CHAPTER 8

Predators and Parasites

Deception and detecting deception both gave evolutionary advantage to greater brain size.

—THE MACHIAVELLI HYPOTHESIS

Man, biologically considered, is the most formidable of all beasts of prey, and, indeed, the only one that preys systematically on his own species.

—WILLIAM JAMES

Goods and services may be bought in the market as exchange transactions or may be secured by the exercise of coercive power through predation and parasitism (P&P). P&P are transactions in the economy that are as driven by self-interest, as conventional theory assumes, but are dominated by power relationships. It is difficult or impossible to argue that in pursuing self-interest in such cases the predator or parasite, as if “led by an invisible hand,” serves the general interest. Economic self-interest exercised through power can at times result, as is illustrated most poignantly in the discussion below on slavery, in immoral and humanly destructive outcomes or in other instances in economic regression or stagnation.

Predation and parasitism receive little notice in mainstream economic theory, but unless they do our understanding of the economy is deficient. They are interwoven with all life, and economic life is no exception. They have been important in all economies, including those of today. To understand how economies work, it is essential to include P&P in economic analysis. At present, national accounts statistics make no distinction between income earned through the provision of productive services and gains and income earned through predation or parasitism. Only the former add to the national welfare. A country blissfully free from most predatory activities may be better off than one that has a higher per capita income but suffers from widespread predation.

Predation and parasitism are inherent in nature. Human beings, at the top of the food chain, are the most successful of all predators; even vegetarians exist by devouring vegetable life. Both parasites and predators live
off others without making useful contributions to society. Predation is abrupt or intermittent, it implies actual or potential violence, and usually the prey dies. A parasite, on the other hand, not only lives off its host but has an interest in its survival. Parasites are often permanently attached to their hosts. Parasitism is common throughout nature.

Human beings are hosts to a range of fauna and flora. We are colonized by some 100 trillion bacteria, some of which have symbiotic relationships with us, and a host of viruses and mites. The AIDS disease has revealed how intense this colonization is. The weakened systems in AIDS patients not only allows the common tuberculosis and bacterial pneumonias to flourish but also the rare fungi, yeasts, viruses, and hostile bacteria that are usually tightly controlled by our immune systems. In poor tropical countries, human beings are regularly hosts to numerous parasites: lice, fleas, roundworms, tapeworms, whipworms, hookworms, schistosomes, nematodes, flukes, and a wide range of protozoans, bacteria, and fungi.

Parasitism may even have been responsible for the evolutionary invention of sex. While dandelions and 360 species of bdelloid rotifers (multicelled freshwater invertebrates) propagate successfully without DNA exchange (i.e., without sex), most life appears to find sexual reproduction necessary. While biologists have no firm, established theory to explain why this is so, the Red Queen hypothesis has considerable evidence in its favor. Just as the Red Queen in *Through the Looking Glass* has to run to stay in place, DNA is changed each generation through sexual reproduction to foil pathogens that attempt to prey on the species. The remixing of the parents’ genes in the offspring increases the rate of genetic variation and so changes the genetic set of immunological locks of the cell, blocking the previous method of entry a bacterium or virus may have used to penetrate the cells of a parent.

If this hypothesis is true, then in order to minimize the danger of parasitism nature has imposed a large, continuing, and immeasurable cost on most species, for sex is a costly means of reproduction. The sexual process is shot through with inefficiency. Being forced to take time and energy from seeking food and evading predators to search for a partner is a great waste of time and energy. Some species, like the bees and ants, have to produce, feed, and dispose of a vast number of idle males—drones—only a few of whom serve any useful purpose and that for a brief moment. In other species, including some males of the human species, the male fertilizes the egg but makes no further useful contribution, abandoning the care and upbringing of the young to the female. Then there are all the costs of making oneself attractive to prospective sexual partners, either through dress and ornament, as humans do, or through physical change such as the stags
who have to grow massive antlers to dispose of rivals or the peacocks with the great feather displays that make them vulnerable to predators. Finally, the act of sexual intercourse facilitates the spread of many pathogens and parasites.

**P&P in Economics**

Most of modern neoclassical economics ignores the influence of power and tends to silently assume that economic reward is usually related to the productive contribution that an individual makes. Theory does recognize, however, that power can be used in a few special instances to secure unjustified economic rewards. It recognizes the existence of monopoly and oligopoly and circumstances under which an individual or firm may succeed in using power to raise prices above those that would rule in a freely competitive market. But economic theorists usually prefer to operate on the assumption of perfectly competitive markets. In the real world, where perfectly competitive markets are rare, companies with a dominant position in a market have opportunities to increase their profits through predation.

Economic theory recognizes the existence of predatory pricing; that is, the uneconomically low prices a large or wealthy company might charge to drive a smaller or more poorly financed competitor out of business. Usually this has been downplayed, however, on the reasoning that the low prices benefit consumers, that the predatory price fixer is not likely to succeed in maintaining the market power advantage it won as soon as it tries to profit by raising prices, and that consumers won’t accept a lower priced or free product if this exposes them to the danger that in the long run their range of choice will be narrowed. In fact, the experience of several industries argues otherwise.

In the high-tech sector, once a company succeeds in dominating a market its product tends to become the dominant standard and consumers incur extra costs if they switch to a rival. Further, in industries with increasing returns due to technology or learning curves, the additional volume that predators acquire puts them on a lower section of the cost curve and helps to insulate them from potential entrants. Again, in products for which brands are important, a new entrant has higher costs to create brand loyalty than an established firm has in maintaining its position. In the American airline industry, whenever a small start-up airline tries to compete with a major airline it is usually driven into bankruptcy by the major lines, which drastically cuts fares on the small line’s routes. In both this and the high-tech case, the aggressive behavior discourages other entrepreneurs from
daring to challenge the predator in its other markets as well. Finally, the idea that consumers today will pass up a cheaper or free product (like Microsoft’s browser, which was initially given away in its attempt to dominate this market) because of long-term fears of the consequences of a predator’s success is naive. The economist’s notion that “contestability” mitigates oligopoly may thus be diametrically wrong (contestability, in brief, is defined as the idea that potential competition is as effective as actual competition in influencing a company’s market behavior).

Conventional economics also recognizes that in periods of violent or runaway inflation, economic motives do not work normally. In such periods, nearly everyone has to divert time and energy away from trying to earn income through producing goods or services to coping with inflation by extraordinary measures. Inflation distorts normal economic calculations, and to survive people have to adjust. Individuals and corporations find that they may be rewarded more from juggling finances and profiting at the expense of someone else than from producing goods and services or worrying about how to improve their productive efficiency. It may pay to take on as much debt as possible so as to expropriate less nimble creditors. Managers of corporations often find that speculating on rises in inventory values is more rewarding than trying to produce goods efficiently.

Economics generally ignores the existence of human predators or parasites. It could be argued that they are properly outside the realm of economics, which should be only concerned with the productive activities of human beings rather than the whole spectrum of ways in which humans make a living. When this narrow focus is adopted, the impact of predators on the economy is overlooked. For most of human history, leaving P&P out of the economy is like presenting Hamlet and omitting the king.

Aristotle, the first economist, accurately observed that in making a living some men are producers and some are predators. Of the latter, some hunt wild birds and beasts, some fish, and some prey on other men (1926, 39). Aristotle regarded predation as a far more honorable occupation than commerce. Wealth was an essential need of the state, and it should properly be won by means of piracy, brigandage, and waging war to round up slaves. The state should depend on slave workers (Viner 1991, 40).

There has been recognition of predatory activity by other economists. As mentioned in chapter 3, Adam Smith, in his remarks about the benefits to society of the “invisible hand,” left open the possibility that at times society may suffer from an individual’s pursuit of his or her own interest. He also argued that when there are accumulations of valuable property in a society and “the affluence of the few supposes the indigence of the many,”
then the poor, “driven by want and prompted by envy,” are tempted to invade the property of the rich (1776, 670).

Alfred Marshall noted (in his preface to the eighth edition of *Principles of Economics*) that he was omitting any discussion of times “when trusts are striving for the mastery of a large market; when communities of interest are being made and unmade; and, above all, when the policy of any particular establishment is likely to be governed, not with a single eye to its own business success, but in subordination to some large stock exchange maneuver, or some campaign for the control of markets” ([1920] 1952, xii). Schumpeter, too, was highly aware of predatory activity and as a result was pessimistic about the survival of capitalism because “the beneficial competition of the classic type seems likely to be replaced by ‘predatory’ or ‘cutthroat’ competition or simply by struggles for control in the financial sphere. These things are so many sources of social waste” (1942, 80).

Keynes, with his deep experience in finance, sounded a warning against one special type of predatory behavior: financial manipulation. He cautioned against productive enterprise in an economy becoming “a bubble on the whirlpool of speculation” (1936, 159). And, like Aristotle, Pareto understood the fundamental fact of economic life: men use their energies in two different ways, either producing economic goods or trying to appropriate the goods produced by others ([1927] 1971, 341).

In recent years, it has become respectable for economists to recognize one category of economic parasitism, rent-seeking behavior. There is now a large volume of research in the “public choice” literature on this subject. Since “economic rent” is any payment made to a factor above the amount necessary to keep that factor in its present employment, individuals who secure income higher than the necessary payment are receiving rent. Thus, *rent seeking* is usually defined as use of the power of the state to transfer wealth by means of taxes or regulation from one group to another or to some individual when there is no social end involved. It does not include action by the state to secure a more equitable distribution of income but rather those actions for which the purpose is personal and purely mercenary and the individuals benefiting are the ones manipulating the state.

The fact that some individuals acquire wealth in this way rather than by a productive contribution is not the worst aspect of this kind of parasitism; the primary harm stems from the fact that when resources are diverted to this activity the gain to those who are profiting is less than the loss to other people or the whole economy. There are no hard data to indicate how prevalent and important rent seeking is in the high-income economies, although some estimates have been made of the cost of govern-
ment restrictions in countries like Turkey and India. There are many indications that lead one to believe that this kind of behavior can be richly rewarded and accounts for some significant fraction of the acquisition of wealth in today’s world.

While most of the focus on rent seeking has been on government activities, the private sector is not immune. A most glaring instance is the remuneration of corporate chief executive officers (CEOs). One study found that the remuneration of CEOs in firms in which there was no large shareholder present on the board of directors appeared to be characteristic of skimming, that is, of CEOs controlling the remuneration process and paying themselves as much as they can (Bertrand and Mullainathan 2000, 203–8). Such CEOs are receiving payments above the amounts that would keep them in their present employment. Baumol and Blinder, in fact, used the salary of Lee Iacocca, then chairman of the board of Chrysler Corporation, to illustrate the concept of economic rent (1988, 783). An indication that this is fairly widespread comes from the great chasm between CEO pay in the United States and that of workers on the factory floor. American CEOs in the Standard & Poor’s fifty leading companies in 2000 took 475 times more pay than manufacturing workers did. In European countries, bosses take only 10 to 24 times the pay of their workers. The discrepancy between American and German CEO incomes was highlighted in the Daimler Benz merger with Chrysler in spring 1998. Although Daimler was taking control of Chrysler; Chrysler’s CEO’s pay in 1997 was seven times that of Daimler’s (Ryback 1998, 86).

