight of his original goals - power, money, fame, all three. It is a relentless pursuit, an obsessive hunt, a ruthless and unscrupulous chase. In his war, no prisoners are taken, no price too dear, no human in his orbit left untouched. He will manipulate and threat and beg and promise and plead and blackmail and extort to accomplish that which he set out to achieve: decision making powers, wealth, clout, exposure and resultant fame. It is at this stage that the latter day Rasputin emerges from the shadows and joins officialdom or concludes lucrative transactions based on favourably deflated prices and insider dealing. By now, his shady past is no longer a hindrance. His prowess far exceeds his invidious biography. Well installed, he ignores both media and the people. He brushes aside contemptuously all criticism and enquiry. His true, narcissistic, face is exposed and it is hideous to behold.

But there is nothing to be done and all resistance is futile.

The con-man now is in a haste to maximize his hard earned profits and exit the scene, on his way to another realm of guile and naivet.

XLVIX. The Eureka Connection

How East and Central Europeans Defraud the Gullible West

A common, guttural cry of "Eureka" echoed as the peoples of East Europe and the Balkan emerged from the Communist steam bath. It was at once an expression of joy and disbelief. That the West should be willing to bankroll the unravelling of a failed social experiment, freely entered into, exceeded the wildest imaginings. That it would do so indefinitely and with no strings attached was a downright outlandish fortuity.

Transition in the post communist countries was coupled with a hubristic and haughty conviction in the transforming powers of the Western values, Western technology, and Western economics. The natives - awe struck and grateful - were supposed to assimilate these endowments and thus become honorary Westerners ("white men"). Where osmosis and imitation failed - bayonets and bombs were called upon. These were later replaced by soft credits and economic micromanagement by a host of multilateral institutions.

Accustomed to Pavlovian interactions, adept at manipulating "the system", experts in all manner of make belief - the shrewd denizens of the East exercised the reflexive levers of the Great Democracies. They adopted stratagems whose sole purpose was to extract additional aid, to foster a dependency of giving, to emotionally extort. In one sentence: they learned how to corrupt the donors.

The most obvious subterfuge involved the mindless repetition of imported mantras. Possessed of the same glazed eyes and furled lips, the loyal members of a perfidious nomenclatura uttered with the same seemingly fervid conviction the catechism of a new religion.

Yesterday communism - today capitalism, unblushingly, unhesitatingly, cynically. Yesterday, a recondite dictatorship of the proletariat or, more often, a personality cult - today "democracy". Yesterday - brotherhood and unity, today - genocidal "self determination". Yesterday - genocidal inclinations, today - a "growth and stability pact". If required to bark in the nude in order to secure the flow of unsupervised funding (mainly to their pockets), these besuited "gentlemen" would have done so with self- sacrificial ardour, no doubt.

When it dawned upon them that the West is willing to pay for every phase of self-betterment, for every stage of self- improvement, for every functioning institution and law passed - this venal class (the soi-disant "elite" in government, in industry and academe) embarked on a gargantuan blackmail plot. The inventors of the most contorted and impervious bureaucracies ever, have recreated them. They have transformed the simplest tasks of reform into tortuous, hellish processes, mired in a miasma of numerous committees and deluged by cavils, captious "working" papers and memoranda of stupefying trumpery. They have stalled and retraced, reversed and regressed, opined and debated, refused and accepted grudgingly. The very processes of transformation and transition - a simulacrum to begin with - acquired an aura of somnolent lassitude and the nightmarish quality of ensnarement. And they made the West bribe them into yielding that which was ostensibly in their very own interest. Every act of legislation was preceded and followed by dollops of foreign cash. Every ministry abolished was conditioned upon more aid. Every court established, every bloodletting firm privatized, every bank sold, every system made more efficient, every procedure simplified, every tender concluded and every foreign investor spared - had a tariff. "Pay or else ..." was the overt message - and the West preferred to pay and to appease, as it has always done.

The money lavished on these "new democracies" was routed rather conspicuously into the private bank accounts of the thin layer of vituperable "leaders", "academics" and "businessmen" (often the same people). One third cigarette smugglers, one third uncommon criminals and one third cynical con-artists, these people looted the coffers of their states. The IMF - this sanctuary of fourth rate economists from third world countries, as I am never wont of mentioning - collaborated with the US government, the European Union and the World Bank in covering up this stark reality. They turned a common blind eye to the diversion of billions in aid and credits to mysterious bank accounts in dubious tax havens. They ignored fake trading deals, itinerant investment houses, shady investors and shoddy accounting. They expressed merely polite concern over blatant cronyism and rampant nepotism. They kept pouring money into the rapidly growing black hole that Eastern Europe and the Balkan have become. They pretended not to know and feigned surprise when confronted with the facts. In their complicity, they have encouraged the emergence of a criminal class of unprecedented proportions, hold and penetration in many of the countries within their remit.

To qualify to participate in this grand larceny, one needed only to have a "sovereign" "state". Sovereign states are entitled to hold shares in multilateral financial institutions and to receive international aid and credits. In other words: sovereignty is the key to instant riches. The unregenerate skulks that pass for political parties in many countries in East Europe and the Balkan (though not in all of them - there are exceptions), carved up the territory.

This led to a suspicious proliferation of "republics", each with its own access to international funds. It also led to "wars" among these emergent entities.

Recent revelations regarding the close and cordial co-operation between Croatia's late president, Franjo Tudjman and Yugoslavia's current strongman, Slobodan Milosevic - ostensibly, bitter enemies - expose the role that warfare and instability played in increasing the flow of aid (both civil and military) to belligerent countries.

