SHADY BUSINESS: WHITE-COLLAR CRIME IN HISTORY

Conference at the GHI Washington, September 18-20, 2014. Co-sponsored by the Said Business School at the University of Oxford. Conveners: Edward Balleisen (Duke University), Hartmut Berghoff (GHI), Christopher McKenna (University of Oxford). Participants: Gavin Benke (Southern Methodist University), Susanna Blumenthal (University of Minnesota), Oliver Buxton-Dunn (European University Institute, Florence), Jonathan Coopersmith (Texas A&M University), Neil Fligstein (University of California, Berkeley), Corey Goettisch (Emory University), William J. Hausman (College of William & Mary), Matthew Hollow (Durham University), Gisela Hürlimann (GHI/ETH Zurich), Annika Klein (Goethe University Frankfurt), Michael Kwass (Johns Hopkins University), William A. Pettigrew (University of Kent), Mitt Regan (Georgetown University), Arjan Reurink (Max Planck Institute for the Study of Science, Cologne), Anna Rothfuss (Technical University of Darmstadt), Malcolm Salter (Harvard Business School), Llerena Searle (University of Rochester), Uwe Spiekermann (GHI), Mark Stoneman (GHI), James Taylor (Lancester University), Thomas Welskopp (University of Bielefeld).

White-collar crime is different: it is nonviolent, financially motivated, and committed by professional elites. For a long time, executive and judicial officials treated it less rigidly than offenses against persons or the state. But this changed more than a decade ago, namely with the 2002 U.S. Sarbanes-Oxley Act. The first panel, “Toward a Theory of Economic Crime,” offered definitions and key terms for the conference and placed all contributions within the framework of current research. In his talk, “Organized Crime or Criminal Organizations? An Attempt at Systematic Differentiation,” Thomas Welskopp noted that there is no consensus on a definition of “economic crime.” Edwin Sutherland’s 1939 definition of white-collar crime as “a crime committed by a person of respectability and high social status in the course of his occupation” is often quoted but does not really distinguish white-collar crime from other forms, namely from “organized crime.” The latter can be defined as “the organized illegal economic activities of a group or network of perpetrators” or as the “illegal economic activities of criminal organizations.” Welskopp argued in favor of a clear distinction between “economic crime,” “organized crime,” and “criminal organization”; without such a distinction, public discussion and legal responses become ineffective. Arjan Reurink’s contribution, “Financial Crime: A Literature Review,”
started with the changed public perception of the financial sector after the global financial crisis of 2007–2008. The rapidly expanding literature on financial crime has shifted from a criminological and sociological understanding of white-collar crime to an economic analysis of the distinctive role of financial markets in post-1970s capitalism, especially in the context of deregulation under Reagan and Thatcher and after the end of the Cold War. Reurink pleaded for the recognition of the inherently criminogenic nature of contemporary financial capitalism: financial crime is triggered by the rise of arbitrage finance, the increasingly complex nature of modern financial services, and the parallel, mostly successful, efforts of market participants to decriminalize their previously illegal conduct. The first day of the conference ended with a well-attended public panel discussion. Joel Kirsch (Siemens USA) and Don Langevoort (Georgetown University) spoke on “Fighting White-Collar Crime in the Twenty-First Century.” They discussed the fundamental changes in how corporate economic crime, predominantly in the United States, has been treated and gave detailed insights into the motives of the key actors: corporations, lawyers, and the nation-state. Moderated by Hartmut Berghoff and Christopher McKenna, the panel discussion examined the changes in prosecuting economic crime in the context of the more general trends of globalization, taxation, debt-creation, and the crisis of the modern nation-state.

