

# WHITE-COLLAR CRIME AND MAJOR FINANCIAL DEBACLES IN THE UNITED STATES

*Henry N. Pontell, Ph.D.\**



## I. INTRODUCTION

Until rather recently, many persons around the world have not been very comfortable with the term white-collar crime. It often has been a designation that arouses great controversy. Following its introduction by the American sociologist Edwin Sutherland<sup>1</sup> more than sixty years ago, social scientists began to debate its usefulness as a criminological concept. Sociologist/lawyer Paul Tappan, for example, called the term loose, derogatory, and doctrinaire, and argued that criminologists should confine themselves to the study of those adjudicated by the legal system and found guilty of a particular offence. He argued further, "White collar crime is the conduct of one who wears a white collar who indulges in occupational behaviour to which some particular criminologist takes exception".<sup>2</sup> Not relying on the criminal justice system to determine criminality, he claimed, would allow value judgments to dominate social inquiry on the topic.

Sutherland responded to this charge by emphasizing that if studies were grounded in the well-documented biases of the criminal justice system, researchers would lose all claims to science. More recently, Gilbert Geis notes, "Sutherland got much the better of the debate by arguing that it was what the person had actually done in terms of the mandate of the... law, not on how the criminal justice system responded to what they had done, that was essential to whether they should be regarded as criminal offenders".<sup>3</sup>

Today, there is little debate regarding the existence of various forms of white-collar crime, and the fact that they can cause widespread harm and loss. There remains, however, considerable disagreement regarding the role of such economic crimes in major financial debacles that have occurred in recent years in the U.S. This current controversy reaches far beyond traditional criminological and law enforcement concerns, and entails fundamental questions of finance, economics, politics, law making, as well as the interplay among them. The stakes in this debate are quite high; the sheer scales of such crises have far-reaching consequences that transcend national boundaries and affect economic conditions worldwide.

The "fraud minimalist" position, influenced by ideas from the law and economics literature on corporate governance theory, represents one side of this question. Beginning in the 1930s, its emphasis was on the separation of ownership and control in publicly traded corporations to avoid exploitation of shareholders by officers.<sup>4</sup> It has since been replaced by a new-old paradigm<sup>5</sup> that sees market mechanisms combining to act as an "invisible hand" that purportedly brings harmony to the interests of investors and officers by providing natural governance provisions that are "optimal for society".<sup>6</sup>

---

\* Professor, Department of Criminology, Law and Society, School of Social Ecology, University of California, Irvine, California, United States.

<sup>1</sup> Sutherland, Edwin H. "Is 'White-Collar Crime' Crime?" *American Sociological Review* 10, 1945: 132-39.

<sup>2</sup> Tappan, Paul W. "Who is the Criminal?" *American Sociological Review* 12, 1947: 99.

<sup>3</sup> Geis, Gilbert, "White-Collar Crime: *What Is It?*" In *White-Collar Crime Reconsidered*, edited by Kip Schlegel and David Weisburd. Boston: Northeastern University Press, 1992: 36.

<sup>4</sup> Berle, Adolf, and Gardiner Means. *The Modern Corporation and Private Property*. New York: Macmillan, 1932.

<sup>5</sup> Smith, Adam. *An Inquiry Into the Nature and Causes of the Wealth of Nations* (7<sup>th</sup> Edition). London: A. Strahan and T. Cadell, 1793.

<sup>6</sup> Easterbrook, Frank H., and Daniel R. Fischel. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991: 4, Black, William K., "Reexamining the Law-and-Economics Theory of Corporate Governance," *Challenge* 46: 2, March/April, 2003: 23.

This “free market” law and economics movement, influenced by the work of Frank Easterbrook and Daniel Fischel, trivializes the notion of fraud, as the markets, it is claimed, can readily identify and correct fraud. In fact, it goes so far as to declare that the markets are so successful in accomplishing this that “a rule against fraud is not an essential or even necessarily an important ingredient of securities markets”.<sup>7</sup>

This corporate governance framework not only denies that there is any significant degree of fraud in economic markets, but accounts for major financial scandals, when they do occur, in terms of larger structural disorders, mismanagement and incompetence, government and regulatory interference, overzealous enforcement efforts, and the “risky business” that is a natural feature of free markets.<sup>8</sup>

This view stands in direct opposition to the major tenets of almost all white-collar and corporate crime theorizing and research conducted over the past fifty years. Such research focuses largely on organizational structures that prevent or encourage fraud, motivational mechanisms, regulatory regimes, criminogenic industry environments, inadequate laws, enforcement capacity, and the like.<sup>9</sup> Wheeler and Rothman’s classic conceptualization of the “organization as weapon”, for example, emphasizes that *organizations* can become *vehicles for fraud*, and that insiders in control may use a company as both a sword and a shield.<sup>10</sup> Acting as a sword, an organization can steal from another entity. As a shield, it can use its resources and legitimacy to avert detection and negative sanctions. In other words, those who run organizations can effectively neutralize both internal and external controls and thus optimize the firm for fraud.<sup>11</sup> When such “control frauds,” or frauds perpetrated by controlling insiders exist in organizations with large assets, the results can be devastating.

For a number of reasons it is important to examine the question of how much fraud - especially control fraud - has played a role in producing the enormous losses in recent financial debacles in the United States. First, and perhaps foremost, assessing the role of fraud accurately portrays history without political or ideological colourings. Identifying the significance of fraud can also inform theories regarding both corporate crime and corporate governance. For another, acknowledging the role of fraud is essential for effective policymaking, law enforcement responses, and the prevention of future abuses.

This paper addresses the question of the significance of fraud by presenting both fraud minimalist and criminological explanations of two major debacles that represent unprecedented financial failures in the United States. They are the 1980s savings and loan crisis, which at the time produced the largest single industry failure in history, and the recent corporate and accounting scandals which have set a new record for monetary losses and have affected financial markets worldwide.

## II. THE SAVINGS AND LOAN CRISIS

### A. A Brief History of the Industry and Conditions Leading to the Crisis

The federally insured savings and loan system was created in the 1930s, primarily to encourage the construction and sale of new homes during the Great Depression and to protect savings institutions from the kind of disaster that followed the collapse of the American economy in 1929. The Federal Home Loan Bank Act of 1932<sup>12</sup> established the Federal Home Loan Bank Board, designed to provide a credit system to ensure the availability of mortgage money for home financing and to oversee federally chartered savings and loans (S&Ls, also known as “thrifts”). Two years later, the National Housing Act<sup>13</sup> created the Federal Savings and Loan Insurance Corporation (FSLIC) to insure thrift deposits. Until the broad reforms enacted by the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Federal Home Loan Bank Board was the primary regulatory agency responsible for federally chartered savings and loans.