The more unstable the region, the more ominous its rhetoric, the more fractured its geopolitics - the more money flowed in. It was the right kind of money: multilateral - not multinational, public - not private, deliberately ignorant - not judiciously cognizant. It was the "quantum fund" - capable of "tunnelling" (as the Czechs called it) - vanishing in one place (the public purse) and appearing in another (the private wallet) simultaneously. Even the exception - the never-enforced sanctions against Yugoslavia - served to enrich its cankerous ruling class by way of smuggling and monopolies.

And why did the West collaborate in this charade? Why did it compromise its goodwill, its carefully crafted institutions, its principles and ethos? The short and the long of it is: to get rid of a nuisance at a minimal cost. It is much cheaper to grease the palms of a deciding few - than to embark on the winding path of true and painful growth.

It is more convenient to co-opt a political leader than to confront an angry mob. It is by far easier to throw money at a problem than to solve it.

It was not a sinister conspiracy of the Great Powers as many would have it. Nor was it the result of foresight, insight, perspicacity, or planning. It was a typical improvident European default, adopted by a succession of lacklustre and lame American administrations. It enriched the few and impoverished the many. It fostered anti-Western sentiments. It provoked skirmishes that provoked wars that led to massacres. To reverse it would require more resources than should have been committed in the first place. These are not forthcoming. The West is again misleading and deceiving and collaborating to defraud the peoples of these unfortunate netherlands. It again promises prosperity it cannot deliver, growth it will not guarantee and stability it cannot ensure. This prestidigitation is bound to lead to ever larger bills and to the attrition of good will of both donor and recipient.

Never before was such a unique historical opportunity so thoroughly missed. The consequences may well be as unprecedented.

L. The Treasure Trove of Kosovo

Nothing like a juicy, photogenic human catastrophe to enrich corrupt politicians and bottom-line-orientated, stock-option-motivated corporate executives. The Balkan is teeming with both these sad days.

Even as the war was raging, shortages of food and other supplies led to the dispensation of political favours (in the form of import licences, for instance) to the chosen few.

Bulgarian, Greek and Albanian firms, owned by ruthless criminals and criminals-turned-politicians benefited mightily. Millions were made and shared as artificially high prices were maintained by various means while cronies and crime controlled firms shared the spoils. This orgiastic intercourse between the corrupt and the criminal was not confined to one country. The whole region partook in robbing the most impoverished populations in Europe by "legal" means.

Their more refined and perfumed Western brethren were never far behind in taking advantage of American largesse on the one hand and re-emerging alarmist tendencies, on the other. Thus, American, German, Greek, French and Italian firms enjoyed funds allocated to international humanitarian aid by the likes of the US government, the United Nations, the World Bank, the IMF and other long arms of the American octopus. Defence contractors and the dubious characters known as weapons intermediaries stoked the atavistic fires

of war in securing defence contracts. And aid workers resided in six star hotels, driving the latest sports utility vehicles and brandishing futuristic laptop computers as they went about the business of dispensing aid. In the meantime, at least one half of all aid money was pilfered - not to use a harsher term. Aid rations were freely available in Macedonian, Albanian, Greek and Bulgarian markets - offered at a discount by aid workers who stole them from their supposed recipients. The refugees were never given mattresses, were short of blankets, water, showers and toilets (I visited the camps - this is an eyewitness account). Only bread was abundant.

Now that the war is over, some people are counting their dead - while others are counting their blessings. But this has all been a prelude. It is the next wave of aid which is the main course in this bacchanalia. Outlandishly feverish numbers are tossed around. Kosovo's immediate reconstruction (housing and infrastructure) will require well over 2 billion US dollars in the next 2 years. Of this, 1.5 billion dollars has already been raised. A further 2 billion USD is slated as direct aid to the shattered economies of Macedonia and Albania. But the real booty lies in Serbia. A minimum of 10-13 billion dollars will be required simply to restore Serbia's infrastructure to its former, inglorious self. To resuscitate the whole languishing area, a staggering 30 billion dollars is touted as the minimal bill.

Rest assured that at least one third of this generous cornucopia will end up lining the pockets of the rich and mighty. At least 1 billion dollars will end up festering in Swiss, Cypriot, South African and Israeli bank accounts.

The politicians know it, the "grupirovki" (business cartels controlled by mafia-style organizations) know it, Western governments know it. This is the REAL stability pact.

Financially inebriated politicians are better motivated to maintain peace and stability, or so the thinking goes.

The history of the Balkans will play a major role in determining the topography and geography of this flood of cronyism, nepotism, criminality and vice. The Balkan is composed of states run by crime organizations and crime organizations run by states. Old alliances last long (as opposed to the Middle East where alliances, dune-like, shift with the winds). Bulgaria and Macedonia, for instance. Serbia and Greece. Albania and Kosovo. And now Albania and Macedonia. Meetings of regional "leaders" in the Balkans were always reminiscent of scenes from "The Godfather". The dons, uncomfortably clad in expensive business suits and wearing golden rings, deciding life and death and a jovial yet vaguely menacing atmosphere. Only the leaders of the New Balkans are much younger, less experienced, more prone to superstition, extremism and moodiness. The old tensions are bound to re-emerge, this time in the employ of business interests. Expect a flare up of animosity between Greece and Macedonia. Despite its Bulgarophile regime, expect uneasy moments between Bulgaria and Macedonia.