The scholarly discussion continued with the second panel, on “Conceptualizing Business Fraud.” This conceptualization is crucial because public and academic discourse on white collar crime often present individual stories but lack any convincing macro-analysis. In their joint paper on “Dodgy Business within the Long Arc of Capitalism: A Historical Framework for Understanding Fraud and White-Collar Crime,” Edward Balleisen and Christopher McKenna shared their conceptual framework for writing books on the American and European histories of business fraud. Balleisen gave an overview of his forthcoming book entitled “Business Fraud: An American History,” which focuses on organizational fraud against consumers and investors. This nineteenth and twentieth-century history pays attention both to the legal framework and to the varieties of business self-regulation. In contrast, McKenna analyzed the different forms of post-WWII scandals: Consumer and investment fraud, Ponzi schemes, control and contractor fraud, gatekeeper and accounting scandals were presented as keys to understanding the changing world of white-collar crime. Scandals matter; they allow for the examination
of specific aspects of Anglo-Saxon business and governance and thus of varieties of capitalism. Fraud, however, is more than a crime. In his presentation on “Trailblazers and Troublemakers: Risk, Innovation and Fraud in the British Financial Sector, 1900–1980,” Matthew Hollow discussed the relationship between fraud and innovation, using examples from Great Britain. Farrow’s Bank (1904–1920), advertised as “the people’s bank,” developed different marketing strategies, addressed new target groups, including women, and offered new services. In this case, however, innovation was used as a mode of suggesting respectability and of hiding crime. Other examples presented were outside brokers, like Jacob Factor, or the London and County Securities Bank, also known as “the shopper’s bank,” which institutionalized Saturday banking. Hollow argued that fraudsters were often innovators who met market needs and acted similarly to innovative competitors. In addition, they had an important influence on internal standards and the definition of “legitimate” business. Similar problems were addressed by Jonathan Coopersmith in his talk, “Like Flies to Honey: Emerging Technologies and Fraud.” Fraud and froth closely accompanied the rise of new industries and technologies. Technology especially received much publicity, which stressed the revolutionary potential of innovation but failed to mention the uncertainty of further technological developments and the lack of deep knowledge by investors. Fraudulent and frothy firms took advantage of this situation and thus levied an invisible “scam tax” on legitimate businesses. Coppersmith discussed the historical responses to this challenge: self-regulation led to due diligence, the creation of private fraud prevention organizations, and, in 1988, the founding of the Association of Certified Fraud Examiners. State regulation included anti-gambling laws, “blue sky” laws, and, in 1934, the creation of the federal Securities and Exchange Commission. These measures have reduced fraud and froth since the 1930s, but at the level of individual firms and investors, both can still be devastating today.

The third panel looked at “Shady Business and the State in Early Modern Societies.” Oliver Buxton Dunn explored “Corporate Fraud in Renaissance England: the ‘Eruption of Corruption’ in the Royal Custom Houses, London 1570–1603.” This paper focused on the introduction of British customs “taxation,” which triggered a myriad of fraud cases across Elizabethan England. The methods by which merchants and customs officers embezzled and concealed customs from the 1560s until roughly 1600 reveal highly organized networks
and schemes, which began to be described as forms of “corruption.” From 1588, governors ambitiously tried to supplement royal trade taxation using sophisticated methods. This was to be achieved by controlling strategic locations along rivers and in English towns, and most strikingly, by controlling the information to be submitted and collected by merchants and customs officials. Multiple volumes were to be kept independently by officers, to be later cross-checked. The most salient issue in contemporary sources was the “corrupting” of this new administration, particularly in terms of official fraud by customs officers. Thus fraud and corruption were an inextricable part of the development of modern tax administration, as the “white-collar crime” of Tudor professional elites drove the formation of a substantial part of the early British State. William A. Pettigrew’s paper, “Criminality and the First Century of English Multinational Trading Companies,” used the international histories of seventeenth-century English trading corporations to reflect on particular contexts for economic crime. As privileged legal franchises that operated across different jurisdictions, early modern trading corporations offer insights into the relationships between commercial expansion and lawlessness. The paper examined the first hundred years of these corporations’ activities to assess how merchants and politicians defined, contested, and located economic criminality. It explored how the agency problem in international trading corporations intersected with malfeasance as part of a developing discussion about corporate governance. Pettigrew stressed the need to understand the cultural meaning of fraud within mercantile and political debates and the ways it helped to inform the development of economic theory. Michael Kwass analyzed the “The Economic Crime of Contraband in Eighteenth-Century France,” which he also called a contribution towards “Historicizing the ‘War on Drugs.’” Smuggling was one of the most widespread economic crimes of the eighteenth century. As European rulers sought to stimulate, control, and fiscalize trade, they inadvertently created massive underground markets. The royal tobacco monopoly (1674-1791) and the prohibition of Indian cotton (1686-1759) generated particularly robust black markets, in effect globalizing an underground economy that had previously consisted primarily of local salt. The monopoly was policed by the General Farm (Ferme générale), a private customs and excise agency that was empowered to collect duties and taxes on behalf of the French king. Legions of smugglers colluded with, overpowered, or simply circumvented Farm agents to introduce large quantities of contraband into France. The growth of this underground economy had profound
political and cultural ramifications. The French crown attempted to roll back the underground by revamping the criminal justice system. Newly-created extraordinary courts sought to stigmatize smuggling by subjecting traffickers to corporal punishment before large crowds. But because smugglers and the wider population saw nothing morally wrong with smuggling, police and judicial repression only encouraged more sophisticated and violent methods of trafficking, as large gangs, forerunners of today’s drug cartels, moved contraband into the kingdom. Unfolding in the age of Enlightenment, the vicious cycle of repression and rebellion drew increasing attention from public critics. Philosophers, legal scholars, and practitioners of the new “science” of economics published numerous tracts that defended the smugglers. Intense public debate exerted tremendous pressure on a state that could only be fully reformed through the act of revolution.