---

<sup>7</sup> Easterbrook and Fischel, *op. cit.*, p. 283.

<sup>8</sup> *Ibid.*

<sup>9</sup> For an excellent review of such research, see Simpson, Sally S., and Nicole Leeper Piquero, “Low Self-Control, Organizational Theory, and Corporate Crime.” *Law and Society Review* 36: 3, 2002: 509.

<sup>10</sup> Wheeler, Stanton and Mitchell Lewis Rothman. “The Organization as Weapon in White Collar Crime.” *Michigan Law Review* 80, 1982: 1405.

<sup>11</sup> Black, *op. cit.*, p. 24.

<sup>12</sup> 12 U.S.C. 1421 et seq.

<sup>13</sup> 12 U.S.C. 1724 et seq.

Economic conditions of the 1970s substantially undermined the health of the S&L industry and contributed to the dismantling of the traditional boundaries within which they had operated for decades. Perhaps most important, high interest rates and slow growth squeezed the industry at both ends. Locked into low-interest mortgages from previous eras, prohibited by regulation from paying more than 5.5 percent interest on new deposits, and with inflation reaching 13.3 percent by 1979, the industry suffered steep losses. As inflation outpaced the small return on their deposits, thrifts found it increasingly difficult to attract new funds.

Along with these economic forces a new ideological era had begun. Though policymakers had been considering further loosening the restraints on savings and loans since the early 1970s, it was not until the deregulatory fervour of the Reagan administration years that this approach gained widespread support as a "solution" to the thrift crisis. Policymakers dismantled most of the regulatory infrastructure that had held the industry together for over 40 years.<sup>14</sup> The deregulators were convinced that the free enterprise system worked best when left alone, unhampered by perhaps well-meaning but ultimately counterproductive government regulations. In 1980 the Depository Institutions Deregulation and Monetary Control Act<sup>15</sup> phased out restrictions on interest rates paid by savings and loans. At the same time, in a move that seemed to contradict a free market ideology, the law increased FSLIC deposit insurance (and correspondingly, the government's risk) from a maximum of \$40,000 to \$100,000 per individual account.

In 1982, the Garn-St. Germain Depository Institutions Act<sup>16</sup> accelerated the phase out on interest rate ceilings initiated in 1980. More importantly, however, it expanded the investment powers of thrifts, authorizing them to make consumer loans up to a total of 30 percent of their assets; make commercial, corporate, or business loans; and invest in non-residential real estate worth up to 40 percent of their assets. The new law also allowed for 100 percent financing, which required no down payment from the borrower. Federal regulators also dropped the requirement that thrifts have at least 400 stockholders, which allowed for a single entrepreneur to own and operate a federally insured savings and loan.

Federal and state governments - whose state-chartered thrifts' deposits were, by and large, insured by federal funds - had created an industry environment that encouraged lawbreaking. Martin Mayer, former member of the President's Commission on Housing under the Reagan administration, describes these deregulatory years:

What happened to create the disgusting and expensive spectacle of a diseased industry was that the government confronted with a difficult problem, found a false solution that made the problem worse. This false solution then acquired a supportive constituency that remained vigorous and effective for almost five years after everybody with the slightest expertise in the subject knew that terrible things were happening everywhere. Some of the supporters were true believers, some were simply lazy, and most were making money - lots of money - from the government's mistake.<sup>17</sup>

## **B. The Crimes**

The S&L crisis eventually cost American Taxpayers over \$150 billion.<sup>18</sup> Numerous accounts of crime, especially expensive insider or control frauds, were brought to light in media accounts, government hearings and reports, and academic research. According to the most authoritative criminological studies, three major categories of white-collar crime contributed to the savings and loan debacle; *unlawful risk-taking*, *collective embezzlement*, and covering up.<sup>19</sup> Unlawful risk-taking involved what some have termed "gambling for resurrection" whereby thrift owners struggled to turn their institutions around and make them profitable again. In the case of unlawful risk taking they broke the law while doing so. Examples included violations of

---

<sup>14</sup> Mayer, Martin, *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry*. New York: Charles Scribner's Sons, 1990.

<sup>15</sup> Pub.L. 96-221.

<sup>16</sup> Pub. L. 97-320.

<sup>17</sup> Mayer, op. cit., p. 8.

<sup>18</sup> Pontell, Henry N., Calavita, Kitty and Robert Tillman. "Fraud in the Savings and Loan Industry: White-Collar Crime and Government Response". Grant #90-IJ-CX-0059, National Institute of Justice, Office of Justice Programs, U.S. Department of Justice, October, 1994.

<sup>19</sup> Ibid.

loans-to-one borrower limits, inadequate or sometimes non-existent underwriting of loans, and other unsafe practices that were illegal. Collective embezzlement, or “looting” entailed the siphoning off of funds for personal gain. This self-interested fraud has been shown to be the most costly category of thrift crime. As one high-ranking government official has noted, “*The best way to rob a bank is to own one*”.<sup>20</sup> Unlike traditional embezzlement, which is usually committed by a low level employee,<sup>21</sup> collective embezzlement is perpetrated by those in charge of the organization. It is a crime by the organization *against* the organization, which, in the case of thrifts, was made possible in part by government insured deposits, lax regulation, and transactions that involved other peoples’ money. The real (as opposed to formal) goals of management were to provide owners and insiders with a personal money machine. It is a prime example of what Wheeler and Rothman have referred to as the “organization as weapon”, whereby the thrift was merely a tool to steal money, just as a knife or gun would be used by a common criminal. The principal difference here was that the organization was both weapon and victim, as the crime was also against the organization’s best interest in the long run, and would eventually lead to financial ruin through insolvency. The third major category of thrift fraud, *covering up*, involved attempts to hide both the thrift’s insolvency from regulators, and the fraudulent transactions that led to the insolvency. File stuffing was one common form of covering up whereby false post-dated documents were put into files to deceive regulators regarding the underwriting and status of loans as well as other business transactions.<sup>22</sup> This manipulation of books and records was also made possible by accounting schemes that misrepresented the true financial health of the institution.

These basic categories of insider economic crimes were pervasive during the thrift crisis, and as will be shown, also surfaced in the recent corporate and accounting scandals in the United States. Together, these crimes can be seen as part of a more general category of what has recently been labelled “control fraud”. Control frauds involve major economic crimes for personal gain that are committed by controlling insiders of large organizations.

### C. The Report of the National Commission

In 1993 The National Commission of Financial Institution Reform, Recovery and Enforcement issued its report to the President and Congress entitled “Origins and Causes of the S&L Debacle: A Blueprint for Reform.”<sup>23</sup> The Report analyzed the history of the crisis, documenting the collapse of the S&L industry, and makes numerous policy recommendations. The Report noted the perverse incentives of the time, and the role of government insured deposits that presented severe moral hazard during the crisis, but at the same time notes that such moral hazard may exist in situations without deposit insurance.

