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Dear Colleagues,

As was announced in CIO.GAL/28/03 of 4 April 2003, the Netherlands Chairmanship has invited experts to prepare discussion papers for the three working groups at the Economic Forum, which will take place in Prague from May 20 to 23.

It is my pleasure to forward herewith the discussion paper for Working Group A, written by Professor Dr. Michael Levi of Cardiff University (UK) and Professor Dr. Thomas Naylor of McGill University (Montreal, Canada). It should be noted that this paper reflects the opinion of the authors and not necessarily that of the Netherlands Government.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jos Schellaars'. The signature is fluid and cursive, with a long horizontal stroke at the end.

Jos Schellaars  
Counsellor

To: All OSCE Delegations

***Trafficking in Drugs, Light Weapons and Human Beings:***  
***The Role of the Business Community in the OSCE***  
A Guidance Paper for Working Group A

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### *Executive Summary*

In this paper we undertake three tasks.

The first is to diagnose problems with the existing discourse applied to understand economic crimes in general and trafficking in particular. We do so in the belief that sensible policy prescription is impossible if the problem for which it is being prescribed is poorly understood.

The second is to lay out an formal methodology for the analysis of market-based crimes, of which trafficking is a particular subset. This will help create an alternative framework for understanding the crimes, for elucidating the strengths and weaknesses of traditional forms of crime control, and for highlighting possible directions for alternatives.

The third is to suggest some specific alternatives that may be useful to combat trafficking, which have as their central feature, the active participation of the business community.

Implicit, sometimes explicit, in most discourse on the problem of economic crime, including trafficking in prohibited or restricted goods and services, are several basic notions:

- a) that the challenge of economic crime is largely the result of actors working from outside the realm of normal business activity, though they may use their profits and powers to infiltrate and corrupt legal markets;
- b) that the sums involved are so large as to pose a serious threat to legitimate society either by corruption of its institutions or, in the case of small and vulnerable countries, the wholesale subversion of the financial system;
- c) that modern advances in transportation and communications technology, combined with the reduction of barriers to international movements of labor and capital, have made the menace all the harder to meet;
- d) that, while not entirely neglecting the demand side of the market equation, the primary solution lies on the supply side which, in turn, means aggressive action on the part of the criminal justice system and/or the regulatory agencies of government;
- e) that, since trafficking poses a powerful threat to the position of the legitimate business sector, it can be mobilized in a proactive way to join the public sector in combating the menace.

To the extent that these assumptions are incorrect, at least in part, policy interventions based on them could have negative effects on the legitimate economy and society. Indeed, some have suggested that precisely the opposite to the general understanding is closer to the truth, namely:

- a) that some 'home grown' crimes (such as Enron, transnational corruption, etc.) can cause more harm than outside infiltration;
- b) that, compared to the total value of goods and services crossing borders, the aggregate amounts involved in trafficking are almost trivial;
- c) that modern advances in communications and transportation have done as much or more to reduce the opportunities for and to improve enforcement against trafficking crimes as to facilitate them;
- d) that in almost all trafficking offenses, strong and persistent demand drives the illegal market, and that the measurable vice levels tend to be sustained despite supply-side

efforts unless strong demand side efforts are made (and even then, success is by no means assured);

- e) that although it is always useful to involve as wide a range of private sector institutions as possible, the real onus lies on the public sector to define sensible limits of acceptable behavior.

Once again warnings are in order. Some of these generalizations may be true in particular societies in particular times, but, like their generic opposites, are never true 100% everywhere and always.

Irrespective of these grand macro positions, however, both governments and corporations need to act positively and sensibly in undertaking concrete action. More specifically a number of measures might be considered. These include:

- **Encourage policy ‘buy-in’ from business and the citizens if we are to develop sustainable initiatives.**
- **Irrespective of whether or not there are powers of compulsion in legislation, build in co-operative arrangements between business and law enforcement agencies, wherever feasible, and use Corporate Social Responsibility positively.**
  - Partly because of the nature of the market, anti-arms trafficking initiatives are those in which there is least evidence of effective practice. There should at the minimum be required labeling of small arms sent by suppliers to countries like the UK in which possession of guns is normally illegal, so that postal inspection can occur more readily.
  - In the people trafficking area, the most ready progress has been made in attempts to reduce child sex tourism, but there are promising initiatives to use NGOs to inspect transport for signs of oppressed or forcible removal, and there is scope for business to search proactively as well as to support reactively likely trafficked people.
  - In drugs precursors, it is vital to engage in outreach education, especially as more impersonal methods of distribution make it less likely that trained chemists will supervise orders. There is scope for electronic customer profiling to review patterns of suspicious ordering.
  - In money laundering, there have been very positive moves towards commercial cooperation, especially in low-end retail banking and in high-end private international banking.
- **Intervene against non-cooperators who can undermine industry initiatives by undercutting.** Without such occasional action (whether by criminal justice agencies or by regulators) the virtuous will feel cheated, though some may seek a positive reputational advantage by super-ethical conduct that should be encouraged and praised to raise general standards.