And expect an unholy alliance of business interests between Mr. Thaci and his sprawling business empire and the governments of Albania and Macedonia. If not assassinated before, Thaci is definitely the Man to watch.

Young, well educated, ruthless, involved in business (read: corrupt to the core) - an aptly dangerous man in dangerous times.

The problem is that everyone hold high expectations. This is a poor recipe for an amicable carving of the cake of international funding. Macedonia expects to lead the reconstruction effort of Kosovo. It was offended greatly by the decision to base the Kosovo reconstruction agency in Pristina. Greek and Italian firms expect to snatch profits out of the jaws of their near treacherous behaviour during the war. Turkish firms expect to be rewarded for the loyalty of Turkey during the same. American and German firms expect to exclude all else in gaining access to American and German (=EU) funds (as they have done in Bosnia). These all are mutually incompatible expectations and they will lead to mutually exclusive behaviour.

Expect some very ugly scenes, including spilt doses of this cheap, red liquid, blood.

Albania, already governed by the ungovernable crime gangs it spawned in the last few years, has formed an alliance with the KLA, never a moral standard-bearer.

This expanded amusement park of drug trafficking, prostitution, weapons smuggling, contraband and much worse is now threatening to take over its more virtuous (though by no means virginal) neighbour, Macedonia. A flare up of hitherto unimaginable brotherly love has indicated this sacrilegious rapprochement. The Macedonian Prime Minister - encumbered by a demanding Albanian coalition partner - has met Thaci and the encounter had all the trappings of a state visit. Soon after senior Albanian politicians started talking about a Macedonian recognition of an independent state of Kosovo and an Albanian language university (the reason for student riots just two years before).

To a large extent, the Kosovo war was a gang warfare.

The Serb criminal organization known as Yugoslavia against the Albanian gang known as the KLA. It was a war over turf and lucrative businesses. In what used to be the Third World and moroso in the post-communist countries in transition, criminal activities often accompany "wars of liberation". In Congo, in Sierra Leone, in Chechnya, in Kashmir - wars are as much about diamonds, oil and opium poppies as about national aspirations. Kosovo is no exception but it was here that the West was duped into intervention. NATO was called upon to arbitrate between two crime gangs. There is no end to the mischievous irony of history.

Perhaps the following incidents are more telling than any learned analysis: In late April, the Albanian telecom switched off the roaming facility of cell phones in Albania. Foreigners - including aid workers - had to pay the company 1000 dollars for a special roaming-enabled chip.

Rumour has it that the post of the Chief of Police in the Tirana Airport was "sold" at the beginning of April for an undisclosed amount (presumably 250,000 US dollars).

The reasons: all shippers (including NATO and aid organizations) have to pay enormous kickbacks to airport and customs officials to release their goods.

Most Albanian families charged refugee families an average of 500 DM a month for their accommodation in subhuman conditions. Refugees who could not pay (or who had no relatives in Germany and Switzerland to pay for them) were evicted, often cruelly.

As Serbs were murdering their supposed brothers in Kosovo, Albanian crime gangs laid an oil pipeline (through Lake Shkoder) to Serbia and supplied the Serb army with the oil it was deprived of by NATO.

Welcome to the Balkans.

LI. Milosevic's Treasure Island

Milosevic and his cronies stand accused of plundering Serbia's wealth - both pecuniary and natural. Yet, the media tends to confuse three modes of action with two diametrically opposed goals. There was state sanctioned capital flight. Gold and foreign exchange were smuggled out of Yugoslavia and deposited in other countries. This was meant to provide a cushion against embargo and sanctions imposed on Yugoslavia by the West.

The scale of these operations has been wildly over-estimated at 4 billion US dollars. A figure half as big is more reasonable. Most of the money was used legitimately, to finance the purchase of food, medicines, and energy products. Yugoslavia would have frozen to death had its leaders not have the foresight to act as they did.

This had nothing to do with party officials, cronies, and their family members enriching themselves by "diverting" export proceeds and commodities into private accounts in foreign lands. The culprits often disguised these acts of plunder as sanctions-busting operations. Hence the confusion.

Thirdly, members of the establishment and their relatives were allowed to run lucrative smuggling and black market operations fuelled by cheap credits coerced out of the dilapidated and politicised "banking" system.

As early as 1987, a network of off-shore bank accounts and holding companies was established by Serbia's Communist party and, later, by Yugoslavia. This frantic groping for alternatives reached a peak during 1989 and 1991 and after 1992 when accounts were opened in Cyprus, Israel, Greece, and Switzerland and virtually all major Yugoslav firms opened Cypriot subsidiaries or holding structures. Starting in 1991, the Central Bank's gold (and a small part of the foreign exchange reserves) were deposited in Switzerland (mainly in Zurich). A company by the name of "Metalurski Kombinat Smederevo - MKS" (renamed "Sartid" after its bogus privatisation) was instrumental in this through its MKS Zurich subsidiary. MKS was a giant complex of metal processing factories, headed by a former Minister of Industry and a Milosevic loyalist, Dusko Matkovic. The latter also served as deputy chairman of Milosevic's party.

The lines between party, state and personal fortunes blurred fast. Small banking institutions were established everywhere, even in London (the AY Bank) and conducted operations throughout the world. They were owned by bogus shareholders, out of the reach of the international sanctions regime.

When UN sanctions were imposed in stages (1992-5), the state made sure its export proceeds were out of harm's way and never in sanctions-bound UK and USA banks.