A somewhat wider category of predation and parasitism is covered by the term directly unproductive profit seeking (DUP). This includes rent-seeking behavior and all other ways of seeking a profit that do not contribute to production. While DUP describes activities in the private as well the public sectors, most of the interest in it has also been to demonstrate the evil consequences of government action.

During the Middle Ages, “robber knights” made a living by controlling access to a pass in the mountains or a ford or bridge over a river and levying a charge on everyone who wished to use it. Rent seeking focuses on the benefits derived by people who have passed the gate (and who may have been largely responsible for the gate having been erected) and can then exploit the reduced competition from people kept outside. But there is another important predatory gain involved: the profits from what I call gatekeeping.

Gatekeeping focuses on the “toll” extorted by the gatekeepers for allowing or influencing access. A large portion of modern corruption falls into this category. For example, in 1989 and 1992 the financial adviser of the
Massachusetts Water Resources Authority fed crucial internal information to Merrill Lynch, making it possible for that firm to secure the top position in the agency’s securities underwriting team. Merrill Lynch was thus able to earn millions of dollars in fees and commissions. In return, it steered bond business, preferably outside of New England, to the adviser, who at the time was head of the Boston office of Lazard Frères (Kurkjian 1993, 1, 44).

When Communist China introduced economic reforms allowing private investment, party members went into business to make money. The easiest way to make money for a high-placed party member or a member of his family was to become a gatekeeper, that is, a trafficker in influence. With the Communist Party above the law, there is no guarantee of equitable justice or security of property rights except through the influence of an important party member. With this system, widespread corruption was inevitable.

Not all gatekeeping tolls are illegal. In Boston, near where I live, newspapers have documented instances in which lawyers have become millionaires several times over in a few years simply by using their political influence to secure for developers from public offices lucrative zoning exceptions, building code variations, and so on. This is one of the profitable ways in which the “courthouse gangs” in many rural counties throughout the southern United States used to finance themselves.

Exploiting the control of access is not a practice restricted to the public sector, although it is best known there. As the public sector is normally judged by higher ethical standards, the private sector escapes the same degree of scrutiny.

When a corporation is interested in acquiring another, a key player is the CEO of the target company. If a generous enough personal settlement is arranged for the CEO, he or she may be induced to promote the deal rather than evaluating it on its merits. In 1997, Drew Lewis, the CEO of Union Pacific, agreed to a merger with the Southern Pacific Rail Corporation and received a $4 million bonus and a five-year, $3.75 million consulting contract. The merger turned out to be an economic disaster for the southwestern United States. The merged company could not cope with the traffic; snarled rail transport cost businesses and regional economies billions in unnecessary costs.

In 1999, when BankBoston was taken over by Fleet Bank in a $16 billion deal, the agreement promised Charles K. Gifford, BankBoston's CEO, a package that included stock and stock options totaling an estimated $26 million; a three-year contract guaranteeing him the same income as the CEO of Fleet Bank (which in 1998 amounted to more than $4 million a year); a severance payment worth up to $15 million if he was...
forced out of the new bank; and a pension on his retirement of $1.25 million a year for life, with his wife getting $937,500 a year for life if she survived him. The new company also expected to dismiss five thousand employees of the combined work force (Browning 1999, C1, 10).

Even the business press has questioned the justification for the “eye-popping” packages arranged for some CEOs when their companies are taken over. When ITT was taken over by Starwood Lodging, ITT’s CEO received $20 million in cash and stock and an option grant of 162,500 shares of Starwood. The company also agreed to pay the “gross-up” taxes due on his cash severance payments. When MCI was taken over by WorldCom, Bert Roberts, the chairman of MCI, remained chairman but was paid a “retention bonus” of $10.5 million. These are just two of a large number of similar cases (Reingold and Wolverton 1998, 33).

The Columbia/HCA Healthcare Corporation became the world’s largest health care company in 1997 through growth and an aggressive policy of buying other providers. In its successful battle to gain control of a cancer care center in El Paso, Texas, the company secretly paid a key player, one Dr. Abboud, $152,000 for “outstanding expenses” that he had not incurred and $120,000 for used medical equipment without any appraisal of its true value. In February 1997, a federal jury found that the money was part of an unlawful conspiracy and awarded a business partner in the center $6.5 million in damages (Eichenwald 1997, 25, 27). In another case, until forced to desist by an antitrust suit in 1994, Microsoft Corporation forced computer manufacturers that used its MS-DOS operating system to pay it “royalties” on computers they shipped that used other operating systems.

The modern global economy is so complex that it is difficult for investors to secure and master enough information to make optimum decisions. In addition to the long-standing role of banks in meeting this need, there are now “financial advisers” who specialize in providing counsel to investors. While an attempt is being made to “professionalize” this occupation, many such advisers profit from commissions paid by the companies to which they steer their unwary clients. In the financial press, one finds advertisements such as the following (the company’s name has been changed):

**Introducers Wanted by Credit Paris de Berlin (CPB)**

The Credit Paris de Berlin is a Luxembourg open-ended fund which offers investors three specialist sub funds in a range of currency denominations. Following recent strong performance, CPB now seek to appoint additional high quality introducers to complete their global net-
work. The fund offers an extremely attractive commission structure and intermediaries with the ability to make a substantial placement are invited to contact.

Occasional instances of gatekeeping tolls in other industries surface from time to time. In the investigation of the Atlanta, Georgia, branch of the Banca Nazionale del Lavoro, which was active in financing Iraq before the Gulf War, the manager admitted that he had received a $300,000 loan from a Turkish trading company and never repaid it. The company also paid $100,000 to his father for unrelated services (Fialka 1993, B12).

Buyers for large retailers and other large corporations control the spending of millions of dollars. Securing an order is important and sometimes vital to a supplier or manufacturer’s agent. It is not rare for a buyer to use his or her influence to secure commissions, kickbacks, or bribes from the avid sellers. Some set up front companies through which transactions are channeled to conceal their interests.

J. G. Locklear, a buyer for the J. C. Penney Co., when caught, confessed, “I became captive to greed.” He supplemented his salary of $56,000 a year with $1 million in bribes and kickbacks from vendors and sales representatives in the course of four years. It is unusual for a retail buyer who is caught in this sort of practice to be prosecuted. Usually, the retailer, concerned with its image, obtains some restitution from the buyer and sweeps the matter under the rug. In Locklear’s case, he was sentenced to eighteen months in prison and fined $50,000 (Gerlin 1995, B6A).

Scandals in the late 1970s revealed that some of the most respected American corporations regularly paid influential people (gatekeepers) in other countries (in business and government) to use their influence to steer orders to the bribing corporation. The American government passed legislation forbidding American companies from paying such bribes. Other governments were slow to take similar action. France and Germany were opposed to banning bribery because of fear that this might hurt their companies’ sales abroad. Germany, Canada, and a number of other countries even allowed companies to take tax deductions for foreign bribes as a cost of doing business. A French court went even further, extending this tolerance to bribing the French government itself. On February 6, 1997, the French Cour de Cassation reversed a lower court that had convicted a corporate executive for bribing a relative of the minister of trade. The court held that the executive was not guilty of misusing corporate money since the bribe of 760,000 francs resulted in a reduction of 10 million in taxes on the company (Economist 1997b).

In December 1996, the United Nations adopted a declaration con-
demning the practice of bribery. On February 15, 1999, an international
collection agreed on by all the twenty-nine members of the Organization
for Economic Cooperation and Development (OECD) and five other
nations went into force, criminalizing bribes paid by their companies to
public officials and officers of parastatal corporations in foreign countries
and ending the tax deductibility of bribes. The OECD nations also agreed
to work for an international treaty against such bribery. Some progress has
therefore been achieved toward cutting back on this kind of predation.
Note, however, that the corruption of private citizens and companies was
deliberately excluded from this agreement.

Gatekeepers, that is, persons who influence decisions on allocating
resources that are not theirs, are pervasive in large-scale bureaucratic orga-
nizations, both private and public. And wherever there are gatekeepers
there is parasitism or the potential for it. Bathed in an environment in
which moneymaking is revered and central to the operations of the eco-
nomic system, it takes a gatekeeper with strong moral character to overlook
temptation.

Although rent seeking and gate tolls are important instances of the
exploitation of power, there are numerous other kinds of behavior that profit
from coercion. Many of these have been and still are important in modern
economies.

Slavery, Piracy, and Crime

Slave owning is a classic form of the exercise of coercive power. It has
existed in virtually every known historical society, and it still exists today.
Slaves have been one of the most important commodities in international
commerce for thousands of years. In the ancient world, slavery was of
course practically synonymous with the labor market.

A largely unfamiliar slave trade that went on for several centuries was
the export of captives from the Slavic lands of the Commonwealth of
Poland and Lithuania, the Ukraine, and Russia and from the Caucasus to
the Ottoman Empire. Capturing people for export was a principal occupa-
tion of the Tartars of the Crimea during the sixteenth and seventeenth cen-
turies. The route trodden by the slaves to the coast through the Ukraine
became known as the Trail of Tears. Until the fall of Constantinople in
1453, Venetian and Genoese merchants purchased slaves from countries
bordering the Black Sea. These slaves were sold throughout the Mediterr-
anean. Male Circassian slaves transported to Egypt were recruited into the
Mameluke (slave) forces that ruled Egypt for two and a half centuries until
The trade in Slavs was sufficiently widespread for many centuries to cause the Latin word *sclavus*, for “Slav,” to transmute into the modern *slave*.

Trading slaves developed naturally as one of the few commodities available for export from Africa. From the beginning of dynastic Egypt right down to modern times, slaves, gold, and ivory were principal exports of sub-Saharan Africa. After the rise and spread of Islam across North Africa, the demand for slaves increased and the normal supply was augmented through slave hunts. By the late ninth century, slave merchants from as far away as South Asia were established in the Fezzan (southern Libya), dealing with suppliers from across the Sahara. Islam provided the slave hunts with the ideology of *jihad*, which justified aggression against black animist believers. At times, the slave hunts (razzias) resembled large-scale military operations, lasting two or three months at a time.

The explorer Heinrich Barth reported on one razzia that he accompanied in 1851 in the western African middle belt (between the desert and the forests). After two months, the expedition returned to its base with between three and ten thousand captives. These were mostly children under the age of eight and women. Nearly all the men were killed as soon as they were captured (Oliver 1991, 118).

From eastern Africa, Arab slavers exported their captives by sea directly to Arabia. Dr. Livingstone, an involuntary spectator, described one eastern African slave hunting razzia in 1871 on the upper Congo River: The Arabs’ Swahili gunmen fired without warning on the people in a market, killing and drowning hundreds. They burned some seventeen villages, rounded up the survivors that were marketable, fitted them into slave-sticks and marched them to the Indian Ocean coast. (Livingstone 1871, 86–88).

The export of slaves to Asia lasted in all about twelve centuries. A substantial commerce in slaves continued across the Sahara and the Indian Ocean until the end of the nineteenth century. The trade in slaves and ivory was the basis of the coastal Swahili and Arab economy of Zanzibar. Large-scale trade in slaves across the Indian Ocean was only ended by the European occupation of the Sudan and East Africa.