“‘Moral hazard’ — that is, adverse incentive — can exist even when deposit insurance is absent, because with limited liability, borrowers obtain the gains while losses are shared with lenders. Private, uninsured creditors handle the problem by insisting that borrowers have a substantial equity stake to lose (i.e., they impose net worth standards)...With deposit insurance, private creditors (depositors) have no obvious incentive to impose discipline. Instead the burden is shifted to the government, which is why the latter must regulate and examine insured institutions.”<sup>24</sup>

<sup>20</sup> United States Congress, House, Committee on Government Operations, *Combating Fraud, Abuse and Misconduct in the Nation’s Financial Institutions: Current Federal Reports are Inadequate*. 72<sup>nd</sup> report, 13 October, 1989.

<sup>21</sup> Calavita, Kitty and Henry N. Pontell, “Other People’s Money Revisited: Collective Embezzlement in the Savings and Loan and Insurance Industries.” *Social Problems* 38 (1) February, 1991: 94-112. In discussing various forms of white-collar crime, Sutherland noted, “the ordinary case of embezzlement is a crime by a single individual in a subordinate position against a strong corporation.” (Sutherland, Edwin H. *White-Collar Crime*. New York: Dryden, 1949.) In contrast, collective embezzlement represents the siphoning off of funds from an institution by that institution’s top management. Different from the traditional embezzlers described by both Sutherland and Cressey, those who perpetrate collective embezzlement are not lone lower-level employees but institutions’ owners and operators, acting within networks of co-conspirators inside and outside the institution. See Cressey, Donald R. *Other People’s Money: A Study of the Social Psychology of Embezzlement*. Glencoe, IL: Free Press, 1953.

<sup>22</sup> U.S. General Accounting Office. *Thrift Failures: Costly Failures Resulted From Regulatory Violations and Unsafe Practices: Report to Congress*. GAO/AFMD-89-62. Washington, D.C.: Government Printing Office, June, 1989, p. 21.

<sup>23</sup> National Commission of Financial Institution Reform, Recovery and Enforcement (NCFIRRE). *Origins and Causes of the S&L Debacle: A Blueprint for Reform*. A Report to the President and Congress of the United States, Washington, D.C: Government Printing Office, 1993.

<sup>24</sup> *Ibid.*, p. 62.

The Commission also related how the perverse environment within which thrifts operated could encourage fraud and lawbreaking, noting that “*fraud and misconduct were important elements in the S&L debacle*” (emphasis added).<sup>25</sup> The report goes on to note:

“The S&Ls were tempting vehicles for abuses and fraud, greatly increasing the risk of losses from those sources. Insured deposits combined with non-existent net worth requirements allowed massive growth to keep Ponzi-schemes going and to maintain access to additional sums to prevent collapse. Cash could be easily withdrawn from an institution either directly through salaries, bonuses, perks, and dividends, or indirectly through nominee loans, kickbacks, and other devices. Moreover, S&Ls were cheap to acquire. It was easy to get approval to control the entity and easy to dominate it. The regulatory laxity introduced as a part of forbearance provided the ideal fraud environment. It allowed the fraudulent to report financial strength and disguise losses while S&Ls were being looted. It required no financial risk from those engaged in the fraud, and offered little chance of fraud being discovered, proved, and punished.”<sup>26</sup>

The Report concluded that the incidence of fraud was high among insolvent institutions, or those that were taken over by the government. “For example the GAO studied 26 S&Ls that failed from 1985 to 1987, and which accounted for about 60 percent of the FSLIC’s estimated losses....While the GAO found few cases of fraud and insider abuse in solvent institutions, it found evidence of fraud and insider abuse in every failed S&L...”<sup>27</sup> The report then, and in fact quite mysteriously, goes on to note that fraud did not necessarily cause the failures of thrifts, and explains other potential sources of insolvency. It arrives at a figure of 10-15% of total net losses due to fraud, without explanation, or any specific data to back up this estimate. For some reason that is not explained in the Report itself, it appears that this figure is quite low, and may in fact represent a compromise between those on both sides of the material fraud debate. The report simply explains the low estimate in the following way:

“The high incidence of fraud among failed institutions does not imply that fraud caused the failures or even contributed greatly to them. There were many other sources of failure. Estimates of the dollar losses due to fraud and misconduct differ widely - in part because the terms mean different things to different investigators, and because it is hard to measure the role of fraud, however defined, as distinct from other causes that were at work. These estimates range from a low of 3 percent to a high of 33 percent of total losses. While strong methodological reasons favour discounting the low estimate, the Commission cannot determine with precision actual losses due to fraud. We are convinced, however, that taxpayer losses due to fraud were large, probably amounting to 10 to 15 percent of total net losses. While losses of this magnitude are significant, it is important to realize that fraud was not a cause of the S & L debacle.”<sup>28</sup>

The Report may be correct in that fraud did not cause the debacle, but the question remains as to its role in causing the massive losses that resulted. A dissenting view by Commissioner Elliot H. Levitas followed, which noted that he felt strongly enough, based on the evidence presented to the Commission, that fraud played a much larger role than stated in the Report.

“While I realize some Commissioners believe to the contrary, I believe the effect of fraud and abuse, or, more generally, misconduct is understated in the Report. There is reason to suspect the indirect losses from misconduct are greater than the 15 percent stated in the Report. A GAO study of 26 failed S & Ls “found evidence of fraud and insider abuse in each and every [one]”. The Report states further that: “[o]ther case studies have found a similar high incidence of fraud and abuse among failed S & Ls.” Therefore it is highly likely that the impact of misconduct goes far beyond the direct financial losses attributed to it. The coincidence of misconduct and failure is startling. The impact of the wrongdoers was likely pervasive. Most S&L managers resisted the temptations, but where the bad actors did their mischief, financial ruin seems to have resulted. That a number of excuses have been presented as to why more criminal charges were not brought (e.g., regulators and prosecutors were unqualified and inadequately staffed, and the S & Ls had top legal talent and the crooks did not look like hooligans) is

---

<sup>25</sup> *Ibid.*, p. 70.

<sup>26</sup> *Ibid.*, p. 69.

<sup>27</sup> *Ibid.*, p. 70.

<sup>28</sup> *Ibid.*, p. 70-71.

even more reason to believe that the amount of fraud and abuse is underestimated. Just because a criminal is not caught does not mean that a crime has not been committed (emphasis added).”<sup>29</sup>

This last sentence harkens back to the yet seemingly unresolved debate engaged in by Sutherland and Tappan over a half-century ago that was mentioned earlier.