The main financial agent was "Beogradska Banka" and its branch in Novi Sad. In a series of complex transactions involving foreign exchange trades, smuggled privatisation proceeds, and inflated import invoices, it was able to stash away hundreds of millions of dollars. This money was used to finance imports and defray the exorbitant commissions, fees, and costs charged by numerous intermediaries. Yugoslavia (and the regime) had no choice - it was either that or starvation, freezing and explosive social discontent.

Concurrently, a massive and deeply criminalized web of smuggling, illegal (customs-exempt) imports, bribe and corruption has stifled all legal manufacturing and commerce activities. Cigarettes through Montenegro, alcohol and oil through Romania, petrol, other goods (finished and semi-finished) and raw materials from Greece through the Vardar river (Macedonia), absolutely everything through Croatia, drugs from Turkey (and Afghanistan). UN personnel happily colluded and collaborated - for a fee, of course. The export of commodities - such as grain or precious metals (gold, even Uranium) - was granted in monopoly to Milosevic stalwarts. These were vast fiefdoms controlled by a few prominent "families" and Milosevic favourites. It was also immensely lucrative. Even minor figures were able to deposit millions of US dollars in their Russian, Cypriot, Lebanese, Greek, Austrian, Swiss, and South African accounts. The regime leaned heavily on Yugoslav banks to finance these new rich with cheap, soft, and often non-returnable, credits. These were often used to speculate in the frenetic informal foreign exchange markets for immediate windfalls.

The new Yugoslav authorities are likely to be deeply frustrated and disappointed. Most of the money was expended on essentials for the population. The personal fortunes made are tiny by comparison and well-shielded in off-shore banking havens. Milosevic himself has almost nothing to his name. His son and daughter may constitute richer pickings but not by much. The hunt for the Milosevic treasure is bound to be an

expensive, futile undertaking.

LII. Macedonia's Augean Stables,

or: Don't Hurry to Invest in Macedonia

In the near past, Macedonia seemed to have been bent on breaking its own record of surrealism. While politicians in other countries in transition from communism and socialism strive to be noticed for not stealing, their Macedonian counterparts, without a single exception, aim to steal without being noticed.

The previous VMRO-DPMNE government (1999-2002), in which Nikola Gruevski, the current Prime Minister, served as Minister of Finance, plundered the country shamelessly. The local papers accused then outgoing prime minister, Ljubco Georgievski - a virtual pauper when he attained power - of owning land and a residential building in the capital's most expensive neighborhood.

The erstwhile Minister of Defense, Ljuben Paunovski, was recently sentenced to 42 months in prison for his pecuniary shenanigans during his tenure. Another leading figure, the former Minister of interior, Ljube Boskovski, is in the dock in the Hague on war crime charges.

Inevitably, VMRO-DPMNE lost power to the SDSM in the heated elections of 2002 and then fractured as its new leader, Gruevski, purged the old guard and installed his own cohorts everywhere.

Then prime minister designate, Branko Crvnkovski (the country's current President whose legitimacy is contested by the Gruevski government), vowed to learn from his party's (SDSM) past mistakes when they venally ruled the land until 1998. In a sudden and politically-motivated resurrection, the high court began scrutinizing the "Okta" deal: the opaque sale of the country's loss-making refinery to the Greeks in 1999. Heads will roll, promised both the election victors (the SDSM) and their Western sponsors.

Nothing happened.

The country's current Governor of the Central bank and then minister of finance, Petar Goshev, a former socialist high-level functionary known for his integrity, announced that his top priority would be to eradicate corruption by instituting structural and legal reforms. His newfound socialist partners - he headed a center-right outfit - found this bizarre ardor unpalatable and promptly kicked him out of office.

Four years later, with Georgievski relegated to the political wasteland, Crvnkovski ensconced in the presidential suite, and his successor, Buckovski a resounding failure, Gruevski's ascent in 2006 was all but secure. It was the SDSM's turn to crumble acrimoniously amid a virulent contest for its leadership. It has never recovered and Macedonia has had no viable opposition ever since.

Macedonia's post-electoral euphoria faded, in July 2006, into arduous coalition-building negotiations replete with arm-twisting by the worried representatives of the "international community".

The country's new VMRO-DPMNE Prime Minister, Nikola Gruevski (36), excluded from his government the party that won the majority of Albanian votes because of its roots in the much-hated Albanian NLA, National Liberation Army, the instigator of the 2001 near-civil-war.

Albanian factions clashed in a chilling reminder of the country's inter-ethnic fragility.

To add to Macedonia's precarious standing, its greenhorn Minister of Foreign Affairs, Antonio Milososki, engaged in intermittent - and utterly avoidable - spats with its neighbor and biggest foreign investor, Greece, virtually guarantee delayed accession to both NATO and the European Union, the much ballyhooed strategic goals of the current administration. Milososki adopted a similarly belligerent and ill-informed stance against Bulgaria, another flanking polity and the newest member of the coveted European club.

Where the government claims great strides is in its uncompromising stance against all forms of malfeasance and delinquency in both the public and the private sectors.

From the army to various municipalities, scandals erupt daily in an atmosphere often bordering on a frenzied, media saturated, witch-hunt.

Gruevski is alleged to have rejected a bribe of 3 million euros (c. 4 million USD) offered to him by a Serb firm.

His government embarked on highly publicized campaigns against illegal construction (the "urban mafia") and other festering nests of corruption.

Alas, Gruevski himself appointed members of his family and innumerable political hacks to senior government positions in a series of blatant acts of nepotism and cronyism decried by the European Union and other watchdogs. Consequently, with one exception (Zoran Stavreski, the talented vice-premier), the government in all echelons is largely made up of utterly inexperienced operators. Plus ca change.