The Atlantic slave trade from West Africa started when the Portuguese began to import slaves into Western Europe around 1442 and the Spanish brought slaves to the New World after 1517. The large-scale Atlantic trade run by American, British, and other European merchants into North America, the Caribbean, and South America continued for three centuries. The British abolished its slave trade in 1807. At that time, the Royal Navy, and later the French Navy, began to enforce a ban on the slave trade. It was not until after the American Civil War, when slave ships
could no longer take refuge under the American flag, that the slave trade across the Atlantic was effectively ended, with the last trickle not ceasing until perhaps 1880.

There is no way to accurately assess the number of slaves exported from Africa in the large-scale trade of modern times. A reasonable estimate is from ten to fifteen million. Millions more lost their lives in the raids, on the journey to the coast in slave coffles, while waiting for the ships to appear, in barracoons on the coast, and finally during the trip across the Atlantic to the Western Hemisphere or across the Indian Ocean to Arabia (Kamarck 1971, 6–10).

Slavery did not end in the nineteenth century. In 1926, a member of the ruling family in what is now Botswana described in court the social position of some of the people in his country:

The Masarwa are slaves. They can be killed. It is no crime. They are like cattle. If they run away, their masters can bring them back and do what they like in the way of punishment. They are never paid. If the Masarwa live in the veldt, and I want any to work for me, I go out and take any I want. (Oliver 1991, 195)

Even though the slave trade was legally banned, slavery continued to be legal in Saudi Arabia and Oman until the 1970s. Today there are many complaints that female domestics recruited in the Philippines to work in oil-rich Middle Eastern countries find themselves in conditions of virtual slavery from which they cannot escape.

Mauritania officially abolished slavery three times between 1961 and 1980 but has not really eliminated it according to the International Labor Organization (ILO). The U.S. State Department’s 1993 Human Rights Report stated that credible reports indicate that there are from thirty to ninety thousand black Africans living in slavery in the Islamic Republic of Mauritania. In the Sudan, Arabized northerners used to hunt slaves in the animist and Christian black African south up to the time of the British conquest at the end of the nineteenth century. During the current generation-long civil war between north and south, the Sudanese government’s Arab tribal militias operating in the south take slaves as compensation according to United Nations investigators and the U.S. State Department. Members of the Dinka tribe are sold as slaves in the north for the equivalent of thirty to sixty dollars each. Girls are especially desirable as potential concubines. In the famine of 1988, some parents sold their girls to save them from starvation. The price of a healthy girl dropped from the equivalent of thirty dollars to five at that time (Horwitz 1989; Economist 1990, 42; Associated Press 1998, A16).
Trade in children is reported to be common in Benin and Nigeria. Traders visit poor farmers in Benin and offer parents the equivalent of twenty to forty dollars for a child, promising that he or she will be well taken care of and better off. The children are sold to households in Nigeria and Central Africa where they perform unpaid household work or they are forced into prostitution (New York Times 1997, 9).

Another contemporary trade in children is their sale for prostitution in Southeast Asia. Sex tourism is an important source of foreign exchange from the Philippines to Thailand. AIDS has increased the value of the youngest prostitutes because the risk of infection is less when the he or she has had fewer sexual contacts. The coordinator of the International Campaign to End Child Prostitution in Asiatic Tourism has reported that there are villages in northeastern Thailand where few children remain; the others have been sold into brothels in Bangkok (Kempton 1992). Burmese girls are sold into Thailand and Nepali girls into India; there are some twenty thousand of the latter in Bombay alone (Economist 1996b, 43).

Throughout the third world, millions of people, especially children, work in virtual or real slavery. Child slave workers are reported in Sri Lanka and Haiti. In India, millions of children work in conditions approaching slavery. The plight of children, age six and up, who work in the carpet industry around Varanasi (Benares) is well known. Their numbers in India have grown since the late 1970s, when the industry moved from Iran; there were around half a million in 1996 (Economist 1990, 42; 1996b, 43).

There are 15 million indentured servants in India, and, although it is against the law, 20 million laborers are held in bondage for their debts in Pakistan, according to the ILO. A similar system of debt bondage known as enganche (the hook) keeps workers in Peruvian gold mines. In Brazil, contractors called gatos (cats) hire rural workers and transport them long distances to jobs that pay less than promised while gunmen prevent the workers from leaving.

Piracy is a classic way of making a living through predation. It has been endemic throughout history wherever there has been maritime commerce. At times, as in the late Roman Republic, an effort comparable to a major war had to be undertaken to bring piracy under control.

In modern times, from the sixteenth to the early part of the nineteenth century, peaceful traders ran major risks from pirates (and from privateers, who often crossed the line into outright piracy). The risks were not restricted to the sea itself: in the Caribbean, for example, French privateers captured and burned Cartagena and Havana in 1559; Cartagena was sacked again in 1585 by Sir Francis Drake; the “Brethren of the Coast” controlled
the island of Tortuga during most of the seventeenth century; and the Spanish colonial city of Panama was sacked in 1671. Blackbeard blockaded Charleston, South Carolina, in 1718 and held the town for ransom. For several centuries, Madagascar was used as a base for pirates preying on Indian Ocean trade and pilgrims on their way to Mecca.

The U.S. Navy owes its birth to piracy, for Congress had to vote funds for a permanent navy to protect American merchantmen against the Barbary pirates based in Algiers, Tunis, and Moroccan and Libyan ports. The young navy operated a Mediterranean squadron off the coast of North Africa from 1801 to 1806, fought several battles against the corsairs, and even had to pay ransom to free the crew of the frigate Philadelphia, which was captured off Tripoli. The campaigns are commemorated in the U.S. Marine Corps anthem’s words, “to the shores of Tripoli.” It took an attack on Algiers by a combined British and Dutch fleet in 1816 to eliminate most of the threat of Mediterranean piracy.

Even today, pirates exist. According to an informed observer, “In 1999, piracy constitutes a new and legitimate threat to shipping worldwide” (T. Hunter 1999, 72–74). In our postcolonial period, with the withdrawal of the colonial powers’ fleets from the sub-Saharan African coasts, shipping in these waters has been scantily protected. Piracy is a threat to seagoing yachts in the Caribbean and Mediterranean and to commercial shipping off the coasts of Southeast Asia and Brazil. From around one hundred attacks on commercial shipping annually reported in 1994 and 1995, the numbers had increased to more than two hundred by 2000. In 1998, sixty-seven crew members were killed. Four ships have vanished off the Libyan coast, with no wreckage or survivors found. This is not unusual, as the pirates paint over the name of a seized ship and Belize, Honduras, and Panama offer temporary registration of ownership by fax, with little investigation, for a simple fee. More often, the pirates are more interested in the cargo: when a tanker is captured, another soon appears and the oil is pumped into it.

More than half of these attacks may go unreported. According to the director of the International Maritime Bureau, “The problem is the industry does not want incidents reported. They don’t want their reputation scarred.” Ship owners suspect that some of the pirates are off-duty members of national navies; one British captain reported that the pirate who put a sword to his throat was “obviously a military officer.” Quite appropriately, the thirty pirates who seized the Anna Sierra in the Gulf of Thailand in September 1995 and sailed it into a Chinese port carried passports identifying themselves as “entrepreneurs” (Goh 1995, 91; Moulier 1997, 33–34; Economist 1997f, 40; Economist 1999, 87–89).
Every country has to live with crime. The best study to date (the International Crime Survey, which is coordinated by the Dutch Ministry of Justice) on the incidence of crime found that each year in the early 1990s 25 to 30 percent of the people in Australia, Canada, Holland, New Zealand, Poland, and the United States were victims of one or more crimes. In Britain, Italy, Spain, Sweden, and West Germany, the figure was 20 to 25 percent. In Belgium, Finland, France, Norway, and Switzerland, the percentage of people affected by crime was 15 to 20 percent. Only in Japan did the figure drop below 15 percent (Economist 1993e, 57).

In many cities across the world, a morass of social and economic pathology locks out millions of poor—in large part, ethnic or religious minorities in their societies—from normal, legal, economic occupations. Television shows and direct observation of the many luxuries available as well as the need for the necessities of life stimulate these poor to try to find ways to get money. With few jobs available to the untrained, poorly educated inhabitants of the inner cities the legal opportunities to earn money are limited. Demoralized, unaffected by the normal process of socialization, and without conventional family ties but with drug dealer and other criminal role models, many young people growing up in these cities find their most advantageous outlets in illegal predation on the rest of society.

Others find their best opportunities in businesses that supply illegal services or commodities. The more fortunate, enterprising, or ruthless may succeed through the use of force in organizing and managing others in these activities. With time, such successful managers may branch out and utilize their criminal skills and money to take over what otherwise are legal economic activities.

In one poor family from South Boston, one brother, William Bulger, went into politics, became the unchallenged leader of the Massachusetts State Senate, and by 2000 was president of the University of Massachusetts. Another brother, James (Whitey) Bulger, went into crime and became the leader of the Winter Hill gang, competing with the New England mafia. While acting as an informant for the Federal Bureau of Investigation, he levied racketeering tribute on bookies and escaped prosecution for three decades. He was finally indicted in 1995 for several murders (O’Neill, Lehr, and Cullen 1995, 1, 24). He went underground and was still free in 2001.

Criminal predation has widespread and pervasive costs. One can cite a few indications of this.
• In 1993, a fairly reliable official survey reported that nearly 11 million violent crimes and more than 32 million property crimes were experienced by U.S. residents over the age of twelve.
• In 1996 in the United States, 1.2 million convicted criminals were in prison. Two percent of the male labor force, and 9 percent of all black males were incarcerated at any one time. In addition to the prison population, another half a million persons were in jail awaiting trial or sentencing, 700,000 were on parole, and another 3 million were out on probation.
• Prison operating costs in Texas exploded from $91 million in 1980 to $1.84 billion in 1994. This is probably an extreme case, but it is representative of the trend.
• Private security guards in the United Kingdom and the United States are estimated to outnumber police officers—in America, by nearly three to one (see DiIulio 1996 and Freeman 1996).
• Shops have almost universally had to place electronic tags on much of the merchandise they sell to keep them from being shoplifted.

If you examine the course of your own life you can perceive the pervasive influence of predation, parasitism, and the costs they force you to undergo. In Massachusetts, if you refinance your home you have to pay a lawyer a fee equal to 1 percent of the mortgage. The size of the fee has nothing to do with the amount of work involved: it is the customary fee. In fact, the lawyer may have very little to do when the only change in the mortgage is a drop in the interest rate. The whole legal cost is pure parasitism—the lawyer is there not to look after your interests but the interests of the bank. If the homeowner wants representation by a lawyer, he or she has to get another one. Of course, the bank has no concern about the size of the fee since it is not paying it; the homeowner is.

Most people receive a phone call or mail once or twice a week from someone trying to swindle them in some ingenious way, usually offering a “once in a lifetime opportunity.” A substantial percentage of the charitable appeals we receive are from organizations that use very little of the money for their ostensible purpose. And so it goes.