#### **D. The Debate over the Significance of Fraud in the S&L Debacle**

Much of the fraud minimalist position regarding the S&L crisis maintains that moral hazard, brought on by economic circumstances and government deposit insurance combined with ineffective regulation, led thrift owners to (legally) take risks and gamble for resurrection. The central issue is not actual criminal adjudication, but of *the intent* of those involved in the complex financial deals that led to insolvent thrifts. Even if fraud minimalists concede that criminal adjudication provides an erroneous measure of the true extent of thrift fraud, they still maintain that the deals that thrifts entered into and which caused mass insolvency and losses in the industry do not necessarily represent fraud. Rather, they were behaviours by honest thrift owners acting as rational economic persons faced with extreme moral hazard who desperately gambled in a vain attempt to save their institutions. The “gambling for resurrection” model represents the conventional economic wisdom regarding the catastrophic losses resulting from the S&L crisis, and in large part, the official history of the debacle.

The general argument that fraud did not cause the economic or regulatory environments within which the debacle occurred is well taken. The economic environment resulted largely from social structural forces, while the regulatory environment was due to a mix of political ideology, heavy lobbying by the thrift industry, and disastrous public policy choices based on the prevailing politics and economic wisdom of the era. None of this necessarily implies, however, as fraud minimalists have argued, that fraud, and more specifically, control fraud, did not play a significant role in producing catastrophic failure in the industry. On the contrary, there is much evidence that shows that ineffective regulatory policies that ignored the potential for control fraud allowed it to proliferate and concentrate in the particular institutions that underwent massive insolvencies during the crisis.

Numerous accounts of massive control frauds appeared in media accounts, government hearings and reports, and academic research. The major federally funded study on S&L fraud and the response of the government to the ensuing debacle concluded, among other things, that fraud played a material role in the crisis, that government agencies were swamped with cases, and that significant amounts of fraud would remain undetected.<sup>30</sup> Some have gone so far to claim, that the financial losses directly attributable to white-collar crimes that were discovered and recorded in official statistics represent only “the tip of the iceberg”.<sup>31</sup>

Finally, some government reports estimated that fraud played a central role in 70-80 percent of all thrift failures.<sup>32</sup> A study by Nobel economist George Akerlof and his colleague, Paul Romer<sup>33</sup> found that deliberate insider looting of institutions accounted for 21 percent of government resolution costs, and that this was “likely to be an underestimate”. Some regulators claimed that when indirect and direct costs of S&L fraud were considered that they would add up to virtually 100 percent of resolution costs.<sup>34</sup>

<sup>29</sup> *Ibid.*, p. 86.

<sup>30</sup> Pontell, Henry N., Calavita, Kitty and Robert Tillman. “Fraud in the Savings and Loan Industry”, *op. cit.*; Calavita, Kitty, Pontell, Henry N. and Robert Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis*. Berkeley: University of California Press, 1997. One high-ranking official put the enforcement response to the S&L crisis in particularly graphic terms when he compared the financial damage to a major environmental disaster, too enormous to be cleaned up effectively: “I feel like it’s the Alaskan oil spill. I feel like I’m out here with a roll of paper towels. The task is so huge, and what I’m worrying about is where can I get some more paper towels? I stand out there with my roll and I look at a sea of oil coming at me, and it’s so colossal!” Quoted in Pontell, Henry N., Calavita, Kitty and Robert Tillman, “Corporate Crime and Criminal Justice System Capacity: Government Response to Financial Institution Fraud.” *Justice Quarterly* 11, September, 1994: 400.

<sup>31</sup> Rosoff, Stephen M., Pontell, Henry N., and Robert Tillman, *Profit Without Honor: White-Collar Crime and the Looting of America* (Second edition). Upper Saddle River, NJ: Prentice Hall, 2002: 279.

<sup>32</sup> U.S. General Accounting Office, 1989, *op. cit.*

<sup>33</sup> Akerlof, George A., and Paul M. Romer, “Looting: The Economic Underworld of Bankruptcy for Profit.” *Brookings Papers on Economic Activity* 2, 1993: 1-73.

<sup>34</sup> Personal interview.

In contrast to these views regarding the role of material fraud in the S&L debacle, others claim that fraud costs were minimal, exaggerated by the press, enforcement personnel, and others who were looking to find scapegoats for the government's own mishandling of the problems that beset the industry. Made up mostly of economists and thrift industry consultants, this group of individuals claim that fraud did not play a material role in the crisis, and that it had only minor effects. Factors such as falling oil prices, the collapse of the Texas real estate market, and excessive risk taking and mismanagement were the primary sources of insolvencies and the resulting costs to government and taxpayers.<sup>35</sup> Noted economist Lawrence White devotes less than three pages of his book on the crisis to fraud and crime, and claims that the "fraud factor" was greatly exaggerated in popular depictions. His argument, unsupported by any in-depth analysis of quantitative data, reflects the conventional economic wisdom on the subject.

*The bulk of the insolvent thrifts' problems...did not stem from...fraudulent or criminal activities. These thrifts largely failed because of an amalgam of deliberately high-risk strategies, poor business judgments... excessive optimism, and sloppy and careless underwriting, compounded by deteriorating real estate markets*<sup>36</sup> (emphasis in the original).

Other researchers, however, found that the variety of criminal activity uncovered in the S&L debacle was seemingly endless. These researchers employed not only historical evidence, but qualitative and quantitative data, criminological concepts and theories, and scientific reasoning based upon patterns of insolvency and financial loss in order to examine the nature, extent, and role of fraud in the debacle. The most costly form of control fraud they discovered, and one that was previously not recognized by legal and criminological scholars was "collective embezzlement".<sup>37</sup> Such embezzlement ranges from an outright looting of an institution's cash or other resources to business practices where the sole purpose is the generation of personal profits for management, despite the negative effect on the health of the organization. One way embezzlers robbed their own banks was to go on "shopping sprees" with thrift funds.<sup>38</sup> Thrift operators around the country spent huge sums on personal luxuries,<sup>39</sup> throwing lavish parties, travelling around the world in private jets, and buying expensive antiques, cars and yachts. Less outright forms of embezzlement included schemes to obtain excessive compensation for directors and officers.<sup>40</sup> Transactions were fabricated in order to receive fees and commissions; profits were inflated to extract additional dividends.<sup>41</sup>

An empirically based study<sup>42</sup> of 686 failed thrifts analyzing federal data on organizational characteristics and criminal referrals found that various S&L practices were significantly related to levels of fraud, and not

---

<sup>35</sup> See Ely, Bert, "Crime Accounts for Only 3% of the Cost of the S&L Mess." Unpublished report, 1990; White, Lawrence J., *The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation*. New York: Oxford University Press, 1991.

<sup>36</sup> White, *op. cit.*, p. 117.