Politics, venality, and terrorism are the sole venues of social mobility in this tiny, landlocked, country of 2 million impoverished people. Immediately following their insurgency, the former terrorists of the Albanian National Liberation - courtesy of Western pressure and the Albanian voters - occupied crucial ministries with lucrative opportunities of patronage of which they are rumored to have availed themselves abundantly.

Comic relief is often provided by bumbling NGOs, such as the International Crisis Group. In 2001, its representative in Macedonia, Edward Joseph, went to Prilep to conduct an impromptu investigation of the thriving cigarette smuggling trade. Posing to the cameras he declared that only the local leaf-rolling plant was not involved in this pernicious line of work.

Macedonia is a hub of expats and consultants in the Balkans. Ante Markovic, an Austria-based former Yugoslav prime minister, who served as an oft-criticized economic advisor to the government until he was dumped, sued Macedonia for \$1 million. In 2001-3, the youthful former minister of finance, Nikola Gruevski, was asked by USAID, on behalf of the Serbian-Montenegrin government, to serve as its consultant on matters of reform of the financial system. The author of this article acted as Economic Advisor to Georgievski's government and, later, to Gruevski himself.

But to no avail. The country is a shambles. In the wake of a civil war, the official unemployment rate is 31-35 percent. Close to 70,000 people work in the bloated central and local administrations. The trade deficit is an unparalleled 17 percent of GDP. In 2001, the budget deficit climbed to 5 percent, though it was since halved. "The Heritage Foundation" has consistently ranked Macedonia 95-97 out of 155 countries in terms of economic freedom. The country is "mostly unfree" it correctly concludes in its reports, though it cites sometimes erroneous data. A moderate level of trade protectionism, low tax rates, moderate inflation, a moderate burden of the government, moderate barriers to capital flows and foreign investment, and moderate interference in the economy are offset by a dysfunctional banking system, intervention in wages and prices, low level of protection of property, a high level of regulation, and a very high level of activity of the black market.

Owing to the IMF's misguided emphasis on exchange rate stability, the currency is inane overvalued. The manufacturing sector has all but evaporated. Industrial production declined by a vertiginous 20 percent in August 2002 compared to the average the year before - or by 11 percent year on year. The trend has not been reversed since.

Macedonian steel is exempt from the latest bout of American protectionism, but not so its textile industry.

Europe is fending off the country's agricultural products.

People make their meager and desultory living catering to the needs of an ever-expanding international presence or dabbling in illicit activities. Piracy of intellectual property, for instance, is thought to yield c. 1 percent of GDP.

Close to half the population is under the poverty line. The number of welfare cases increased by 70 percent between 1994 and 2002. Generous and incessant multilateral and bilateral credits sustain the faltering economy (and line politicians' ever-deepening pockets). The country is alternately buffeted by floods and droughts. There has been only one day of rain in all of January 2007.

In a much-touted donor conference after the 2001 skirmishes, the pledges amounted to a whopping 15 percent of GDP. Then governor of the central bank, Ljube Trpski (currently detained for his role in a murky affair involving the country's foreign exchange reserves), cheerfully predicted that these handouts will cover the gaping hole in the balance of payments.

Macedonia also received 7.5 percent of the gold reserves of the former federated Yugoslavia of which it was a component. At between \$700 million and one billion USD net, foreign exchange reserves are at an all-time high.

Macedonia has recently decided to prepay its \$104 million debt to the Paris Club creditors.

Both the IMF and the World Bank, who did their best to obstruct the previous VMRO-DPMNE government in its last few months in power, promised a speedy return to business as usual. An hitherto elusive standby arrangement is likely to be concluded by the end of the year. World Bank funds, frozen in material breach of its written contracts with the state, will flow again. The EU promised development funds if the new government acts in a "European spirit" - i.e., obeys the diktats of Brussels.

The incoming administration is likely to enjoy a period of grace with both the trade unions and international creditors. Strikes and demonstrations by dispossessed miners and underpaid railways workers have waned. But Macedonia joined the WTO in 2002 and will thus be forced to open even more to devastating competition.

Labor unrest is likely to re-erupt soon.

Foreign investment in the country mysteriously wanes and waxes - some of it laundered money reinvested in legitimate businesses. The government is doing a great job of building up the image of Macedonia as an FDI (Foreign Direct Investment) destination. But public relations and perceptions management must be followed by palpable actions and the new government is woefully short on concrete steps. It talks the talk but hitherto does not walk the walk.

The government's attempts to attract foreign investors by introducing lower taxes may backfire: studies clearly evince that multinationals worry less about taxation and more about functioning institutions, a commodity that Macedonia is irreparably short of. Moreover, vanishingly lower taxes signal desperation and Macedonia indeed sounds more desperate than confident. No one wants to buy the country's leading bank, long on offer. Only one contender (Mobilkom Austria) entered a bid for Macedonia's third operator cellular network licence.

On a few occasions, domestic firms, using international fronts, have bid for local factories, such as the textile plant "Astibo". The national payment card project has been guzzled by two banks incestuously close to the outgoing ruling party, VMRO-DPMNE.

But there are real investments, too. The capital's central heating utility was purchased by a unidentified French energy outfit, announced the general manager. The utility's shares were listed in the Athens stock exchange.

The Macedonian construction firm "Granit" will build a \$59 million highway in Ukraine, with which Macedonia enjoyed an unusually cordial relationship, to American chagrin. Johnson Controls and others are eyeing a string of free trade zones and infrastructure projects (dams, roads, railways, oil pipeline). A much hyped Vardar Silicone Valley is in the works.