Many people take costly precautions against crime. Some are prudent enough to purchase a security system that monitors all movement and is tied into a central office and the police. Many communities are “gatehouse developments” in which the area is accessible only through a single gate.
and security guards stop and check every person desiring entry. There are
now more than 20,000 such gated communities, containing around 3 mil-
lion homes, in the United States. A small number of rich people go further,
building into their homes “God forbid rooms.” If, “God forbid,” it proves
necessary, the owner can retreat to a safe room, which is an armored, bul-
letproof, impenetrable, electronically controlled, fortresslike space. It can
be quickly shut off from the rest of the house and has its own power gener-
ator and separate buried phone line.

Both men and women pay a cost in time spent arranging behavior that
will minimize the risk of becoming a victim of crime. A high proportion of
men and women never go out after dark alone. People driving through a
city keep their car doors locked and windows closed, especially while wait-
ning for someone or for the traffic light to change. Many a woman will not
take the elevator if the only other person in it is a male stranger. Other self-
defense habits that steal time include passing up a convenient parking area
for a safer one, ferrying children to and from school to shield them from
dangerous strangers, and making social arrangements so that after a party
no woman needs travel home alone.

Women in particular pay a special “predation cost” in modern Amer-
ican cities. These are everyday costs incurred just for being of the female
sex. An apartment chosen because it is in a safer area will probably exact a
higher rent. Safety features in an apartment—more secure locks, an alarm
system, a doorman, grates on the windows—are additional costs. A woman
may have to balance the higher wages of a job against the risks of working
in a less safe neighborhood or at unusual hours. A taxi maybe taken instead
of walking or taking mass transit. Some women take self-defense or karate
lessons and carry mace or a police whistle. At night, women may avoid
going to a movie, a play, or a restaurant or visiting friends or family because
of the risks.

Sales of cellular phones have grown faster after their introduction than
the sales of other consumer electronics products under comparable circum-
stances. Fear of predation is a principal reason. An industry survey in the
United States found that two-thirds of all buyers of cellular phones pur-
chase them for security reasons. One of the industry’s most effective ads
shows a young woman with a disabled car in an isolated area. The woman
is fearfully talking into a car phone: “Please hurry, it’s getting dark!”

While it helps to sell its services by arousing fear of predation in its
customers, the industry itself has fallen victim to predators. It is only just
awakening to the realization that cellular theft is also growing rapidly.
Skillful thieves use scanners to pluck the electronic serial number codes of
phones out of the air, clone the data into phones that can be programmed
with up to ninety-nine stolen numbers, and sell these “lifetime” phones to drug dealers and others who want unidentifiable communications equipment. They also sell the opportunity for immigrants and others to call overseas for a fraction of the charges of the phone companies. The cellular trade group in the United States estimates that losses from theft are around half a billion dollars a year; industry consultants put the figure at around a billion dollars a year, that is, 7 percent of industry revenue (Naik 1995, 1996). To try to thwart the pirates, the companies have had to resort to measures such as requesting that their clients notify them in advance if they plan to use their phones outside of their usual calling areas!

There is no way of knowing how much wealth is siphoned off through successful fraud. During every recession, when the prices of some assets have fallen sharply and firms holding them are subject to financial strain, a number of previously respected individuals and firms are found to have been engaged in fraud or other criminal behavior.

Savings and loan institutions in the United States were one of the main avenues through which average Americans saved and financed the buying or building of their homes. They are still an important part of the American capital market. The savings and loan industry debacle in the United States in 1989–94, which cost the American government directly $153 billion (and, with the interest cost of the money over thirty years, a total of around $500 billion), was largely caused by fraud and corruption. Accountants and auditors who certified the books were often on the take. Professional appraisers were willing to provide any desired appraisal of the value of property for a suitable fee. Regulators proved amenable to influence. Alan Greenspan, for a fee of $40,000 testified that Charles Keating’s savings and loan institution, which cost investors hundreds of millions of dollars, was a well-run thrift (Waldman 1990, 95). Charles Keating was only the most prominent among others who were eventually convicted of fraud and sentenced to jail (Mayer 1990).

George Staple, the head of the British Serious Fraud Office, estimated in 1993 that the amounts allegedly looted in Robert Maxwell’s pension robbing (at least £400 million) and the Bank of Credit and Commerce International (BCCI, $9.5 billion missing) cases alone exceeded the annual total lost through burglary in England and Wales (Economist January 30, 1993). But the losses in the pension fund are only a small part of the total lost by creditors of Maxwell’s empire. Two years after his disappearance at sea in 1991, administrators of his private holdings had recovered only £155 million of the total indebtedness of £1.4 billion and creditors of his defunct public company, Maxwell Communications Corp., may receive at a maximum
$1.35 billion of the $3.1 billion owed. Totaling everything, pensioners and creditors lost $4.5 to $5 billion.

The BCCI case was the greatest bank fraud in world financial history to date. It collected $20 billion in deposits from around 1 million people in seventy-two countries. When it was closed by banking regulators on July 5, 1991, $9.5 billion were missing. In total, $12 billion of depositors’ claims were filed against the closed bank.

The BCCI was founded in 1972 with initial capital provided by Sheikh Zayed, the ruler of Abu Dhabi, and other Gulf states investors. It was active in the major financial centers. Incorporated in Luxembourg and the Cayman Islands, its head office was in London. BCCI was generous and hospitable to a whole array of influential people, including Lord Callaghan of Great Britain and former president Jimmy Carter, while bribing third world rulers to get their currency reserves as deposits and acting as the bank for Abu Nidal, the deadly Arab terrorist. It covertly bought and managed the former First American Bankshares in Washington, D.C., and three other banks in the United States. The true nature of its activities only began to be revealed when the American Customs Service in Miami discovered that BCCI was running a money-laundering service for the drug trade. It was the persistence of Senator John F. Kerry and two New York prosecutors that exposed the widespread fraud, corruption, and stealing that characterized the bank's activities. Its nickname in the financial community, the Bank for Crooks and Corruption International, was truly earned (Truell and Gurwin 1992).

In the United States, nine out of the ten top defense contractors admitted guilt or was found guilty of procurement fraud at least once during the 1980s (Bulletin 1993, 4). Usually the contractor paid a fine, was suspended from bidding on defense contracts for a period of time, and then was back in business.

Only a confirmed Dr. Pangloss would believe that every instance of fraud has been immediately detected and punished. For example, President Reagan’s Commission on Organized Crime reported in 1985 that organized crime “controls entire industries in some areas of the country” (Shenon 1985, 4E). The FBI testified that mobsters ran the business of collecting and disposing of refuse in New York. Competition was eliminated through extortion, violence, and threats of violence. One new competitor promptly exited when the owner received a phone call. The voice at the other end described how the owner’s ten-year-old daughter was dressed that day and warned him to shut his business down or his daughter would disappear.

Browning-Ferris Industries (BFI) bravely entered the commercial
waste-hauling business in New York City in 1993. Its first customer, a large hospital, cut its monthly costs for waste removal from $100,000 to $40,000. BFI secured contracts with 500 companies, but most of these changed their minds after visits from large intimidating men. One BFI manager found the head of a German shepherd dog under his mailbox. Taped to the dog’s mouth was the message “Welcome to New York.” BFI’s equipment was stolen and vandalized, and managers and drivers were harassed. With a potential customer market of 150,000 enterprises, in two and a half years BFI was able to persuade only 200 to take advantage of its lower prices and better service. It had to provide special compensation for its people and swallow losses in the hope of eventually being able to operate freely.

In 1995, Manhattan district attorney Robert Morgenthau secured indictments of a number of carting company men on charges of racketeering and antitrust violations. Fourteen pleaded guilty in 1997 and were sentenced to prison terms ranging from one to six years. The two top bosses were found guilty in October 1997 after a five-month trial. Three national companies are now competing for business in the city. The economic cost of the predation in this one service alone was enormous. As the result of the prosecution, the rate for collecting waste for an office building dropped from $200,000 to $150,000 a year, a supermarket from $25,000 to $20,000, and a restaurant from $15,000 to $12,000. The total savings of the 200,000 customers served should amount to around $400 million a year. All this does not include the indirect costs to the economy of the businesses that were driven out or discouraged from entering the city’s market (Angell 1996, A16; Raab 1997a, A25; Raab 1997b, A18; Raab 1997c, A25).

For a century, criminal activities have permeated another of New York City’s largest economic sectors, the construction industries. There are thousands of small and medium-sized construction firms and material suppliers, dozens of major developers, hundreds of general contractors, thousands of specialized subcontractors, and more than one hundred thousand workers belonging to about one hundred local unions in the building trades. Total yearly expenditures ran around $10 billion dollars a year in the late 1980s.

A state government crime task force found pervasive corruption and racketeering throughout the whole construction sector in New York City. Professional criminals have been involved in the industry for decades. There is long-established cooperation between organized crime and labor unions, contractors, and suppliers. Illegal payments flow from companies to union and public officials. Money is extorted to avoid sabotage, disruption in the delivery of materials, beatings, and so on. Former secretary of
labor Raymond J. Donovan testified that to avoid labor shutdows on a project being built by his company he had to put a teamster on the payroll to work as chauffeur for the local’s business agent.

Bribes (in the form of “tips” or “grease”) are paid to buy favors such as inspection approvals of unsatisfactory work, overlooking of legal requirements, and the granting of “sweetheart deals” (payment of substandard wages, allowing substandard or dangerous labor conditions, and so on). “Sometimes contractors claim not to know exactly why they pay; experience tells them that payoffs are necessary to assure that ‘things will run smoothly’” (New York State 1990, 19). Extortion and bribery often extend into the day-to-day work on a project. It is common for a foreman on the job to demand a bribe for allowing access to the site or for a hoist, elevator, or crane operator to demand cash for taking supplies or workers up or down. Theft of materials and equipment by workers from a project is widespread, and a contractor often finds it is cheaper and more efficient to buy back the stolen property than to replace it from his usual suppliers.

Since extortion and bribes have to be factored in as a part of the cost of doing business, the work costs more and is of poorer quality. In fact, at times the work being paid for is nonexistent. These direct economic costs are bad enough, but even more devastating and incalculable is the warping of the whole sector by its acceptance of corruption and crime as normal: “The fact of the matter is that the construction industry in New York City has learned to live comfortably with pervasive corruption and racketeering. Perhaps those with strong moral qualms were long ago driven from the industry; it would have been difficult for them to have survived (New York State 1990, 5).

Some illegal predators are pillars of society. Descendants, left a sufficient fortune, after the lapse of a generation or two, can aspire to high rank on the social ladder. There is at least one respectable Canadian-American family whose fortune was made from illegal traffic in liquor during the American Prohibition era. While the Continental Group, a multi-billion-dollar concern, was rebuked by the Federal Crime Commission for doing business with associates of racketeers, President Reagan, who appointed the commission, continued to maintain a close friendship with Frank Sinatra and even awarded him one of the highest American decorations, the Medal of Freedom. Sinatra’s close connections with gangsters were public knowledge for a generation.

The criminal underworld is also important in economies of countries other than the United States and Russia. In India, for example, the film industry is financed by the underworld, as well as part of the construction industry in Mumbai (Bombay). Rich businessmen, as in Russia, need
armor-plated cars and armed bodyguards (Business Week 1997a, 50, 52; Economist 1997g, 30).