<sup>37</sup> Calavita, Kitty and Henry N. Pontell, "Other People's Money Revisited," *op. cit.*

<sup>38</sup> Pizzo, Stephen, Frocker, Mary, and Paul Muolo, *Inside Job: The Looting of America's Savings and Loans*. New York: McGraw Hill, 1989: 36.

<sup>39</sup> U.S. General Accounting Office, 1989, *op. cit.*; Mayer, Martin, *The Greatest-Ever Bank Robbery*, *op. cit.*; Pizzo et al., 1989, *op. cit.*

<sup>40</sup> U.S. General Accounting Office, 1989, *op. cit.*, p. 21.

<sup>41</sup> Another important distinction, and one which leads to the importance of recognizing control fraud as a new and insidious phenomenon brought into play by the perverse economic incentives present during the S&L crisis, is that previous studies have differentiated between corporate crime, in which the corporation perpetrates fraud on its own behalf, and embezzlement, in which crime is committed against the corporation. Wheeler and Rothman (*op. cit.*) note that "[e]ither the individual gains at the organization's expense, as in embezzlement, or the organization profits regardless of individual advantage, as in price-fixing". Similarly, Coleman argues, "The distinction between organizational crimes committed with the support from an organization that is, at least in part, furthering its own ends, and occupational crimes committed for the benefit of individual criminals without organizational support, provides an especially powerful way of classifying different kinds of white-collar crime" (Coleman, James William, "Toward an Integrated Theory of White-Collar Crime." *American Journal of Sociology* 93, 1987: 407). These categories neglect, however, the possibility of organizational crime in which the *organization is a vehicle for perpetrating crime against itself*, as in the case of savings and loan fraud (and the more recent corporate scandals). Collective embezzlement in the thrift industry used organizational support to loot the organization. It thus represents a hybrid: "crime by the corporation *against* the corporation". The incentives for such crime were greatly heightened during the S&L crisis (Calavita and Pontell, 1991, *op. cit.*).

<sup>42</sup> Tillman, Robert, and Henry N. Pontell, "Organizations and Fraud in the Savings and Loan Industry." *Social Forces* 73 (4) June, 1995: 1439-1463.

merely to insolvency. This study suggested that many of the factors shown in previous research to have been linked to insolvency<sup>43</sup> were also predictive of *criminality* in failed institutions.<sup>44</sup> Practices such as direct investments and high asset growth, for example, were found not only to be indicators of “reckless and sloppy management”, as they have frequently been described in the S&L literature,<sup>45</sup> but also to be related to fraudulent schemes that ultimately led to the downfall of the institutions. The study notes “[F]or those observers who see mismanagement, declining regional economies, deposit insurance, and faulty regulatory schemes at the root of the S&L crisis, and who assign little significance to fraud and misconduct<sup>46</sup> the study findings suggest at a minimum that these two sets of factors cannot be separated so easily”.<sup>47</sup>

The study also notes that the conventional economic wisdom of characterizing practices such as taking in large amounts of brokered deposits or making large numbers of direct investments as “reckless” implies a lack of attention (and rationality) by the organizational insiders who do such things. The study concludes that these practices were often the *mechanisms* by which control frauds were perpetrated, and that perpetrators were well aware of this. Indeed, they profited greatly from such practices while having little if any concern for the long-term survival of the financial institution, which served, in Wheeler and Rothman’s terms as a tool, or “weapon” in the commission of their crimes.<sup>48</sup> *S&Ls were ideal vehicles for the commission of fraud and insider looting.*<sup>49</sup>

Finally, another study<sup>50</sup> takes the issue one step further by testing three rival hypotheses to account for the catastrophic losses in the S&L crisis. Two of the hypotheses are based explicitly on the fraud minimalist arguments of excessive risk taking (“gambling for resurrection”) influenced by moral hazard, and

<sup>43</sup> Barth, James, *The Great Savings and Loan Debacle*. Washington, D.C.: American Enterprise Institute, 1991; National Commission of Financial Institution Reform, Recovery and Enforcement (NCFIRRE). *Origins and Causes of the S&L Debacle: A Blueprint for Reform*. A Report to the President and Congress of the United States, Washington, D.C: Government Printing Office, 1993.

<sup>44</sup> *Ibid.*, p.1458.

<sup>45</sup> Lowy, Martin, *High Rollers: Inside the Savings and Loan Debacle*. New York: Praeger, 1991: 100-11; White, 1991, *op. cit.*, p.117.

<sup>46</sup> Congressional Budget Office, *The Economic Effects of the Savings and Loan Crisis*. Washington, D.C.: U.S. Government Printing Office, 1992; Kane, Edward, “The Savings and Loan Insurance Mess”. *Society* 29, 1992: 4-10; White, 1991, *op. cit.*

<sup>47</sup> Tillman and Pontell, 1995, *op. cit.*, p. 1458. The results of this study showed that those institutions that were the sites and vehicles for the most frequent, the most costly, and the most complex amounts of white-collar crime were those that: (1) were stock owned; (2) were less involved in the home mortgage market; (3) had committed a greater proportion of their assets to direct investments; and (4) undertook strategies that led to a dramatic growth in assets.

<sup>48</sup> *Ibid.*

<sup>49</sup> Another analysis (Black, William K., and Henry N. Pontell, “Regulatory and Economic Incentives for White Collar Crime: The U.S. Savings and Loan and Insurance Crises of the 1980s”. Paper presented at the 22<sup>nd</sup> Seminar of the European Group of Risk and Insurance Economists, University of Geneva, Switzerland, September 20, 1995) characterizes the conventional economic wisdom on the S&L crisis as constituting the following essential points. S&Ls faced moral hazard as they were exposed to systemic interest rate risk by government limits on their asset powers. The regulators then compounded the problem by failing to close insolvent S&Ls. This, combined with federal deposit insurance and a relaxing of regulatory and accounting oversight provided a significant incentive to “gamble for resurrection” on high risk assets. These gambles often failed, leading to the debacle. Fraud did not play a material role in the crisis. The contrasting view of government regulators, enforcement personnel, criminologists, and some economists is that these factors also provided an optimal environment for control fraud and other crimes. A criminogenic environment is one that facilitates the commission of criminal activity. In the case of the S&L crisis, the environment allowed for the following conditions that would encourage the proliferation of control fraud: (1) complete insider domination (“The best way to rob a bank is to own one.”); (2) plentiful liquid assets relative to liabilities (the larger the amount, the more that can be looted, and/or spent on political intervention to fend off regulators); (3) the ability to grow quickly (growth implies success and garners positive attention as well as increased liquid assets); (4) the ability to convert corporate assets to personal gain (creating phoney income that appears to warrant extra bonuses, “perks,” and stock dividends); (5) the ability to hide losses and create phoney income (investing in assets that have no readily ascertainable market value so they can be overstated and losses hidden); (6) the ability to impede detection and prosecution of fraud (diffuse victimization, and making fraudulent business transactions appear “normal”.); and (7) minimal ethical barriers to insider fraud, i.e., an ethos that considers greed a virtue, and government regulation as unnecessary provides a lethal combination of factors that can only weaken if not ultimately destroy fiduciary standards.

