Title: Crime and Corruption

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Release date: June 1, 2004 [EBook #5888]
Most recently updated: August 23, 2012

Language: English

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1st EDITION

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Editing and Design:
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Lidija Rangelovska
A Narcissus Publications Imprint, Skopje 2002

First published by United Press International UPI
Not for Sale! Non-commercial edition.

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ISBN: 9989-929-36-X

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REPUBLIC OF MACEDONIA

C O N T E N T S

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 Bondean secret agents.

The Kazakh prime minister, Imanghaliy Tasmaghambetov, freely admitted on April 4 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, 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 last 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 is 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, 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 ago 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 2-year old bill requires disclosure of donors to such funds but the House is busy loosening its provisions. "The Economist" listed lately 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 last September 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, 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.

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 behaviours 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 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 behaviour" 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 behaviours 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 southeastern 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.

Money Laundering in A Changed World 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 will make it much easier to smuggle cash out of Europe. A French parliamentary committee accuses 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, 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 tabled EU directive would force 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 last week 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 problems 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 the preferred venue of money laundering. September 11 may have retarded world civilization in more than one way.

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 Afganistan 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, Shaukut 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 Ghandi (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. A few months ago, 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.

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 fiancée 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): (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.

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. (b) 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. (c) 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. (d) 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. (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, 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: (a) 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. (b) 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. (c) 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.

(d) 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. (e) 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. (f) 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.

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 Reppublica, 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."

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."

The Typology of Financial Scandals

I. Overview Also published by United Press International (UPI) 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 o 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 intentsome 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.

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 Mercedesed, 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 Fausts 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.

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, 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 last month. A particularly egregious case - and signs of growing sophistication and coordinated action - is described in the July 1-8 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 last year - 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. Eighty seven attacks were reported during the first quarter of this year - up from 68 in the corresponding period last year. 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 to 17 last year - 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 last year - 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, 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 last year 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 recently 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 accused of 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 a decade 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 a recent 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. This January, 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 Comite 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 two 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 regions 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."

T H E A U T H O R

SHMUEL (SAM) VAKNIN

Curriculum Vitae
Click on blue text to access relevant web sites thank you.
Born in 1961 in Qiryat-Yam, Israel.
Served in the Israeli Defence Force (1979-1982) in training and education units.

Education
Graduated a few semesters in the Technion - Israel Institute of Technology, Haifa.
Ph.D. in Philosophy (major : Philosophy of Physics) - Pacific Western University, California.
Graduate of numerous courses in Finance Theory and International Trading.
Certified E-Commerce Concepts Analyst.
Certified in Psychological Counselling Techniques.
Full proficiency in Hebrew and in English.

Business Experience
1980 to 1983
Founder and co-owner of a chain of computerized 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 Groups Headquarters in Switzerland.
- Manager of the Research and Analysis Division
- Manager of the Data Processing Division
- Project Manager of The Nigerian Computerized 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
Free-lance consultant to many of Israels 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.
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. - Israels largest computerized 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.
Collaborated with the Agency of Transformation of Business with Social Capital.
Economic commentator in "Nova Makedonija", "Dnevnik", "Izvestia", "Argumenti i Fakti", "The Middle East Times", "Makedonija Denes", "The New Presence", "Central Europe Review" , and other periodicals and in the economic programs on various channels of Macedonian Television.
Chief Lecturer in courses organized by the Agency of Transformation,

by the Macedonian 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 present
Senior Business Correspondent for United Press International (UPI)
Web and Journalistic Activities
Author of extensive Websites 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 Announcement and Study List and the Narcissism Revisited mailing list (more than 3900 members)
Owner of the Economies in Conflict and Transition Study list.
Editor of mental health disorders and Central and Eastern Europe categories in web directories (Open Directory, Suite 101, Search Europe).
Columnist and commentator in "The New Presence", United Press International (UPI), InternetContent, eBookWeb 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 Macedonian Economy at a Crossroads - On the way to a Healthier Economy" (with Nikola Gruevski), Skopje, 1998
"Malignant Self Love - Narcissism Revisited", Narcissus Publications, Prague and Skopje, 1999, 2001, 2002
The Narcissism Series - e-books regarding relationships with abusive narcissists (Skopje, 1999-2002)
"The Exporters' Pocketbook", Ministry of Trade, Republic of Macedonia, Skopje, 1999
"The Suffering of Being Kafka" (electronic book of Hebrew Short Fiction, Prague, 1998)
"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 the Israeli Education Ministry Prize (Literature) 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.
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Return

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."

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 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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