Government Corruption

Government corruption occurs in many forms: tolls from gatekeeping, rent seeking, and outright predation or parasitism. In Pepys’s time, the rewards of public office came from the opportunities to use the power of the office to enrich oneself. This was not only a British custom. Talleyrand, who served as foreign minister under the French Revolutionary government, Napoleon, and the restored monarch Louis XVIII, acquired immense wealth from his office (Ori and Perich 1978).

The Christian church has always condemned the sale of church offices. It is a grave sin, the sin of simony. With churchmen generally giving priority to their duties over their own personal interests, the Roman Catholic and Orthodox churches are the only institutions that survived the fall of the Roman Empire, feudalism, and communism in Eastern Europe and still flourish under the various modern varieties of capitalism.

When the pope, head of the church and governor of the Papal States, did resort to corruption, it encouraged the growth and success of the Protestant Reformation. Several popes looked to the sale of cardinal appointments, bishoprics, and benefices for a substantial part of their income. Between March and May 1503, one of the most venal popes, Alexander VI, created eighty new offices in the Curia to be sold for 780 ducats each and appointed nine new cardinals collecting a total of 120,000 to 130,000 ducats for these latter (Tuchman 1984, 89). Stendhal reported that the father of Pope Clemente XIII (1758–69) was a rich Venetian banker and bought a cardinal’s appointment for his son for 300,000 thousand francs. The son was tormented the rest of his life by remorse for this great act of simony (1827, 89, 265).

It was not only Italian patriotism but also the deplorable way in which the Papal States were governed that made the papal subjects welcome enthusiastically their absorption into the Italian kingdom in the nineteenth century. While simony was a sin, nepotism was not. And it was by nepotism that the Papal States were mostly governed in the Renaissance and baroque periods. A new pope, an elective monarch, had no long-lasting dynastic loyalties to ensure having subordinates he could trust. He turned instead to family, his nipoti, that is, his nephews and other relatives. These were given the highest offices of state together with rich benefices, abbeys, and bishoprics whose revenues could be siphoned off to support them and
enrich the family. A nephew, sometimes still in his teens or early twenties, by happy chance might be competent enough to be a capable secretary of state, general of the armies, or commander of the Castel Sant’Angelo. Generally, however, the theocratic, nepotistically chosen elite was more successful in adorning Rome with great baroque palaces and churches than in providing for the material welfare of their miserable subjects.

Many less developed countries today have standards of ethics even lower than those of Pepys’s England. There are well-documented references to widespread corruption in a number of countries. Corruption is often the glue that holds the ruling party or clique together. Nicaragua under Somoza, the Dominican Republic under Trujillo, and Haiti under “Papa Doc” and his son were run like private plantations for the profit of the ruling families.

Countries are sometimes outright kleptocracies. The Philippines under Marcos was one such case. After his downfall, the equivalent of around $500 million was found in his bank accounts in Switzerland and repatriated to the Philippines. In the former Zaire, the loyalty of regional governors was ensured by allowing them to enrich themselves during their terms of office by placing levies on the public for their private purses. As one result, in much of the basin of the Congo River, roads have vanished back into the jungle and people have reverted from an exchange economy to subsistence. One Kamba cabinet minister in Kenya frankly explained to his fellow tribesmen that being in power meant that “We have been fed on bones for long, and it is our turn to feed on meat, while others feed on bones” (Economist 1993c, 47). Even in some of the better-governed African countries, like the Côte d’Ivoire, parasitism and predation are widespread.

The World Bank representative in Abidjan reported:

When I arrived in Côte d’Ivoire, I saw policemen stopping cars and asking for money. More recently, my day guard was attacked on the way to work. The thieves took his watch and broke his arm, but did not get his money. In the next few days, with the police and a doctor, he was less lucky. The police wanted a “tip” before filing a report on the incident. The doctor charged $12 for X-rays and a cast, but $80—half of the guard’s monthly salary—to sign a medical certificate that he couldn’t work. (Calderisi 1994, 20)

In Indonesia, “a willingness to enrich local and national officials is often considered the price of entry” (Sanger 1997, 38). President Suharto asked in December 1996 that foreigners working in the country donate 2 percent of their salaries to Indonesian charities controlled by him and his friends (Zachary 1997, A1).

The situation in India has been fairly public for decades. A compli-
cated tangle of regulations and laws that ensnared the economy contributed to a disappointingly slow rate of growth—labeled by some Indian economists the “Hindu rate of growth”—and fostered ubiquitous corruption. Import quotas resulted in a discrepancy between foreign and domestic prices: whoever could secure an import permit had the opportunity for instant profit. Controlled prices for important commodities like cement in times of shortage were below open market or black market prices, and getting access to fixed-price cement quotas meant a quick profit.

Liberal government economic policies alone will not eliminate corruption in India, however. It has much in common with Pepys’s England: the use of office for patronage and personal profit is sanctioned by tradition. Nepotism is more a virtue than a vice, for it is a duty to help one’s family, caste, and religion. The way to get someone in authority to make a routine decision in one’s favor—at a court, railroad station, or tax office—is to make a gift to the appropriate person. Even the gods can be influenced through the appropriate ritual sacrifice.

In China, widespread bribery is the way to oil the transactions of daily life. Officially, due to rules and restrictions, almost nothing is permitted. To survive and succeed, the most successful cheat and bribe. Official statistics indicate that 30 percent of state enterprises, 60 percent of joint ventures, 80 percent of private companies, and almost all shop owners cheat on their taxes (Xiao-huang Yin 1994, 46). As one policeman explained it, “we all take bribes. We know that our bosses and all the higher-ups do it. So why shouldn’t we? Our salaries are too low to live on and every little bit helps” (Kiely 1991, 48).

There are countries where bribery does not even receive the tribute of official hypocrisy. In Thailand, Deputy Interior Minister Pairoj Lohsoon-thorn told his Land Department officials that taking bribes was all right because it was part of traditional Thai culture: “It’s like if we went to a restaurant and a young boy watched our car for us, we would give him a tip.” Traditionally, officials in the king’s service were not paid salaries and secured their incomes by taking a percentage of the taxes and fees paid by subjects. Today, Pairoj pointed out, bureaucrats’ salaries are low, and this justifies their taking “tea money” (Associated Press 1996, A2).

In Bolivia and Colombia, a government official may be expected to refuse a fortune in bribes and risk his life if large areas of his country are to be kept out of the hands of drug growers and dealers. Not all officials are so dedicated and courageous.

Knowledge of the existence of corruption in much of the world is fairly common but the revelation of the pervasive corruption in Italy came as a shock. In 1990, an undertaker in Milan complained to a reporter that
he had to kick back 100,000 lire (about $70) from each fee he collected for a corpse that he buried from a charity hospice run by the city. This public complaint initially resulted only in the undertaker being replaced by someone more compliant. However, it attracted the notice of a public prosecutor. When in 1991 a businessman who won the cleaning contract at the hospice revolted at the money demanded, the police had him wired for sound and the hospice head was caught with the marked money the businessman had handed over for the bribe.

As the prosecutor followed up this first arrest, he revealed a picture of widespread corruption in the Italian political class. In Milan itself, confessions from some of the people arrested, including two former mayors, revealed a system of kickbacks in virtually all public sector contracts. Investigators found that politicians routinely demanded kickbacks of as much as 10 percent on nearly every public works project in the country. Political parties were dependent on kickbacks to finance themselves. The corruption was systematic and efficient. The political parties split the money according to their percentage of the popular vote. Contracts and patronage jobs were divided in the same way.

The investigation implicated the head of the Socialist Party (former prime minister Bettino Craxi), several ministers from the Christian Democratic and Socialist Parties, the secretary of the Christian Democratic Party, and members of the Democratic Party of the Left and the Republican Party. A total of 150 members of Parliament were involved. Craxi was convicted in 1996 and sentenced to eight years and three months in prison for corruption. He fled to Tunisia, where he died in exile in 2000.

An Italian financial paper calculated that over a period of ten years total *tangenti* (kickbacks) received by 132 members of Parliament came to 380 billion lire (around $400 million). The mayors of Rome, Naples, Turin, Bologna, and Milan resigned, and local governments in many parts of Italy were paralyzed (Kramer 1992; *la Repubblica* 1993; *Economist* 1993a, 45–46).

The private counterparts engaged in this corruption were of course equally numerous but not as much in the public view. In the two years, February 1992 to February 1994, around a thousand businessmen were arrested on bribery charges. The finance director of Fiat and the chief executive officer of the Fiat insurance group were imprisoned in February 1993 and charged with corruption for alleged illegal payments made to win some construction contracts.

In the summer of 1993, the investigation reached Raul Gardini. Gardini was one of Italy’s richest men, the chairman of Montedison and Ferruzzi Finanziaria. He had tried to corner the world soybean market in 1989.
He built the Italian challenger for the America’s Cup. Along with Gardini, Gabriele Cagliari, chairman of ENI (Ente Nazionale Idrocarburi, the state-owned energy conglomerate), was involved in the 1990 purchase by ENI, at an unduly high price, of the equity owned by Montedison in Enimont, a chemicals joint venture. This transaction cost the equivalent of $50 million in bribes. Gardini killed himself on July 13, 1993, and Cagliari killed himself in prison five days later (Zampaglione 1993).

A businessman turned politician, Silvio Berlusconi, with his new party, Forza Italia, won election in March 1994 in a general voter revolt against the old parties. Eight months later he lost his office when it became apparent that his companies had also been involved in the widespread corruption. In 2001, he became prime minister again although questions about him of tax bribery, tax evasion, money laundering, and relations with the Mafia are still unresolved. The Economist commented “to all but the wilfully uncritical, he stands for sleaze, if not outright criminality” (2001, 14).

Carlo De Benedetti, a leading Italian industrialist, confessed that his company, Olivetti, beginning in 1983, had paid kickbacks to Italian political parties to get government contracts. He said he had to do it because it was the common practice. The payments were listed on Olivetti’s balance sheet as “undocumented expenditures”: “Tangentpoli [kickback city] caused a distortion of the market. Companies weren’t even asked to make bids if they were on the black list of those who didn’t pay kickbacks.” He characterized the Italian system as “pseudo-capitalism,” dominated by oligopolies and corrupt ties between business and politics. He went on to say that “Italian capitalism needs rules” (Bannon 1993a, A15, A13). Pietro Marzotto, who runs a large textile company, echoed Benedetti, saying, “What is needed is less statism and more state, in the sense of imposing clear rules on the game” (Gumbel and Bannon 1993).

Romano Prodi (1997 prime minister and an economics professor), estimated that the system of tangenti added 15 to 20 percent a year to business costs. The Einaudi Institute, the economics research institute in Turin, estimates that corruption cost the Italian economy 6.5 trillion lire (more than over $4 billion) annually. It also estimates that corruption has added around 15 percent to the Italian national debt, an amount equivalent to around 15 percent of GDP (Forman and Bannon 1993).

