

Fondazione Centesimus Annus Pro Pontefice Conference

The Good Society and the Future of Jobs

Antonio Maria Costa

The economics of crime & the crimes of economics

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I thank the Centesimus Annus Foundation for the invitation to this conference. I'm honored to be here. I especially thank President Sugranyes for the invitation to join the Foundation's scientific committee.

Adrian Pabst's contribution is really good. I learned a lot. I wish to add a few remarks on the relationship between crime and economics – with a reference to politics and finance. These observations are elaborated at length in the book I'll publish in a few weeks: *The Checkmate Pendulum*.

A. Prof. Pabst says that the future of jobs depends on the intermediation mechanisms that must work properly. Since a most important form of intermediation is banking, I believe a most important step **towards a just and ethical society concerns the re-invention of the banking system.**

Prof. Pabst lists a few examples of 'semi-criminal behavior' by banks. He is right: since deregulation opened the doors to financial malpractices, banks' engaged in interest rate manipulation, foreign exchange rigging, cheating on credit cards, money laundering, inflated billing, tax avoidance, promotion of toxic products, reckless risk-taking, abuse of mortgage bearers, even usury and gambling with other people's savings. These crimes are so enormous in size, and so widely repeated over time and space that, in my book, I establish The Mammon Prize for Outstanding Greed.

Why such a profound resentment on my part? Because at the time of the financial crisis like the rest of public opinion, I believed that there would be retaliation against those who caused it: new rules, meaningful fines, prison terms. In fact, the measures taken have been modest. Banking re-regulation remains inadequate: look at the saga about the Volcker rule and the Liikanen report. The financial penalties, about 100 billion dollars in total, are just a fraction of the banks' annual profits. Nobody, went to jail.

There may be a reason for this governance failure: bankers' malpractices are more than the result of greedy people. There is **something profoundly wrong with banks ethics**: we witness the destruction of the moral compass that should guide activity. No effort to clean up balance sheets, no Basel liquidity criteria, no stress test, no asset quality review can improve the banking system unless and until the ethics of institutions, and of the culture of the players therein improve.

Behind the concepts of banks that are *too big to fail*, or of bankers who are *too big to jail*, lies collusion between politics and banking, a perpetuation of the bond between public finances and private banking. Bankers and politicians have created the current climate of mistrust, they brought the crisis upon themselves and, unfortunately, upon millions of innocent people. Among the policy ideas Pabst's lists at the end of his paper I would add the long-term structural transformation to turn banks into regulated utilities, able to participate in the production system, support entrepreneurial risk, and facilitate innovation, putting an end to the boom and bust cycle we have experienced over the past decades.

Some of the points raised by Pabst are difficult to implement. What I'm proposing it is even harder to put in practice because **governments need financial institutions to conduct foreign policy**. Actually more than that. It was said that war is the continuation of politics. I say finance is the continuation of war. Invading your neighbor is *passé*, only Russia occupies land and sends tanks through borders. That's

old stuff. It's much easier to invest abroad, purchase treasury bonds, buy up companies – encircling the enemy with funds, exports, technology. Modern attacks are conducted by tractor-trailer, container ships or air freight, or by parachuting capital directly into the finance ministry, the central bank, or the stock exchange. Mammon works summer and winter, day and night, hitting not things that must be destroyed, but those to be preserved. Sooner or later, the rest crumbles and the country surrenders.

The coalition between governments and banks has changed the very meaning of war: today, conflicts are won by production, not by destruction. A corporate takeover has greater impact than an attack by a dozen F-4 Phantoms. Market rigging is easier to conceal than the penetration by a B-2 stealth bomber. Buying billions worth of a country's treasury bonds is more effective than sending in the Marines. Hedge funds acquire critical infrastructures more rapidly than Navy SEALs. These are the modern weapons, not even Patriot anti-missile batteries can stop them. What's more, the aggressor can act with a clear conscience: there's not a word in the Bible that forbids investing money in your neighbor's stock market or in its government bonds.

B. My next point is about ways **to promote integrity in society by restraining the animal spirit**. World mafias are today's main *hominis lupus*.

In the past quarter century organized crime has penetrated business and governments, conquering parliaments, armies, even nations. It has become the biggest winner of globalization, reaching macro-economic dimensions. A true cancer of society, organized crime has metastasized from traditional local offenses like loan-sharking, racketeering and smuggling of humans, drugs and arms, into global activities: money-laundering, waste trafficking, environmental disruption, identity-theft and cyber-aggression. In the process, because of the breadth and spread of its activities, crime has become a major obstacle to peace and security.

I propose to add five elements to Prof. Pabst's list of measures for an ethical economy. My first proposal is about **money anti-laundering**. Drug trafficking alone generates an estimated \$300b/y, equivalent to the world's 20st biggest economy. Some of this money goes through rogue jurisdictions (tax havens) and uncontrolled activity (gambling). Most of it finds its way into the rich countries where it generates huge revenue for legions of white-collar crooks.

The financial crises have caused illiquidity of the financial sector, a paralysis of inter-banking lending, and the frantic search for fresh money. This money drought has offered a splendid opportunity for cash-rich mafias to penetrate the financial sector – depositing banknotes, acquiring shares, and claiming boards membership. Law enforcement has failed. (recall the Wachovia Bank in the US, caught in 2010 recycling billions of Mexican Sinaloa drug cartel money: \$378b according to the US Justice Department), and then City Bank, JP Morgan Chase, HSBC, UBS—all gone unpunished except for minuscule (relative to their revenues) fines.

My second point concerns **fighting the duplicity of security policy**. I have personally witnessed, over and over again, cases of priority assigned to security and anti-terrorism, frustrating crime control. Why? Because of intelligence services' desire to protect their sources, or because of their hope that ordinary criminals, exempted from prosecution, would provide information on insurgency, terrorism and alike. These criminals are double-agents in a truly sinister way: they work for governments during the day, and for the cartels at night.

My next suggestion is about recalibrating **development aid**. Mafia knows where risk is low, where the rule of law is weak. That's why illicit activity often

originates in, or transits through the poorest parts of the planet, and/or in conflict zones. In these regions crime has a devastating impact. (The value of cocaine flowing through some West African countries compares to their annual GDP.) Income distribution, foreign remittances, balance of payments, reserves are all altered.

Development assistance is reacting feebly to the crime pandemic. At present only about 9% of development aid is globally provided to fight crime, although anti-crime legislation, anti-corruption measures, law enforcement, financial integrity, a healthy judiciary go along way to promote job, revenue, investment -- saving the aid money spent on development that actually doesn't materialize because of crime.

My fifth and final point is about **fighting (illicit) markets and not only (criminal) people**. Law enforcement alone cannot combat international mafias. First, the police consider organized crime as groups of individuals, because the tools at their disposal (arrests and seizures) can only applied against people and assets. Yet crime problems are often caused by (economic, demographic, environmental, cultural) circumstances related to society at large, and not to individuals. Second, law enforcement is mostly limited to specific jurisdictions, while organized crime is mostly trans-jurisdictional. Third, security protocols see organized crime either structured in loose (*cells*) or in tight (*pyramids*) groups, or a combination. In fact, today's organized crime is less a matter of groups of individuals involved in illicit activities, and more a matter of groups of activities in which people (or groups) are engaged. As a result, organized crime is best addressed by coming to terms with these (mal-functioning) markets.

In conclusion, cooperative action and re-regulation must be part of the larger project of global governance to promote an efficient and ethical economy. In my statement I suggest a few operational points that the conference may consider adding to Prof. Pabst's list of measures.

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