The conference’s chronological survey of white-collar crime continued with the fourth panel, dealing with “Business Fraud and Nineteenth Century Anglo-American Law.” Drawing on a large source base of newspaper articles, James Taylor spoke on “Criminalizing Corporate Fraud in Victorian Britain.” While the first half of the nineteenth century was characterized by a lack of criminal sanctions for corporate fraud, the second half saw an intensified interest in such countermeasures. This shift resulted from changing public perception of investors and companies, which were no longer perceived as greedy and gullible actors but as the movers of basic capital flows in business. Criminal law was also used as an alternative to business regulation; this was in the interest of free business, economic elites, and the rising middle classes. Examining the other side of the Atlantic, Corey Goettsch used indictment records for his presentation, “‘Woe to a Generation Fed upon the Bread of Fraud’: False Pretenses and Capitalism in Nineteenth Century New York City.” His statistical analysis demonstrated that false pretenses were ubiquitous between 1834 and 1842, and that merchants, clerks, and bankers made the most money with this kind of crime. Goettsch also argued that this was a quintessentially capitalist crime: information asymmetry and different understandings of the terms and definitions of business were crucial for this kind of crime — and for capitalism as an economic system. The accused merchants were not “outsiders,” but closer to the mainstream of business than prosecutors and the public were suggesting. This theme was pursued further in Susanna Blumenthal’s paper on “‘A Black Lie and a White Lie at the Same Time’: The Apprehension of Forgery in Nineteenth Century America,” which
focused on the 1857 forgery trial of Wall Street broker Charles B. Huntington. This scandal triggered a broad and intense public debate on white collar crime, the reputation of the nouveaux riches, and the integrity of Wall Street and the financial sector. Although the defense pleaded moral insanity, Huntington was sentenced to five years of imprisonment. The resulting public debate centered on whether he was an exception, whether his customers had been innocent victims of forgery, or whether the speculative financial sector was inherently frenzied and therefore in need of more state regulation.