A wave of corruption scandals similar to those in Italy broke in France in 1994. Jacques Médecin, a former minister and mayor of Nice, was arrested and jailed in Uruguay while awaiting extradition to France on charges of tax fraud and misappropriation of municipal funds. Another former minister, Jean-Michel Boucheron, mayor of Angoulême, fled to Argentina to avoid charges of embezzlement of municipal funds. Bernard
Tapie, a businessman and politician whose new party enjoyed surprising success in the June 1994 European parliamentary elections, was arrested at the end of the month on fraud charges. Hundreds of other politicians, public officials, and businessmen were charged, arrested, and placed on trial on similar charges. By the middle of 1996, included in the hundreds of prominent people mis en examen were eight former government ministers and dozens of mayors and former and current members of Parliament. Business was not spared. One-fourth of the heads of the largest 140 companies were included. According to a poll published in September 1994, two-thirds of French business leaders believe that corrupt practices are normal (Economist 1996a, 49; 1994e, 55). With the courts proceeding at a slow pace, the most notable person convicted of corruption by June 2001 was Roland Dumas, a former foreign minister who had been head of the constitutional council when the investigation had forced him to resign. On May 30, 2001, Dumas was sentenced to six months in prison and a fine of 1 million francs ($130,000) for participating in a scandal involving slush funds from Elf Aquitaine, an oil company. Of the four others convicted and sentenced, the most important was Loïk Le Floch-Frigent, Elf’s chief executive, who was sentenced to three and a half years in prison and a fine of 2.5 million francs. He commented after his trial that the system of awarding contracts through “commission payments” via Switzerland was known and approved by every French president since Charles de Gaulle (Financial Times 2001, 15, 16).

On a smaller scale, there was also a rash of corruption scandals in Spain in 1994 that tainted some members of the Spanish central government as well as the regional government in Catalonia.

Even in Japan, where the standard of everyday ethics is high, corruption has proved to be widespread. The Liberal Democratic government lost a confidence vote in the lower house of the Diet in June 1993 because it had refused to take steps to reform an electoral system that puts a premium on raising and spreading around large sums of money. There have been a series of scandals over the years. In 1976, the revelation that Lockheed had bribed Japanese citizens to secure sales of its planes led to a jail sentence for Kauei Tanaka, a former prime minister. In 1989, the revelations of the Recruit Company’s stock largess to politicians caused Prime Minister Takeshita to resign and ruined other leaders in business and government. In 1992, two companies, Sagawa and Kyowa, were found to have engaged in bribery. Sagawa, a package delivery firm, in addition to bribing legislators, gave nonrepayable “loans” to individuals in other companies. Some of these firms were fronts for one of Japan’s largest crime syndicates. In return, Sagawa received strong-arm help in penetrating competitors’ terri-
tories and bringing recalcitrant employees into line (Economist 1992, 28). In 1993, the National Tax Administration’s investigators found the equivalent of $50 million in banknotes and boxes full of gold ingots in the home of Shin Kanemaru, the former paymaster of the Liberal Democratic Party. The administration charged him with having failed to declare the equivalent of $16.7 million that he allegedly received in kickbacks and donations from companies seeking favors from the government (Reuters 1993b).

Bribery of government officials is supposed to have been particularly widespread in the construction industry. The head of Shimizu Corporation, Japan’s largest construction company, was arrested in September 1993 for allegedly paying the governor of Ibaraki Prefecture 10 million yen for directing business to his firm. This governor and two mayors were detained on accusations of taking bribes. The wave of arrests for business-government corruption led, as in Italy, to a crisis in the old governing party and the formation of a reformist government (Schlesinger and Kanabayashi 1993).

Tax evasion also appears to be widespread in Japan. Just as in the United States, it is the self-employed who comply least. Tax compliance rates are estimated at around 40 percent for farmers, 60 percent for non-farm self-employed persons, and 90 percent for employed workers (Hatta 1992, 233).

Predators, Parasites, and the Corporate Economy

While temptation to corruption is pervasive, the political process in modern democratic countries makes it difficult to keep corruption secret for long. Italy was more vulnerable than most because the Italian system of proportional representation kept the same collection of politicians ruling the country for decades, with individuals merely trading posts from time to time.

Corporations do not benefit from the harsh scrutiny of opposing parties out of power. The discussion on gatekeeping has illustrated one type of parasitism that may infect a corporation. Many of the perquisites, top corporate executives supply themselves with at the expense of their companies can also be classified as a parasitic toll. Many of these executive perks do not have to be disclosed in information available to stockholders.

The case is clearest that management perks are unrelated to performance when the executive is mismanaging his or her company. William Agee was fired as CEO of Morrison Knudsen in early 1995. While his company was losing money, it was providing him with a corporate jet for his private use, paying for a life-sized painting of him and his wife, and even...
planting petunia beds at his home. CEO Anthony J. F. O’Reilly of H. J. Heinz Company gave an annual three-day party at Dublin, Ireland, at company expense, of course. Some five hundred guests were flown in from around the world, housed at the best hotels, entertained at a gala ball at O’Reilly’s Georgian mansion, and hosted in a white pavilion set up at the Leopardstown horse-racing track for the main race, the Heinz 57 Phoenix Stakes. O’Reilly’s compensation totaled $182.9 million in the six years prior to 1997. While he was one of the best paid CEOs during these years, he was also cited by *Business Week* in five of these six years as being among the five CEOs who gave shareholders the least for their money (1997b, 107, 110).

*The Wall Street Journal* made a sample survey of some of the “imperial perks” of CEOs (1995. B1, B10). Here are some of their findings:

- Milan Panic, CEO of ICN Pharmaceuticals, received his salary of $584,000 in 1992 while he was on a leave of absence to serve as prime minister of Yugoslavia and promising the American government that he would not participate in the affairs of the company while prime minister. The company also paid for his personal support staff and some other expenses in the move to and from Yugoslavia.
- Don Tyson, chairman of Tyson Foods, received in addition to salary and bonus, $723,756 in 1994 for travel and entertainment costs; $759,000 to lease farm properties he owns, and $60,000 to lease his sixty-two-foot fishing boat. There were other company transactions with entities that Mr. Tyson owns or in which he has a major interest. In fiscal 1994, ending October 1, Tyson Foods reported a net loss of $2.1 million.
- Vernon Loucks, CEO of Baxter International, received $79,600 in 1993 in use of the company jet for personal travel, $33,450 for club membership fees, and car and financial counseling allowances. In fiscal 1993, Baxter reported a net loss of $198 million.

The so-called information superhighway is a magnificent example of human ingenuity and creativity. Unfortunately, some of it is being directed toward P&P. Predators take millions from banks through electronic financial transactions fraud. Computer programs are broken into and stolen. Information is extracted, deleted, or changed on personal computers by hackers. Electronic mail is easy to forge and can be read by unauthorized persons. A whole industry is being created to protect against and detect people who are trying to prey on Internet users.
Corporate law departments are sometimes used to intimidate. If a
giant corporation has a dispute with a smaller company over a trademark,
for example, a letter threatening legal action may be enough to force the
small company to submit, whatever the merits of the case. The deep pock-
ets of the large company cannot be taken lightly.

Corporate entertaining of customers is regarded as a cost and can be
charged against income tax. Even casual observation shows flagrant abuse
of this privilege: luxury yachts kept on the corporate tab that are used for
weekend entertainment of the top corporate officers and their “business”
friends, the corporate luxury boxes at football stadiums, theater parties,
corporate apartments, and so on. But, abstracting from the abuse, consider
what the substance of this type of transaction is. It is essentially a bribe,
money being spent for the personal benefit of an individual to induce him
or her to make a favorable decision on a corporate transaction. The indi-
vidual should be deciding whether to award a contract, for example, based
on the economic merits, not on which corporation provides the highest
personal gain. A direct payment of money is frowned on and illegal, but
receiving the equivalent in entertainment is not only legal but accepted by
the tax laws. The real essence of what is involved is recognized only in the
rigid restrictions on what government civil servants can accept.

*Predators, Parasites, Capital, and the Financial Markets*

The financial capital markets are crucial in the various forms of market cap-
italism in the world. The financial system mobilizes and allocates capital
resources. The lifeblood of the economy flows through financial institu-
tions. And confidence that the markets operate fairly and honestly is also
the prime condition for maintaining the necessary trust of investors.

Predation may well be one of the principal means through which, his-
torically, capital is accumulated. Schumpeter noted that robbery is one of
the historic sources of commercial capital: “Phoenician as well as English
wealth offers familiar examples” (1951b, 21). Keynes speculated that the
booty brought back to England by Sir Francis Drake in the Golden Hind
“may fairly be considered the fountain and origin of British Foreign Invest-
ment” (1930, 2: 156). Queen Elizabeth I invested part (£42,000) of her share
of the loot in the Levant Company, and the profits from this financed the
East India Company. Keynes, as a curiosity, calculated roughly that over
the years since 1580 the continued reinvestment of this portion of Eliza-
beth’s share of the booty would have accumulated to the aggregate total of
British foreign investments (£4.2 billion) in 1930 (1930, 156–57).
There is a rich history of how war has often been little more than organized predation. The Fourth Crusade was devoted to the conquest and sacking of Byzantium. The Nazi occupations in World War II looted conquered territory both directly and indirectly through purchases of local goods and services with fiat occupation currency. At Potsdam in 1945, the Western Allies recognized the legal right of Soviet troops to take “war booty” from its occupation zone. The history of India is rich with stories of predation through war. The invasion and looting of Kuwait by Iraq’s Saddam Hussein in 1990–91 is a contemporary example.

Extortion or inherited rights won by an ancestor’s exercise of force were commonly accepted ways of securing services or income in feudal or slave societies. In the Middle Ages, predation was an honorable and esteemed occupation. Regular commerce and labor for gain were looked down on. Trade was regarded as motivated by avarice for money and as shot through with cheating and exploitation. To lust for land was noble, for money ignoble. When, with the coming of the Industrial Revolution, the land turned out to be in the center of a growing city or rich in minerals, the harvest in money was serendipity. That it is more socially prestigious to be descended from an ancient predatory ancestor than to have made a fortune by means of your own efforts is still a strong cultural prejudice in England, on large parts of the European continent, and in Japan.

In Britain, the royals and a ducal family are among the richest families in the kingdom, enjoying wealth that comes from the exercise of feudal right and might. Some Japanese fortunes likewise stem from positions of power seized in feudal times. Social register family names whose wealth came from a robber baron ancestry are well known. Less well known is the fact that Franklin Delano Roosevelt’s grandfather, Warren Delano, laid the foundations of his family fortune in the opium trade to China (Meyer 1997, 22). Elihu Yale came away from Madras rich enough to make a large donation to found Yale University. Stanford University had similar origins, except that the money in question (which Harvard refused to accept) came from Stanford’s predatory success in the United States.

We can observe a similar process taking place in the former Soviet Union. The transition to capitalism brought both McDonald’s and the mafiya. When the Soviet economy was liberalized, the persons who were best acculturated to become successful entrepreneurs in a market economy were those who had lived as entrepreneurs in the socialist economy, that is, the black marketeers and corrupt bureaucrats. People in positions of power in the state or state-owned enterprises when enterprises were privatized could use their power to amass property. Other Russian biznessmen are founding their fortunes through crime and violence. When the transition
to a market economy is completed, a very large portion of the wealth held by individuals will not measure the productive contribution they made to the economy but rather the magnitude of the ruthlessness and cunning the members of the mafiya and former apparatchiks possessed in cashing in on the opportunities available to them.