<sup>50</sup> Black, William K., Calavita, Kitty, and Henry N. Pontell, “The Savings and Loan Debacle of the 1980s: White-Collar Crime or Risky Business?” *Law and Policy* 17 (1) January, 1995: 23-55.



mismanagement, while the third derives from the material fraud model.

The first hypothesis, based on excessive risk taking, which entailed “gambling for resurrection”, considered the following arguments of the minimal fraud school:

*Thrift owners and managers were rational profit maximizers. Given the state of their insolvent institutions in the early 1980s, managers took on technically legal, but very risky investments in the hopes of extraordinary returns that could rescue their thrifts from bankruptcy. The thrift debacle of the 1980s resulted from the collapse of these excessively risky investments.*<sup>51</sup>

The managerial incompetence model (hypothesis two) was stated as follows:

*Thrift failures in the 1980s were primarily due to managerial incompetence. Deregulation permitted individuals with no previous banking experience to buy and operate thrifts, at the same time allowing them to make a wide variety of risky investments with which they had little or no prior experience. The epidemic of thrift failures was the predictable result of this lack of experience.*<sup>52</sup>

The material fraud model (hypothesis three) posited the following:

*Fraud and deliberate abuse were central factors in the thrift crisis of the mid-1980s. Not only did*

---

<sup>51</sup> *Ibid.*, p. 33. This explanation is related directly to the concept of “moral hazard”. There were perverse economic incentives for behaviour, and individuals benefited with little to no personal risk by engaging in activities that were inefficient or counter-productive at the organizational level. According to this gambling for resurrection hypothesis, the bulk of the losses associated with the thrift crisis resulted from potentially high yield investments in extremely risky assets that had very high default rates. Thrift owners, acting as rational economic actors trying to resurrect their institutions, engaged in high-risk gambles, which if they paid off, would save their S&Ls from insolvency. For insolvent thrifts, the perverse incentive for such gambling was clear: “Heads I win and tails you (FSLIC) lose”. An insolvent thrift had nothing to lose and everything to gain by engaging in such long-shot gambles. If this excessive risk taking explanation is correct, the study argues that one would predict the following historical artifacts in the S&L crisis using both logical deduction and an extension of the underlying economic paradigm: (1) Thrift owners most influenced by such moral hazard would be those whose institutions were the most deeply insolvent, and they should be at stock owned thrifts rather than at mutuals, since according to finance theory, mutual managers tend to be more risk averse, and because shareholders of stock associations would stand to gain the most through stock appreciation and dividends if the gambles succeeded. For insolvent institutions this would be an entirely rational approach, since shareholders had already lost their capital investment unless some long-shot gambles saved them; (2) Losses would be concentrated in thrifts where managers made high-risk investments, because of the higher likelihood of failure of these investments. In addition, one would expect to see faster growth in these thrifts through increased high-risk investments, and according to portfolio diversification theory, greater diversification of portfolios, as rational economic actors would seek to increase potential returns. Only a few “plungers” would concentrate their portfolios in relatively few assets, as this would limit their chances for a successful return on their investment; (3) Exceedingly careful underwriting would be present. Thrift owners who were trying to make their high-risk investments succeed, and bring their institutions back to solvency, would have employed excellent underwriting practices, since the only chance for resurrection would be picking successful high-risk investments, which, by their very nature require increased scrutiny by rational economic actors; and (4) At the aggregate level, thrifts should have had a significant level of success in gambling for resurrection in the 1980s. While they started from a deficit (i.e., they were market value insolvent), interest rates dropped sharply by 1982 and by the mid-1980s most unrealized market losses were eliminated. Many markets such as real estate and junk bonds produced fine returns throughout most of the 1980s. Had rational thrift owners enjoyed *even a minimum level of success* in a diversified portfolio of investments with adequate underwriting, they should not have failed. On the contrary, one would expect to see a *reasonable number of highly successful gambles*. Moreover, among those institutions that did fail, one would expect to see a wide range of failures, including relatively minor losses and much greater ones.

<sup>52</sup> *Ibid.* p. 37. This model predicts the following: (1) Stock associations would have a much greater incentive to secure expert management, and thus failures would be concentrated among mutual associations. Failures should also be disproportionate among institutions that had a change in ownership; (2) Poor asset diversification and non-traditional investment strategies; (3) Although inexperienced and incompetent managers might have engaged in inadequate underwriting, one would reasonably expect that even they would be able to understand the most basic aspects of the procedure, and improve internal controls over time. Moreover, one would expect that they would be responsive to regulatory concerns about underwriting, potential violations, and the soundness of their investments. Well-intentioned, rational, yet inexperienced managers should have welcomed such free advice; (4) Regarding patterns of failure, one would expect to see insolvencies following the entrance into the industry of such managers, and that these should have decreased with time as managers gained greater experience.

*fraud contribute to many of the insolvencies of the period, but it was a key ingredient in the most costly thrift failures.*<sup>53</sup>

Using government reports and a wide consensus among experts on all sides of the fraud debate regarding the worst thrift failures, the study concluded that when the predicted patterns of the excessive risk taking, managerial incompetence, and material fraud models are compared to these facts, the data are most consistent with the material fraud hypothesis. “*If we assume that thrift managers are rational economic actors, deliberate insider abuse is the only viable explanation for the behaviour of insiders at the worst failures.*”<sup>54</sup> The study also explains that clearly not all failures were due to fraud, and that there was certainly overlap among these categories. Some thrift managers convicted of fraud were also incompetent. “*However, these cases did not produce the worst failures and the catastrophic losses associated with the thrift debacle. Nor, as we have seen, can they account for the pattern of thrift failures that together comprise this financial disaster.*”<sup>55</sup>

### III. THE UNITED STATES CORPORATE AND ACCOUNTING SCANDALS

#### A. Enron: A Case Study in Control Fraud

Another example of the destructive power of control fraud, and the denial by fraud minimalists that it is a concrete social phenomenon is found in the recent corporate and accounting meltdowns in the United States. While events, indictments, prosecutions, and new legislation are still underway, the news is quite disconcerting not only because of the unprecedented losses throughout the world, but because virtually no lessons were learned from the example of the savings and loan industry regarding effective regulation, assets that have no clear value, accounting abuses, or control frauds. After the fall of Enron, *Fortune*, one of the media bastions of corporate capitalism and which for six years in a row hailed Enron as the most innovative company in America, changed its stance, and not only ran an unprecedented cover story on white-collar crime and the need for punishing corporate offenders, but in later issues depicted corporate officers as pigs in suits on both its cover and throughout the magazine.