The fifth panel dealt with “Corruption and Fraud in the 20th century.” Annika Klein and Anna Rothfuss gave a joint paper entitled “Political ‘Opportunists’ Under Public Surveillance: Matthias Erzberger between Politics and Economy.” Erzberger, a prominent member of the Catholic Center Party and a deputy in the German Reichstag, accused Germany’s colonial administration of corruption. When it became known, in 1906, that Victor von Podbielski, the Minister of Agriculture, held stakes in one of the businesses that Erzberger had targeted, the ensuing debate developed into a scandal, resulting in the Minister’s resignation. When Erzberger was about to be appointed Minister of Finances in 1919, Karl Helfferich accused him of “political-parliamentary corruption,” arguing that Erzberger had systematically abused his political office and his connections to the Thyssen Corporation for personal gain. Erzberger sued Helfferich for libel and won. The court, however, also ruled that Erzberger was indeed guilty of “political-parliamentary corruption,” thus severely damaging Erzberger’s political career. Although the “corrupt” practices changed little between 1906 and 1919, their perception among contemporaries changed: close connections to the economic sphere were seen as increasingly problematic for political actors and ministers in particular. This process had already begun by the time of the Podbielski case and further intensified in the Weimar Republic. Corruption charges were often filed for political reasons and increasingly used to criticize democracy in the Weimar Republic. In his paper, “Cleaning San Francisco, Cleaning the United States: The Graft Prosecutions of 1906-1909 and Their Nationwide Consequences,” Uwe Spiekermann examined the constitutive period of American big business and the ensuing social conflicts. From the late 1880s, the “progressive” movement tried to cure modern society of some of its evils. One of the most pressing and ubiquitous grievances was corruption. While research has focused on the East Coast and the Mid-West, the first successful fight against corruption was fought
in the American West: a San Francisco graft prosecution from 1906 to 1909 not only removed San Francisco’s corrupt city government from office and lead to the imprisonment of the Republican political boss and the Labor Party mayor, but exposed the close interaction between political and business interests. The main supporter of the prosecution was a young multi-millionaire, Rudolph Spreckels, a prominent member of the business community and the Republican Party. Although supported by the federal government and his personal friend President Theodore Roosevelt, he was perceived as a “traitor to his own class” in San Francisco. This second-generation immigrant entrepreneur stood in the tradition of German social reform and American pragmatism. Although the battle in San Francisco did not achieve its goals, the leading prosecutors became national symbols of progressivism in the United States. William J. Hausman analyzed a corruption case from the 1920s and 1930s, a period of boom, financial contortion, and bust. His paper, “Howard Hopson’s Billion Dollar Fraud: The Rise and Fall of Associated Gas and Electric, 1921-1940,” showed that the rise of utility holding companies was an important factor in the overheating stock-market of the late 1920s. The stocks of utility holding companies rose much faster than industrial stocks, and they crashed much harder. The Associated Gas & Electric Company (AG&E) was one of the largest utility holding companies of the period. Controlled by a former New York state utility regulator by the name of Howard C. Hopson, AG&E epitomized both the opportunities and the excesses of the era. The assets of the company rose from $7 million in 1922 to nearly $1 billion in 1930 (current dollars). As is so often the case, few if any commentators saw the eventual crash and collapse of the holding company system coming. After the fact, however, recriminations were rampant. The industry was subjected to an extensive Federal Trade Commission (FTC) investigation. In 1935 Congress passed legislation that banned non-contiguous utility holding companies and mandated the dissolution of most of the remaining companies. Hopson tried to save the company, using various financial manipulations. Asked in 1935 to testify before U.S. Senate and House committees investigating utility company lobbying, Hopson fled, eluding authorities for days. After being relentlessly pursued, he was finally indicted in 1940 on federal mail fraud and conspiracy charges.

examined one of the most prominent scandals of the early twenty-first century. In 2006, the headquarters of Siemens, Europe’s largest electrical-engineering company, were raided by police in the course of an investigation by the Munich public prosecutor into massive off-the-books cash deposits for bribing foreign officials. In the ensuing weeks, Siemens commissioned an independent investigation. A U.S. law firm collected over 100 million documents and analyzed ten million banking records. The results were shocking. The scale of the alleged crimes was beyond imagination. By the end of 2008, Siemens had settled with all of the German and U.S. authorities involved, agreeing to pay a record 1.6 billion dollars in fines and disgorgement. A German judge coined the phrase “organized irresponsibility,” which implied that management had conspired to prevent efficient controls and thus facilitated corruption. Challenging this as an oversimplification, Berghoff proposed a set of different, more differentiated explanations ranging from economic to cultural factors inside and outside of Siemens. In his paper, “Short-Termism at its Worst: How Short-Termism Invites Corruption … and What to Do About It,” Malcolm S. Salter criticized the excessive focus of executives of publicly traded companies and investors on short-term results as the driving force behind increasing institutional corruption. Short-termism brings about behavior that, while not necessarily unlawful, erodes public trust and undermines companies’ legitimacy, core values, and their capacity to succeed in the long run. Among the consequences are the use of misapplied performance metrics, perverse incentives, the decreasing tenure of institutional leaders, and ineffective board oversight. Institutional corruption in business typically entails gaming society’s laws and regulations, tolerating conflicts of interest, and persistently violating laws and accepted norms of fairness. Salter recommended: several drastic reforms to improve board oversight; the adoption of compensation principles and practices that mitigate the destructive effects of inappropriate incentives; the termination of quarterly earnings guidance; and the elimination of the short-term bias embedded in our current capital-gains tax regime.