Experience in Russia suggests that the highest economic cost of P&P may come when it is disorganized, that is, when there are a number of individual freebooters, each operating independently for his or her own pocket, preying on enterprises. The International Institute of Strategic Studies in London estimated that four-fifths of Russian businesses have to pay, on average, a tenth to a fifth of their profits as protection money. A new business might have to pay tribute to a local and central government official, a neighborhood mafiya, and local police, fire, and water officials. Each tries to extort as much as possible. The result is a discouragement of new business. If the bribe taker were a monopolist, he or she would have had an incentive to hold down the total amount of the bribe to encourage a larger volume of business. In short, a monopoly in parasitism is more economically productive than competition! Just as in nature, it is to the long-run advantage of a parasite if it does not unduly weaken or kill its host (Economist 1997d, 6).

By 2000, crime in Russia had become better organized and less likely to be engaged in destructive feuds. The new rich are becoming strong advocates of law and order. With the interpenetration of crime, business, and government, the individuals who have been most successful in coming out on top are trying to legitimize their newly acquired wealth and power through government action and buying control of the press and television. Viktor Chernomyrdin, the managing director of Gazprom, Russia’s gas monopoly, who became prime minister in December 1992, shared control of one of the three main television channels with the owner of a bank that helped pay for President Yeltsin’s reelection. The president’s national security adviser, a financier, controlled a second channel (Cottrell 1997, 30).

Drug dealers in the United States, drug cartels in Colombia, cocaine growers in Bolivia, and drug smugglers and money launderers across the globe are amassing wealth that will provide important pools of capital for the future. According to estimates of the “World Drug Report” prepared for the United Nations International Drug Control Program, the illicit drug trade generates as much as $450 billion annually in revenue, equal to about 8 percent of total international trade and comparable to the annual turnover in textiles. Of this total revenue, only 3 to 5 percent is received by the primary producers of the drugs; most of the rest fills the pockets of the traders and recipients of bribes (Wren 1997, A12).
The market in U.S. Treasury securities, with several trillion dollars outstanding, has an average trading volume of over $100 billion a day. It’s a world market that is dominated by the forty investment and commercial banks that are authorized by the Federal Reserve Bank of New York to deal directly with it. Of these, almost half are non-American.

In 1990, Salomon Brothers was the largest securities dealer in the United States and one of the five largest in the world. In August 1991, it was discovered that the firm had been breaking the competitive rules and attempting to “squeeze” the market by cornering the supply of new Treasury securities and driving up prices. Two managing directors of the firm were fired, and the chairman and chief executive, the president, and the vice chairman resigned (Siconolfi August 19, 1991). Salomon Brothers and two hedge funds (Steinhardt Management, Inc., and Caxton Corporation), which also were involved, agreed in 1994 to settle a class action suit against them by paying $100 million to bond market participants who claimed to have suffered damages of up to $250 million from the squeeze. (Wall Street Journal 1994, C12).

The remaining four of the world’s top five securities dealers were Japanese. Beginning in 1991, all four were implicated in major financial scandals. Nomura, the world’s largest brokerage house, and the three others confessed publicly to having improperly compensated large favored clients for losses.

The Nomura and Nikko securities firms also admitted that affiliated companies had lent 40 billion yen ($290 million) to Susumu Ishii, the retired head of Japan’s second-largest crime syndicate. Nomura manipulated the stock price of the Tokyu Corporation to allow this gangster to sell his shares at a large profit while small investors were losing money. Nomura’s chairman and president were forced to resign but were reinstated to the board in 1995. In 1997, Nomura was again caught paying 49.7 million yen (around $400,000) to compensate for the trading losses of another client linked to a criminal gang; Nomura’s president, chairman, and members of the board resigned.

The American subsidiaries of three of these four firms agreed to pay cash penalties to settle actions taken against them by the American Securities and Exchange Commission in February 1993. Among the charges settled were: assisting Salomon in illegal purchases of U.S. Treasury securities, improperly reimbursing losses incurred by a client, improperly maintaining licensing records, and improperly logging orders in client accounts. The fourth firm, Nikko, which refused to settle, was accused of concealing an $18 million loss in its accounts (Harlan 1993).

In June 1997, four former directors of Dai-Ichi Kangyo, Japan’s
fourth-largest bank, were indicted for making illegal payments of more than 11.7 billion yen (around $103 million) to a racketeer, Ryuichi Koike. Koike also received around $250 million in loans from Dai-Ichi Kangyo. After prosecutors questioned Kuniji Miyazaki, the former chairman of the bank, who had been involved in making these loans, he hanged himself.

In September 1997, the chairman, president, and four other executives of Daiwa, Japan’s second-largest securities dealer, resigned after they were charged with having made illegal payments equivalent to $560,000 to racketeer Koike (Koike was sentenced to nine months in prison in April 1999).

Yamaichi, the smallest of the four major securities houses, was banned from underwriting government bonds, and five of its current and former employees were arrested on charges that the company had also made illegal payoffs to Koike. Yamaichi closed, bankrupt, on November 24, 1997, confessing that it had tremendous off-balance-sheet losses (Economist 1991a; Economist 1991b; Sterngold 1991; WuDunn 1997; Bloomberg News 1997a, D2; Bloomberg News 1997b, D15; Reuters 1997, D2).

The shares markets are a most important capital market. Prior to the founding of the Securities and Exchange Commission (SEC) in the United States, notorious Wall Street operators like Jay Gould would use their control of corporations to manipulate stock prices at the expense of legitimate investors and come away with the foundation of great fortunes.

Today such manipulation is illegal in the United States, and there are no reports of it occurring on any appreciable scale.

There appears to be another kind of manipulation common today that is legal but costly to investors. In recent years, the total of initial public offerings (IPOs) of shares has run around $40 to $50 billion a year. Such shares, once launched, after the initial period often underperform the market. The record shows that the profits and cash flow of an IPO are generally attractive the year before the issue but fall in subsequent years. A study of this phenomenon found that it appeared that managers artificially boosted profits by “massaging” the accounts—legally. This can be done by changing the rates at which assets and liabilities are depreciated (Teoh et al., 1994).

For investors to maintain their confidence in the integrity of the market, the playing field has to be fair: all investors should have access to material information. Trading on insider information has been illegal in the United States since 1934. In many cases, when the SEC found reason to act, the individual concerned was penalized only by having to give up his or her ill-gotten gains.

In recent years, the SEC has become firmer. In 1985, Paul Thayer, the former deputy secretary of defense in the Reagan administration, was con-
victed for trading on insider information and given a four-year jail sentence. Then, in 1986, through a fortunate chance a series of insider traders were found and convicted. The unraveling began when some of the staff of an offshore bank noticed the extraordinary success of one of their clients in trading on the New York market. By piggybacking their transactions on his, they created enough suspicious activity in the stocks to alert the SEC. Once the first culprit was caught, following the trail led to others. The first, Dennis Levine, a Drexel Burnham Lambert managing director, exploited confidential information involving the shares of fifty-four companies over a period of four years. After being caught by the SEC, he paid $11.5 million in fines and drew a prison sentence to boot. The trail finally led to Michael Milken, who was the biggest catch of all.

In 1997, the Supreme Court strengthened the ban on insider trading by extending it to people who trade on confidential information even if they do not have any connection to the company whose shares are traded. The conviction of a lawyer, James H. O’Hagan, was sustained. O’Hagan had made a profit of $4.3 million by trading in the shares of the Pillsbury Company using information from his law firm, which was acting for a company planning a hostile takeover of Pillsbury.

The European Community (EC) issued a directive in 1989 to ban insider dealing, and most members of the EC that lacked such laws have since made it an offense. But enforcement is another matter. The British record is the best but still pitiful.

From 1980, when insider dealing became an offense, to July 1994, some three hundred cases were investigated by the British Department of Trade and Industry (DTI). Fifty were prosecuted and only twenty-three convicted. New, more stringent insider-trading laws came into effect on March 1, 1994. During the whole of 1994, the Stock Exchange referred seventeen suspected cases of insider trading for investigation; only two were successfully prosecuted.

In one notorious case, DTI announced in July 1994 that no action would be taken on referring Lord Jeffrey Archer, a prominent Tory politician and novelist, for prosecution. In January 1994, shortly after the board of Anglia TV, on which his wife was a director, had met to consider the takeover bid of another company, Lord Archer used a stockbroker with whom he had never before dealt to buy fifty thousand shares of the company. The shares were booked in the name of BROOK SAIB, a Kurdish friend. Two hours after news of the merger became public on January 18, Archer sold the shares for a profit of £77,000 (Economist 1998, 98).

Share prices often rise suspiciously before a takeover bid. France banned insider trading in 1974. The enforcement agency, the Commission
des Opérations de Bourse, secured the conviction of seven men (who were given suspended sentences) in September 1993 for insider dealing and fraud for trades made as Pechiney was about to take over American National Can Company.

German action was prompted by an insider-trading scandal in Germany’s biggest bank, the Deutsche Bank. In Germany, the stock market is dominated by the banks, and their employees are allowed to speculate in the market. In the Deutsche Bank, employees were allowed to borrow an amount equal to one year’s salary to speculate in the securities markets, it being understood that an unwritten code kept individuals from profiting from their insider information. As the result of an anonymous tip, in 1991 government authorities investigated possible tax evasion on profits derived from insider trading by Deutsche Bank employees (Protzman 1991).

On August 1, 1994, a law finally took effect making insider trading a criminal offense and creating the Bundesaufsichtsamt für das Wertpapierwesen to administer it. The first conviction occurred in August 1995 when the son of the owner of a machinery company, Krones AG, was fined the equivalent of $1.3 million for trading on insider information. The case was flagrant: he sold his shares just days before the company announced big losses. The stock fell about 45 percent in a few days, and the volume was about ten times the normal level. Less obvious occurrences will be harder to detect, especially because the staff of the supervisory office is tiny and Germany has no automatic notification to the office by companies or stock exchanges that substantial changes in stock prices have occurred that require explanation (Marshall 1995, A5). The German law also bans “front running,” that is, the situation that occurs when a broker gets such a large order to trade in a stock that the price will move and he or she deals on his or her own account first to take advantage of the anticipated price movement. No convictions have been reported. In most of Western Europe and Japan, investors who do not have access to insider information have to tread carefully and remain aware that they may have a substantial disadvantage in investing through the stock markets.

The world currency markets are secret and largely unregulated. Large amounts of “dirty” money, derived from the illegal trade in drugs and other forms of crime and terrorism, flow through the system each year. One estimate by British intelligence puts the volume of money that is “laundered” through the system at around $500 billion a year. This is fairly consistent with the United Nations’ estimate that illicit drug sales total around $450 billion a year, making this industry the fourth-largest in the world (Economist 1994b, 8; 1998c, 45). Nonprofessional customers of traders in foreign exchange markets are usually ignorant or ill informed
about prices. Since rules are few, money may be made from “front running” or exorbitant spreads.