The bankruptcy of Enron in late 2002, which was the first in a wave of major business failures in the U.S., provides a telling example of what was happening in many large corporations during that time. The company, which was one of the largest in the world, has been described as everything from a corporation that sold price stability, to a hedge fund selling peace of mind, to a merchant bank selling energy.<sup>56</sup> While some of this may be true, it was later discovered that Enron was nothing more than a giant sham. It combined the worst elements of both classic and modern frauds. It was a *Ponzi scheme*, in which the top executives who ran the company became rich at the expense of those at the bottom (employees and investors). That is, with the help of the (now bankrupt) major accounting firm of Arthur Anderson, it has become clear that Enron was mainly in the business of selling stock, which in fact was its *only consistently profitable business activity*. Enron was also a *pump and dump*, in which shareholder value and stock prices were grossly inflated through phoney earning statements and false announcements about the company’s health so that corporate insiders

<sup>53</sup> *Ibid.* p. 38. It predicts that: (1) Greater failures in deregulated states that allowed for non-traditional investments, concentrated in thrifts that were insolvent on a market basis, and that were tightly-held stock associations. Failures and losses would also be disproportionate at thrifts that experienced a change of ownership immediately before increased non-traditional investment activity, especially where the recent entrants had substantial conflicts of interest, e.g., real estate developers; (2) Ideal vehicles for fraud entail non-traditional investments, such as ADC loans, and other direct investments where losses should be concentrated. Such investments would entail little portfolio diversification, and many loans would be at or exceeding the loans-to-one-borrower limit. Thrifts would also be experiencing rapid growth, not only to increase the value of the fraud, but because the large development loans, if they provided the vehicles for such fraud, would require a rapidly growing portfolio of reported assets to camouflage such criminality; (3) Underwriting would be weak to non-existent, as the frauds would be more readily exposed to regulators. Internal managers engaged in control fraud would have both the ability and incentive to undo any internal controls that would interfere with the commission of their crimes. Such managers would also have an incentive to deceive regulators, and to cover up the financial transactions that would reveal the failing health of their institutions; (4) Material insider fraud would almost inevitably lead to insolvency, frequently with very large losses. Such failures and losses would surpass the intrinsic (non-fraud) risks of the institutions high-risk assets.

<sup>54</sup> *Ibid.*, p. 44.

<sup>55</sup> *Ibid.*

<sup>56</sup> *Platt’s Energy Economist*, January 30, 2002.

could sell their shares at high prices while other investors were wiped out. Enron was also an insider trading scandal, where damaging information was kept from the public so that executives and others could profit on stock trading. And finally, in terms of the thousands of limited partnerships that were created in order to keep massive company losses off the books, and keep stock prices high, Enron was nothing more than a giant *con game*.<sup>57</sup>

Yet in order to fully understand what happened at Enron, a simple question needs to be asked: How did Enron actually make money? The truth now seems obvious: Almost no one seems to know. The strength and profitability of the company was largely a matter of faith. This raises another fundamental question, which is: Why were so many people willing to believe in something that so few actually understood?<sup>58</sup> The simple answer is that, like Enron's management, investors cared only about the stock price. The truth that the company didn't make much money was lost inside a maze of offshore limited partnerships within partnerships. That truth may have been hard to find, but at the same time, no one was looking very hard. "If a few analysts thought there might be something fishy about what they called "subjective accounting", investors didn't particularly care as long as the profits rolled in."<sup>59</sup>

Other factors cited as allowing for the massive fraud perpetrated at Enron included the rise of a "culture of arrogance" within the organization, and an almost unprecedented tension among employees brought about by a "cutting edge and cut-throat" competitive environment.<sup>60</sup> In such a climate of stress and fear, it becomes easier to understand why and how negative information would never surface within the company. The failure of the board of directors, which was primarily responsible for protecting the interests of shareholders has also been seen as a contributing factor in allowing for the frauds perpetrated at Enron. Some directors had financial ties with companies and organizations affiliated with Enron, and thus had major conflicts of interest.<sup>61</sup> Their vigilance and independence was harshly criticized in a U.S. Senate report that also noted that their compensation was about double the industry average for persons serving on boards of publicly traded companies.<sup>62</sup>

## **B. Accounting, Control Fraud and Corporate Governance**

The fact that the accounting firm of Arthur Anderson was allowed to both *consult* with Enron (helping to set up financial records that disguised company losses), and then *audit* the company's financial statements (certifying that the company was financially sound) enabled the fraud that eventually led to collapse of the company. This corporate-accounting relationship was also found in the failures and losses experienced at other companies such as WorldCom, Adelphia, Rite-Aid, Global Crossing, Xerox, and many others.<sup>63</sup> These relationships between accounting firms and companies that were found to be engaging in fraud *totally negate a basic tenet of corporate governance theory upon which many regulatory policies in modern capitalist countries are based*. The classic textbook *The Economic Structure of Corporate Law* states that only honest companies can pass the inspection of experienced outside auditors because the reputational cost of false certification to accounting firms is greater than any gains to be made.<sup>64</sup> Criminologist William K. Black has called this contention a "myth", and points out that during the savings and loan crisis, every fraudulent savings and loan received a clean bill of health from a reputable accounting firm.<sup>65</sup> This same exact pattern can be found in the recent corporate and accounting scandals in the United States.

## **C. Fraud Denial: Blaming the Victim and Relying on the Invisible Hand**

At a fraud conference held at the University of Texas, Austin in the spring of 2003, a finance professor offered what appeared to be the prevailing view of a good number of his colleagues when he argued that *lack*

---

<sup>57</sup> Rosoff, Pontell and Tillman, op. cit., p. 289-290.

<sup>58</sup> McLean, Bethany, "Why Enron Went Bust." *fortune.com*, December 24, 2001.

<sup>59</sup> Swartz, Mimi, "How Enron Blew It," *Texas Monthly*, November, 2001 pp. 138-139, 174-178.

<sup>60</sup> *Ibid.*, p. 174.

<sup>61</sup> Abelson, Reed. "Concerns Surface About Enron Board's Independence." *kcstar.com*, December 2, 2001.

<sup>62</sup> United States Congress, Senate, Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, *The Role of the Board of Directors in Enron's Collapse*. July 8, 2002.

<sup>63</sup> Rosoff, Pontell, and Tillman, op. cit.

<sup>64</sup> Easterbrook and Fischel, op. cit.

<sup>65</sup> Black, William K. "Repeating the Past." *Newsday.com*, July 7, 2002.