The seventh and final panel, on “Finance and Fraud at the Turn of the Twenty-First Century,” followed up the themes of Salter’s paper and brought the conference close to the present. In his paper, “‘A Bunch of Con Men’ — Enron and the Structural Roots of Corporate Crime,” Gavin Benke discussed an iconic accounting scandal that had an enormous impact on regulation reform. Advocating that historians use business scandals to address larger questions of political economy,
Benke argued that Enron’s fraudulent practices reflected broader developments in business. The accounting structures at the root of the scandal, Special Purpose Entities (SPEs), were not last-minute attempts to defraud the public but had been used by Enron’s managers for years. In 1990, Jeff Skilling and the recently-hired investment banker Andy Fastow began using SPEs as part of a strategy to mitigate the price risk associated with the natural gas industry’s deregulation. Over the course of the 1990s, the firm’s fraudulent activities evolved out of these legitimate operations and other well-established business strategies. Such a trajectory reveals the connections between corporate fraud and larger historical trends. The Enron scandal highlights how the collapse of the Bretton Woods system, the deregulation of numerous industries, increased competitive pressure, the growing power of institutional investors, and a national shift away from production and towards financial services contributed to greater economic instability in the twentieth century’s final decades.

The joint paper by Neil Fligstein and Alexander Roehrkasse, titled “All the Incentives Were Wrong: Opportunism and the Financial Crisis,” tried to explain the causes of widespread fraudulent and collusive behavior in the mortgage securitization industry before and during the financial crisis of 2007-2009. It demonstrated that the crisis was not caused by a few criminals engaging in aggressive behavior but by a systemic, structural problem extending across the industry as a whole. Incentives for organizations and their employees encouraged illegal and unethical behavior that became embedded in the standard operating procedures of organizations. Many actors at each point in the mortgage securitization process consistently engaged in opportunistic behavior as a matter of everyday business. Fee-based revenue schemes, intense demand for mortgage debt, and minimal regulatory oversight combined to provide incentives for various actors to defraud transacting partners. This observation challenges standard economic models of market-based regulation based on reputation and transaction costs. Instead, a sociological argument about the conditions under which market structures can fail to prevent widespread opportunism shows that regulatory institutions may be necessary to stabilize markets. This sharply challenges the Chicago School-inspired theory of self-regulating markets. By the time regulators understood what had happened, they feared that acting against all of the banks would further weaken them and cause the entire banking system to collapse. The conference’s final paper shifted the perspective from the developed to the developing world. Llerena Searle spoke on “Governing Financial Expansion: The Satyam Scandal and Emblems
of Credibility in India’s New Economy.” In 2009, the founder and CEO of Satyam Computer Services, B. Ramalinga Raju, confessed that he had been over-reporting the firm’s earnings for years, accumulating $1 billion in fictitious assets and bank balances. The confession plunged Satyam, a prominent Indian IT consulting and outsourcing firm, into turmoil and caused a crisis of confidence among potential foreign investors. Analyzing discussions of the Satyam scandal in the Western business press, Searle examined the moral economies that shape India’s global integration and the expansion of global finance. Even as the global credit crisis revealed that European and American financiers had been systematically disguising liabilities and exaggerating assets, Western commentators expressed outrage at the Satyam scandal. By exploring the ironies, disjunctions, and moral double-standards at work in these discourses, Searle shed light on the unequal power relations between financiers of the global North and South and on the mechanisms through which financial networks are created. Searle argues that foreign commentators were not bothered by the differences between Satyam and American or international firms, but the similarities: not by a lack of transparency but rather by a false perception of transparency. In short, the scandal cast doubt on the images of credibility on which the global financial system is based and through which Indian firms are integrated into global networks of accumulation.

Hartmut Berghoff (GHI) and Uwe Spiekermann (GHI)