With massive borrowing from banks, currency traders control multi-billion-dollar positions with a fraction of the amount in capital. In a small market, a trader with substantial resources can sometimes control currency prices all by himself. Andrew Krieger, the Bankers Trust New York currency trader, in 1987 made massive sales of the New Zealand currency, the kiwi, driving the price down with sales that eventually equaled 14 percent of New Zealand’s foreign exchange reserves. This and other transactions netted Bankers Trust currency trading profits of $513 million in 1987 (Smith 1992, A7).

In September 1992, the currency speculators took on the EC central banks, which were defending the exchange rate mechanism (ERM) that linked the currencies of the European Community. In spite of massive efforts by the central banks defending their foreign exchange rates, Great Britain, Italy, and Spain were forced to devalue their currencies. Other countries were forced to follow suit. The economic case is not at all clear that the currency parities that the central banks were attempting to maintain were wrong. What is clear is that the speculators prevailed and walked away with billions of dollars in profit. One, George Soros’s Quantum Fund, made a $1.7 billion profit speculating on the British pound’s devaluation alone.

Bank Negara, Malaysia’s central bank, in the 1980s used its resources to make “lightning raids” in currency markets. By coming in late in the afternoon with transactions as large as $250 million in the smaller markets of the 1980s, it was able at times to change the price of the targeted currency as much as 1 percent. Coming up against more able speculators in 1992, it lost more than $3 billion and in 1993 more than $2 billion. In early 1994, to prevent still more losses, Bank Negara changed Malaysia’s banking rules abruptly to fight off attempts by hedge funds, banks, mutual funds, and other large speculators to drive up the value of the Malaysian dollar itself. This whole predatory adventure came to an end in April 1994 with the resignation of the central bank governor and his head of foreign exchange operations (Sesit and Jereski 1994; Economist 1994a, 82–83).

Minority shareholders in a firm are sometimes defrauded by tunneling, that is, transferring assets or profits out of a firm (as through an underground tunnel) for the benefit of controlling shareholders. There have been many cases of such looting of firms by their major shareholders in the emerging market economies. This also happens in developed civil law countries. A study by Johnson, LaPorta, Lopez-de-Silanes, and Shleifer has documented several cases in France, Italy, and Belgium, where courts,
following their customary legal logic, allowed substantial expropriation of minority shareholders. These were cases in which a controlling shareholder simply transferred resources from the firm to himself through advantageous self-dealing transactions such as asset sales, contracts, transfer pricing, loan guarantees, and dilutive share issues (2000, 22–27).

Economies Dependent on Predators and Parasites

During most of human history, the relationship of governments with their hapless subjects—with few exceptions—is distilled in the pithy Italian saying “Governo, ladro” (When you say government, you say thief). For example, during the Spanish rule of Mexico from 1521 to 1821, the viceroys received no pay from the Crown but could keep whatever they could extort from the country, and the same was true of their subordinate officials. The resulting hopeless resignation of the subjects is likewise captured in the Neapolitan adage “Franza o Spagna, purchè se magna” (France or Spain, so long as we eat). The Vikings’ home economy was largely supported by their raiding and plundering of Europe in the Dark Ages, and they then took over as overlords of Normandy and subsequently England and Sicily.

Small countries may derive substantial economic benefits by providing a base for parasitism or predation on larger countries. The Barbary pirate states in the seventeenth and eighteenth centuries profited from preying on and extorting blackmail from shipping in the Mediterranean. A modern spiritual descendent, Abu Nidal, although he controls only a small portion of the earth’s surface directly, did equally well. Abu Nidal is a notorious Palestinian Arab terrorist who was responsible for the 1985 massacres in the Rome and Vienna airports. A 1988 French intelligence report suggested that Kuwait paid $80 million into Abu Nidal’s account in the London branch of the also notorious Bank of Credit and Commerce International in 1987. Until this payment was made, Abu Nidal’s men murdered Kuwaiti diplomats and detonated plastic explosives in crowded Kuwaiti cafes. After the payment was made, Kuwait enjoyed a period of freedom from terrorist attacks (Carley 1991).

In the seventeenth century, an important part of Bermuda’s economy was its income from piracy. During the American Civil War, Bermuda was a base for blockade runners into southern ports. Prohibition in the United States during the 1920s gave a kick start to Bermuda’s modern economy when thousands of American tourists visited Bermuda for the whisky and learned to enjoy its charm. After World War II, British, American, and Canadian firms set up headquarters in Bermuda to escape taxation at
home. An important portion of modern Switzerland’s high standard of living comes from its banking secrecy laws, which hide ethically earned assets but also assets derived from crime or corruption.

Paraguay’s staple export industry, smuggling between its neighbors, has usually been responsible for around a quarter of its GDP. It has also been an important market for Brazil’s and Argentina’s car thieves; a third of Paraguay’s automobiles are estimated to come from this source. Lack of a central registry for auto ownership facilitates the traffic. Autos stolen abroad usually are registered and receive license plates in small towns, which ask no embarrassing questions that might reduce the revenue from this source.

Some of the stolen autos imported into Paraguay are reexported to Bolivia. In May 1992, army colonel Luis Gonzalez Rojas, newly posted to the Chaco area, noticed a heavy traffic of trucks and four-wheel-drive vehicles on the dirty back roads leading into Bolivia. Investigating, he found that some border guards, with the approval of their superior officers, were taking bribes to let stolen vehicles pass. When he made his findings public, the army ordered him arrested on charges of divulging secret documents and slandering superiors. Only after the civil courts took over the case was Gonzalez released from jail (Associated Press 1992).

The Gambia, similarly exploiting the long protrusion of its territory into Senegal, profits from smuggling into and out of Senegal. And then there are all the offshore low-tax banking and insurance company refuges in the Bahamas, Belize, Mauritius, Western Samoa, and so on.

In recent years, the growth of paid telephone sex calls has allowed some countries to exploit this by deceiving customers who think they are making a cheap domestic long-distance call rather than an expensive international one. Moldava, the Netherlands Antilles, and Guyana have all profited. Forty percent (!) of Guyana’s GDP was earned from international telecommunications traffic in 1993 (Economist 1998a, 67).

As of January 1, 2001, 20 percent of Africa’s peoples were afflicted by civil wars, some of which spilled over national boundaries. Some of these wars have gone on for more than a generation. While ethnic differences have played a part in stimulating these conflicts, the ones that last longest are financed by predation. This appears to be true of the civil wars in Angola, Sierra Leone, Liberia, and Zaire/Congo, where exploitation of rich mineral deposits (diamonds or gold) led to competition among militarized predators (often the official government must be included in this category). The generations-long civil war in Colombia persists in part because traffic in narcotics is the source of finance that pays to arm and keep fighters in the field.
Conclusions

We know from economic theory that individuals usually have an interest in maximizing their incomes. The theory largely overlooks the primary choice that people have to make between trying to earn income through productive service or through predation and parasitism, exploiting coercive power. The P&P choice is often taken.

The discussion in this chapter has only scratched the surface of this subject. Ignoring P&P means ignoring an important force shaping the ways in which the regular economy works. An action as conventional as the founding of provincial banks in Britain was stimulated by the desire to avoid highwaymen preying on the transport of specie. Recent research has also shown that parasitism was widespread among artisans and craftsmen in Great Britain up to the eighteenth century. Workers supplemented their small money wages in ingenious ways of cheating their customers and employers (by substituting inferior materials in clothing and hats, stealing remnants, pilfering bits of cargo, etc.). One of the reasons for the introduction of the factory system was to shift production from the home to the factory so that the employer could supervise what was happening more closely (Linebaugh 1991). In a more recent example, most of the general merchandise moving in international trade these days is transported in containers—the use of which was stimulated by the need to avoid the widespread pilfering prevalent before.

Losses due to predation and parasitism and the costs people pay to protect themselves are huge. The obvious costs are losses from war, crime, and fraud and the costs of defending against these such as maintaining a military, the police, the courts, and penal systems. Americans spent $35 billion on local, state, and federal law enforcement in 1995 and almost double that sum, $65 billion, on private security services and products. The Internal Revenue Service (IRS) estimates that some 7 million citizens and 3 million corporations owe income taxes but avoid filing. Millions more cheat on the returns they file. Multinational corporations use creative transfer pricing or bogus transactions to shift income from the United States to lightly taxed jurisdictions. In total, the IRS estimates that about $150 billion in income taxes due on 1993 income, for example, were not paid. This was almost enough to have eliminated the federal government’s deficit for that year.

While the parasitic behavior of corruption may be immediately profitable to the individuals concerned, it may also have large social and economic costs. When corruption is widespread in a government, inertia,
inefficiency, and economic irrationality in the use of resources sap the economic life of the nation. If government officials sell import licenses and award construction contracts to whoever pays the biggest bribe, not only has an economically inferior choice been made but economic behavior across the whole economy is worsened as people observe that rewards flow to crooks rather than producers. Tax evaders reduce government revenues and force honest economic activity to be taxed more heavily. A company allowed to pollute a river may wreck the livelihood and health of thousands downstream. There are clearly social gains to be had if individuals in public life do not work to enrich themselves through corruption but instead are devoted to serving the community.

Some economies are stunted due to the ravages of predators or the costs of having to nourish parasites. Sicily is an attractive island, located at a crossroads of the Mediterranean, with many other natural advantages. In classical times, it was one of the centers of civilization. In modern times, Sicilians who emigrated to northern Italy and North and South America have shown the kind of energy and entrepreneurial skill that drives economic development. One of the reasons why Sicily has not lived up to its economic potential is clearly the heavy weight of the mafia succubus.

Between 1978 and 1992, the Mafia killed the chief of detectives, the head of the fugitives squad, and the deputy chief of the Palermo police; the general heading the military police; Italy’s leading anti-Mafia prosecutors; the leader of the leading opposition political party in Sicily and the head of the leading government party; two former mayors of Palermo; and the highest-ranking regional official, the President of the Sicilian Region. A good example of how the Mafia’s stifled the economy is the story of Palermo’s city opera house, the Teatro Massimo. It was closed for repairs for a quarter of a century. The equivalent of tens of millions of dollars were spent on repairs with the money going to Mafia-controlled construction firms that pocketed the money and made no progress in renovating the opera house. The job was done only after a series of indictments of Mafiosi. (Stille 1999, 49–52)

Southern Italy, also an economic laggard, has suffered from other criminal gangs, the Camorra and N’drangheta. The problems of New York City, described earlier, were exacerbated by the predators and parasites, legal and illegal, that preyed on vulnerable businesses trying to operate in the city.

If predation is sufficiently pervasive, economic regression may set in—as happened in Western Europe during the Viking raids, in African countries such as Angola and Zaire/Congo beginning around the time of their independence in the 1960s, in Equatorial Guinea and Uganda during the 1970s and 1980s, and in Sierra Leone and Liberia around the beginning of
this millennium. A similar process destroyed parts of American cities in the 1970s. Residents fled, driven out by crime and fearing for their children, lives, and property. Areas decayed, burned, and were largely abandoned.

Economic analysis and economic policy that recognize only the existence of exchange transactions and overlook those dominated by power such as predation and parasitism can be woefully lacking. To understand the economy, vulnerability to P&P and its probability have to be taken fully into account. Obviously, in transition economies like those of Russia and other successor states, overlooking P&P means giving up any pretense of comprehension of the economy and its problems. But in all economies to neglect transactions influenced or driven by power is to fail to come to terms with the task.