The contentious census in the first two weeks of November 2002, a part of the "Ohrid Framework Agreement" which ended the internecine fighting the year before, was conducted fairly. The count showed that Albanians make c. one quarter of the population rather than one third, as most Albanians spuriously insisted.

But, with Kosovo's independence looming across the border, the restive Albanians are likely to coerce the enfeebled Macedonia into translating this numerical reality into political and economic clout. The Macedonians are likely to resist. The West will intervene.

Macedonia is facing a hot spring and a sizzling summer.

LIII. The Macedonian Lottery

Every conflict has its economic moments and dimensions.

The current conflict in Macedonia perhaps even more so.

The USA and its Western allies regard Macedonia as a bridge between Greece, Bulgaria, Serbia and Albania.

Hence the EU's plans for the revival of transport corridors 8 and 10 connecting these countries. If all goes well (and nothing has hitherto), railways will connect Bulgaria to Macedonia and river traffic will flow to Serbia from its southern neighbours. All this is envisioned in the Stability Pact. There are talks of an oil pipeline across Macedonia's territory. A pacified Macedonia is fairly crucial to Serbia's recovery and to the prospects of the whole region to attract FDI.

NATO is afraid of Turkish-Greek clashes in the aftermath of Kosovo and Macedonia. Turkey has increasingly cast itself in its ancient role of "protector of the Balkan Muslims". Greece is the only Orthodox-Christian member of the EU and an old foe of the erstwhile Sick Man of Europe from which it won bloody independence at the beginning of the 19th century. Such clashes are likely to destabilize the southern flank of NATO and block the West's access to Iraq, the Middle East, oil-rich Central Asia, and northern China. This will seriously dent the new "Pacific and Middle East Orientations" of the Bush Administration.

And what about the actual combatants? Albanians and Macedonian crime gangs (in cahoots with kleptocratic and venal local politicians) regard Macedonia as a vital route for drugs, stolen cars, smuggled cigarettes and soft drinks, illegal immigrants, white slavery, and weapons dealing. These criminal activities far outweigh the GDP of all the adversary states combined. This conflict is about controlling territory and the economic benefits attendant to such control.

Crime and war provide employment, status, regular income, perks, and livelihood to many denizens of Macedonia, Albania, and Bulgaria. They constitute an outlet for entrepreneurship, however perverted. Fighting for the cause and smuggling often means travel abroad (for instance, on fund raising missions), five star accommodation, and a lavish lifestyle. It also translates into powers of patronage and excesses of self-enrichment.

Moreover, in ossified, socially stratified, ethnically polarized, and economically impoverished societies, war and crime engender social mobility. The likes of Hashim Thaci, Ramush Harajdini, and Ali Ahmeti often start as rebels and end as part of the cosseted establishment. Many a criminal dabble in politics and business.

Hence the tenacity of both phenomena. Hence the bleak and pessimistic outlook for this region. The "formal" economies simply cannot compete. Jobs are not created, the educated are often bitterly idle, salaries are minuscule if paid at all, the future is past. Crime and politics (one and the same in the Balkan) are alluring alternatives.

Moreover, the NLA and its political successor DUI is not a monolithic entity. It is more like an umbrella organization with serious and fracturing differences of opinion regarding the ultimate goals of the insurrection four years ago (2001) and the means to obtain these goals.

Roughly, NLA was made up of one third veteran Kosovo fighters, some of them professional soldiers, who also fought in Croatia, or in the Foreign Legion. These people are bitter and disgruntled by what they see as the betrayal of the West in refusing to guarantee an independent Kosovo and the failure of the current Kosovar leadership to integrate them economically into the emerging polity there. Their motives for joining the fighting in Macedonia were part emotional and part pecuniary.

Another third was made of unemployed, young Albanians, mainly from Macedonia itself. Their fighting is self-interested. They get a monthly salary and perks and, lacking education and skills, they don't have much

of a choice outside the killing fields.

The rest are diehard, hardcore, idealists who either fervently espouse a Great Albania, or would like to take over Western Macedonian in a "constitutional coup" which will grant them their own police force, municipalities, institutions, universities, budgets, and semi-political structures.

The NLA itself was not directly involved in criminal activities, though a few of its members are. But the money that financed it (from the Czech Republic, Switzerland, Germany, and the USA) is tainted by drug dealing, white slavery, illegal immigration, and the smuggling of everything illicit, from cigarettes to stolen cars, to weapons. In this they collaborate with politicians and criminals in Macedonia - both Albanian and Macedonian.

Being a politician in the Balkan is an extremely lucrative proposition. Both Albanian and Macedonian politicians will abandon the peace process if they believe it leads to electoral ruin. Given the current atmosphere, it pays to be a pacifist. Virulent nationalism is a guaranteed vote loser. But every re-election ticket still requires a modicum of xenophobia, ethnic exclusivity, and radicalism. Here lies the future.

LIV. Crime Fighting Computer Systems and Databases

As crime globalizes, so does crime fighting. Mobsters, serial killers, and terrorists cross state lines and borders effortlessly, making use of the latest advances in mass media, public transportation, telecommunications, and computer networks. The police - there are 16,000 law enforcement agencies in the United States alone - is never very far behind.

Quotes from the official Web pages of some of these databases: National Center for the Analysis of Violent Crime (NCAVC) Its mission is to combine investigative and operational support functions, research, and training in order to provide assistance, without charge, to federal, state, local, and foreign law enforcement agencies investigating unusual or repetitive violent crimes. The NCAVC also provides support through expertise and consultation in non-violent matters such as national security, corruption, and white-collar crime investigations.