*of investor vigilance* played a significant role in the run-up of stock prices that helped fuel the incredible losses and bankruptcy filings that resulted at Enron, WorldCom, and other companies. Without willing investors, he argued, such events could not have taken place. What this argument neglects is the fact that Enron employees and investors would have gained nothing by *doing their homework* and reviewing *cooked* corporate financials and complex business deals designed to hide the underlying fraud engaged in by the company. Even the usually vigilant financial press, upon which many investors heavily rely, was completely fooled for years by false profit reports. Blaming those who were victimized not only avoids the central issue of insider fraud, but, taken to its logical extreme, produces the incredible conclusion that there is *no such thing as crime*, or at least *offender culpability*. If investors and loyal employees who represent the most immediate victims are to be held responsible for allowing insiders to loot their organizations, than *anyone* can be blamed for their own victimization. Would fraud minimalists similarly argue that if you don't want to be robbed, you shouldn't carry money or go out at night? One would certainly hope not. Blaming the victim is one of the major fallacious inconsistencies in the fraud minimalist's position regarding the recent corporate scandals.

Another is that the only apparent "hand," invisible or otherwise, produced by free market mechanisms was one of "*infectious greed*", as U.S. Federal Reserve Chairman Alan Greenspan later decried,<sup>66</sup> that pick-pocketed employees and investors, and deposited their funds into the offshore bank accounts of corporate officers who paid accounting firms to do the dirty work of structuring such transactions, and then had them audit and certify their books. This hand existed in opportunity structures provided by the free market itself, where companies grossly inflated their earnings. The strength of such free market forces on behaviour is undeniable, and in this case could be demonstrated by the fact that in those same days that rescuers searched for survivors from the 9-11 attack on the World Trade Center, Enron executives were also in their own race against time to dump their stock before it lost almost all value, and their control frauds were finally exposed.

#### IV. CONCLUSION

It often can be extraordinarily difficult to distinguish white-collar crime, and especially control fraud, from ordinary business transactions. As the well-known British criminologist, Michael Levi notes: "Since the aim of the more sophisticated fraudster is to manufacture the appearance of an ordinary business loss or at worst, of the 'slippery slope' rather than deliberate fraud...the actual allocation of any given business 'failure' to any of these categories is highly problematic".<sup>67</sup>

This brings us right back to Tappan's insistence that the search for the "true" level of crime must be guided by official definitions and criminal convictions. While minimal fraud proponents appear to take this view, most criminologists who study white-collar crime have abandoned it for the scientific reasons noted earlier. Given the evidence compiled by researchers, individual case studies, regional analyses, and from the investigative front, it is quite clear that much fraud remains shielded behind complex business transactions that are designed to hide it. As criminological study has shown, the volume and complexity of insider frauds can easily overwhelm prosecutorial resources, necessitating declinations of some criminal cases, and lesser charges for those that remain.

This being said, the fact remains that the official histories of the two financial debacles described here adopt the positions of fraud minimalists, and in no way reflect the significant role of material fraud in each disaster. Ignoring the potential for control fraud as an outcome of free market forces, or even *the best-intended* regulatory policies, can apparently lead to catastrophic financial events. Moreover, the failure to acknowledge control fraud as a social phenomenon can only encourage those seeking to take advantage in at least two ways. First, the fact that there are no effective mechanisms to prevent control fraud allows actors to engage in various crimes. Second, failing to recognize the possibilities for control fraud until an episode is well underway encourages lawbreaking, as formal control systems will be overwhelmed by massive enforcement workloads. Perpetrators will be able to escape the vast bulk of legal sanctions because of

<sup>66</sup> Quoted in Malloy, T.K. "Greenspan Blasts 'Infectious Greed'". *washtimes.com*. July 16, 2002.

<sup>67</sup> Levi, Michael, "Giving Creditors the Business: The Criminal Law in Inaction". *International Journal of the Sociology of Law* 12, 1984: 322.

resulting strains in criminal justice capacity.<sup>68</sup>

There is a difference between “risky business” and white-collar crime that is defined by statutory law, if not always by the law in action. Despite the arguments of fraud minimalists, it was the ability to grow rapidly using assets that had no clear market value and that could produce phoney income that was the key in the S&L scandals. Similarly, the recent corporate and accounting scandals provided a new and infamous group of corporate executives and others who, as of this writing, await indictment and criminal adjudication. While this newest set of scandals still unfolds, well-known patterns of financial loss and fraud are already apparent. As one account puts it:

Phoney earnings, inflated revenues, doctored financial statements, and an assortment of other crimes, old and new, pushed a healthy economy into intensive care. A cadre of elite executives looted their failing companies and became astonishingly wealthy by cashing in billions of dollars worth of overvalued stock on an unsuspecting market. In many cases, this was stock that they never even bought in the customary way. It had been “handed to them via risk-free options”.<sup>69</sup> When the dust settled, shareholders had lost most or all of their investments. Employees had watched their retirement funds swirl down the drain, along with their jobs. It has been estimated by consumer groups and labour unions that the recent corporate scandals have cost Americans more than \$200 billion in jobs, tax revenues, lost investment savings, and lost pensions.<sup>70</sup>

The seemingly inescapable yet oftentimes ignored policy lesson provided by these financial debacles is that any proposals for reform and prevention, whether directed at deposit insurance, financial institutions, accounting, securities markets, or corporate governance, *cannot assume away the problems of assets that have no clear values, accounting abuses, or control frauds*. Public policies based on analyses that “white-wash white-collar crime” and that do not explicitly recognize the potential devastation of control fraud, will not only be ineffective, but will serve as virtual blueprints for future financial disasters.

---

<sup>68</sup> This, of course is true of common crime as well, and the phenomenon has been empirically demonstrated in terms of the system capacity model of criminal justice, but is exacerbated in the case of white-collar crimes given the legal complexities and intricacies involved, the legal resources of perpetrators whether they be individuals or organizations, and the hidden nature of the crimes themselves. Thus, the major tenets of deterrence and prevention are essentially denied. The legal system simply cannot respond effectively to such massive economic crime after it occurs. 68 Pontell, Calavita, and Tillman, “Corporate Crime and Criminal Justice System Capacity”, 1994, *op. cit.*; Calavita, Pontell, and Tillman, *Big Money Crime*, 1997, *op. cit.*

<sup>69</sup> Emshwiller, John, and Rebecca Smith. “Enron Jolt: Investments, Assets Generate Big Losses.” *Wall Street Journal*. October 17, 2001: C1.

<sup>70</sup> Rosoff, Stephen, Pontell, Henry N., and Robert Tillman, *Looting America: Greed, Corruption, Villains, and Victims*. Upper Saddle River, NJ: Prentice Hall, 2003: 24