It comprises the Behavioral Analysis Unit (BAU), Child Abduction and Serial Murder Investigative Resources Center (CASMIRC), and Violent Criminal Apprehension Program (VICAP).

VICAP is a nationwide data information center designed to collect, collate, and analyze crimes of violence - specifically murder. It collates and analyzes the significant characteristics of all murders, and other violent offenses.

Homicide Investigation Tracking System (HITS) A program within the Washington state's Attorney General's Office that tracks and investigates homicides and rapes.

Violent Crime Linkage System (ViCLAS) Canada-wide computer system that assists specially trained investigators to identify serial crimes and criminals by focusing on the linkages that exist among crimes by the same offender. This system was developed by the RCMP (Royal Canadian Mounted Police) in the early 1990s.

UTAP, stands for The Utah Criminal Tracking and Analysis Project Gathers experts from forensic science, crime scene analysis, psychiatry and other fields to screen unsolved cases for local law enforcement agencies.

International Criminal Police Organization (ICPO) - Interpol's DNA Gateway Provides for the transfer of profile data between two or more countries and for the comparison of profiles that conform to Interpol standards in a centralized database.

Investigators can access the database via their Interpol National Central Bureau (NCB) using Interpol's secure global police communications system, I-24/7.

Interpol's I-24/7 Global communication system to connect its member countries and provide them with user-friendly access to police information. Using this system, Interpol National Central Bureaus (NCBs) can search and cross-check data in a matter of seconds, with direct and immediate access to databases containing critical information (ASF Nominal database of international criminals, electronic notices, stolen motor vehicles, stolen/lost/counterfeit travel and ID documents, stolen works of art, payment cards, fingerprints and photographs, a terrorism watch list, a DNA database, disaster victim identification, international weapons tracking and trafficking in human beings-related information, etc).

Interpol Fingerprints Provides information on the development and implementation of fingerprinting systems for the general public and international law enforcement entities.

Europol (European Union's criminal intelligence agency) Computer System (TECS) Member States can directly input data into the information system in compliance with their national procedures, and Europol can directly input data supplied by non EU Member States and third bodies. Also provides analyses and indexing services.

<http://www.atg.wa.gov/hits/index.shtml> <http://www.mass.gov/msp/unitpage/vicap.htm>
<http://www.fbi.gov/hq/isd/cirg/ncavc.htm> <http://www.rcmp.ca/techops/vicase.htm>
<http://www.justicejunction.com/innocence/ostianwing> [utap.htm](http://www.utah.gov/utap.htm)
<http://www.interpol.int/Public/ICPO/FactSheets/fsADN20> [0501.asp](http://www.interpol.int/Public/ICPO/FactSheets/i247.asp)
<http://www.interpol.int/Public/ICPO/FactSheets/i247.asp> <http://www.europol.eu.int/index.asp?page=facts>

T H E A U T H O R
S H M U E L (S A M) V A K N I N

Curriculum Vitae Click on blue text to access relevant web sites - thank you.

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Certified Financial Analyst by Brainbench.

Full proficiency in Hebrew and in English.

Business Experience 1980 to 1983 Founder and co-owner of a chain of computerised information kiosks in Tel-Aviv, Israel. 1982 to 1985 Senior positions with the Nessim D. Gaon Group of Companies in Geneva, Paris and New-York (NOGA and APROFIM SA): - Chief Analyst of Edible Commodities in the Group's Headquarters in Switzerland - Manager of the Research and Analysis Division - Manager of the Data Processing Division - Project Manager of the Nigerian Computerised Census - Vice President in charge of RND and Advanced Technologies - Vice President in charge of Sovereign Debt Financing 1985 to 1986 Represented Canadian Venture Capital Funds in Israel. 1986 to 1987 General Manager of IPE Ltd. in London. The firm financed international multi-lateral countertrade and leasing transactions. 1988 to 1990 Co-founder and Director of "Mikbats-Tesuah", a portfolio management firm based in Tel-Aviv.

Activities included large-scale portfolio management, underwriting, forex trading and general financial advisory services. 1990 to Present Freelance consultant to many of Israel's Blue-Chip firms, mainly on issues related to the capital markets in Israel, Canada, the UK and the USA.

Consultant to foreign RND ventures and to Governments on macro-economic matters.

Freelance journalist in various media in the United States.

1990 to 1995

President of the Israel chapter of the Professors World Peace Academy (PWPA) and (briefly) Israel representative of the "Washington Times".

1993 to 1994

Co-owner and Director of many business enterprises:

- The Omega and Energy Air-Conditioning Concern
- AVP Financial Consultants
- Handiman Legal Services

Total annual turnover of the group: 10 million USD.

Co-owner, Director and Finance Manager of COSTI Ltd. - Israel's largest computerised information vendor and developer. Raised funds through a series of private placements locally in the USA, Canada and London. 1993 to 1996 Publisher and Editor of a Capital Markets Newsletter distributed by subscription only to dozens of subscribers countrywide.

In a legal precedent in 1995 - studied in business schools and law faculties across Israel - was tried for his role in an attempted takeover of Israel's Agriculture Bank.

Was interned in the State School of Prison Wardens.

Managed the Central School Library, wrote, published and lectured on various occasions.

Managed the Internet and International News Department of an Israeli mass media group, "Ha-Tikshoret and Namer".

Assistant in the Law Faculty in Tel-Aviv University (to Prof. S.G. Shoham). 1996 to 1999 Financial consultant to leading businesses in Macedonia, Russia and the Czech Republic.

Economic commentator in "Nova Makedonija", "Dnevnik", "Makedonija Denes", "Izvestia", "Argumenti i Fakti", "The Middle East Times", "The New Presence", "Central Europe Review", and other periodicals, and in the economic programs on various channels of Macedonian Television.

Chief Lecturer in courses in Macedonia organised by the Agency of Privatization, by the Stock Exchange, and by the Ministry of Trade. 1999 to 2002 Economic Advisor to the Government of the Republic of Macedonia and to the Ministry of Finance. 2001 to 2003 Senior Business Correspondent for United Press International (UPI). 2007 Associate Editor, Global Politician Founding Analyst, The Analyst Network Contributing Writer, The American Chronicle Media Group Web and Journalistic Activities Author of extensive Web sites in: - Psychology ("Malignant Self Love") - An Open Directory Cool Site, - Philosophy ("Philosophical Musings"), - Economics and Geopolitics ("World in Conflict and Transition").

Owner of the Narcissistic Abuse Study List and the Abusive Relationships Newsletter (more than 6000 members).

Owner of the Economies in Conflict and Transition Study List , the Toxic Relationships Study List, and the Link and Factoid Study List.

Editor of mental health disorders and Central and Eastern Europe categories in various Web directories (Open Directory, Search Europe, Mentalhelp.net).

Editor of the Personality Disorders, Narcissistic Personality Disorder, the Verbal and Emotional Abuse, and the Spousal (Domestic) Abuse and Violence topics on Suite 101 and Bellaonline.

Columnist and commentator in "The New Presence", United Press International (UPI), InternetContent, eBookWeb, PopMatters, Global Politician, eBookNet.org, and "Central Europe Review".

Publications and Awards "Managing Investment Portfolios in States of Uncertainty", Limon Publishers, Tel-Aviv, 1988 "The Gambling Industry", Limon Publishers, Tel-Aviv, 1990 "Requesting My Loved One - Short Stories", Yedioth Aharonot, Tel-Aviv, 1997 "The Suffering of Being Kafka" (electronic book of Hebrew and English Short Fiction), Prague and Skopje, 1998-2004 "The Macedonian Economy at a Crossroads - On the Way to a Healthier Economy" (dialogues with Nikola Gruevski), Skopje, 1998 "The Exporters' Pocketbook", Ministry of Trade, Republic of Macedonia, Skopje, 1999 "Malignant Self Love - Narcissism Revisited", Narcissus Publications, Prague and Skopje, 1999-2007 (Read excerpts - [click here](#)) The Narcissism Series (e-books regarding relationships with abusive narcissists), Skopje, 1999-2007 "After the Rain - How the West Lost the East", Narcissus Publications in association with Central Europe Review/CEENMI, Prague and Skopje, 2000 Winner of numerous awards, among them Israel's Council of Culture and Art Prize for Maiden Prose (1997), The Rotary Club Award for Social Studies (1976), and the Bilateral Relations Studies Award of the American Embassy in Israel (1978).

Hundreds of professional articles in all fields of finances and the economy, and numerous articles dealing with geopolitical and political economic issues published in both print and Web periodicals in many countries.

Many appearances in the electronic media on subjects in philosophy and the sciences, and concerning economic matters.

Contact Details: palma@unet.com.mk My Web Sites: Economy / Politics: <http://ceeandbalkan.tripod.com/> Psychology: <http://samvak.tripod.com/index.html> Philosophy: <http://philosophos.tripod.com/> Poetry: <http://samvak.tripod.com/contents.html>

After the Rain

How the West Lost the East

The Book This is a series of articles written and published in 1996-2000 in Macedonia, in Russia, in Egypt and in the Czech Republic.

How the West lost the East. The economics, the politics, the geopolitics, the conspiracies, the corruption, the old and the new, the plough and the internet - it is all here, in colourful and provocative prose.

From "The Mind of Darkness": "'The Balkans' - I say - 'is the unconscious of the world'. People stop to digest this metaphor and then they nod enthusiastically. It is here that the repressed memories of history, its traumas and fears and images reside. It is here that the psychodynamics of humanity - the tectonic clash between Rome and Byzantium, West and East, Judeo- Christianity and Islam - is still easily discernible. We are seated at a New Year's dining table, loaded with a roasted pig and exotic salads. I, the Jew, only half foreign to this cradle of Slavonics. Four Serbs, five Macedonians. It is in the Balkans that all ethnic distinctions fail and it is here that they prevail anachronistically and atavistically.

Contradiction and change the only two fixtures of this tormented region. The women of the Balkan - buried under provocative mask-like make up, retro hairstyles and too narrow dresses. The men, clad in sepia colours, old fashioned suits and turn of the century moustaches. In the background there is the crying game that is Balkanian music: liturgy and folk and elegy combined. The smells are heavy with muskular perfumes. It is like time travel. It is like revisiting one's childhood."

LV. The Author

Sam Vaknin is the author of Malignant Self Love - Narcissism Revisited and After the Rain - How the West Lost the East. He is a columnist for Central Europe Review, PopMatters, and eBookWeb , a United Press International (UPI) Senior Business Correspondent, and the editor of mental health and Central East Europe categories in The Open Directory and Suite101 .

Until recently, he served as the Economic Advisor to the Government of Macedonia.

Visit Sam's Web site at <http://samvak.tripod.com>

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