No one initiative or even set of initiatives is likely to ‘solve’ issues that are driven by demand for pleasure (drugs); pleasure and/or power (sex industry); for a better life (illegal migration); and/or for control over other criminals, law enforcement authorities and the public (small arms). However, though outreach to SMEs remains difficult, we can build positively on business responsibility and use due diligence in takeovers by transnational corporations to encourage adherence to international values where they exist. This requires ongoing attention and support on the ground, however, and cannot be achieved by legislation and regulatory provisions alone.

## Introductory Comments

Analysts of economically-motivated crime are often struck by the contrast between the amount of energy committed by political leaders, law enforcement and justice personnel, academics and mass media to deliberating on the problem, and the lack of usable (for policy purposes) results. Partly the gap reflects lack of good data; partly it reflects fuzzy analytical categories, many of which (like “organized crime”) are so broad in their scope that they are unhelpful. That double deficit makes it much more difficult to produce workable policy recommendations.

Therefore we see our central task not to produce more empirical information (though some problems of existing data will be highlighted), but to clarify the perspective within which information can be assessed, interpreted and applied, and to draw out the implications for policy. In performing this task, we have taken note of and drawn upon the extremely helpful *travaux preparatoires* in the OSCE meetings in Ioannina, Sofia and Tashkent but in the interests of clarity of exposition, we will not discuss them in detail in the text.

Our discussion proceeds in three parts. In the first, we attempt to highlight problems and ambiguities in much standard discourse, problems which are also present in some of the background documents compiled for this Forum. In the second, we lay out analytical elements useful for a clearer understanding of the problem of trafficking, particularly as it impacts the legitimate business community. In the third we suggest alternative approaches to the problem that do not rely so heavily on the standard criminal justice system reflexes. Obviously there is a need for co-operation in dealing with serious cross-border crimes, but if standard criminal justice approaches were so fruitful, there would be little need for this Forum.

We fully appreciate that, in the real world of diplomacy and politics, some of this imposed clarity may turn out to be transient. Nonetheless, before one pronounces on solutions to a problem, it would seem desirable to have a reasonably clear idea of just what the problem is. At the same time we stress the need to keep expectations of what can be accomplished within manageable bounds. Discussions of crime and its consequences are scarcely new. Yet each generation of policy-makers, academic analysts and law-enforcement personnel seems to enter the arena to combat economic crime over-infused with optimism, for three reasons.

One is the conviction that the problem is new, at least in terms of its dimensions. In fact very little is truly new in economic crime. Of course, techniques applied change along with general technical change throughout the economy; the circuits change with normal changes in world patterns of trade and investment; the infrastructure that supports economic crime changes along with the infrastructure that supports legal business; the proportions in which particular forms of economic crime occur likely change along with the proportions of their closest legitimate analogues. The trafficking of legal and illegal commodities tries to hide in the interstices of legitimate global trade and financial flows. Yet the central objectives remain essentially the same.

A second reason is the idealist view that it is possible to eliminate economic crime: that is the message which the popular “war” rhetoric tends to convey. We are not against idealism, but a more realistic hope is that certain forms of economic crime can be tamed sufficiently that they cease, for a time, to pose a serious threat to the health of the economy and society at large. Beyond that, the ambition to conquer can unleash economic and social costs that potentially become a larger threat than the crimes themselves.

A third misapprehension is the notion that the central problem is an alien invasion against which the legitimate must mobilize in a supply-side attack: this is particularly evident in debates over the problem of trafficking, including trafficking in the three commodities on which this Forum has chosen to focus.

Thus, with respect to drugs, the supply issue is almost always confounded with the work of “organized crime” groups usually of an ethnic nature. With respect to arms, the focus is largely on those smuggled into (otherwise peaceable?) recipient countries from (inherently disorderly?) places abroad – as if the relationship between arms supply and social violence is uniquely one-way. With “trafficked humans,” those involved are, by definition, outsiders, and even if seen as victims, may be assumed to be unwanted intruders.

This emphasis on alien invaders recalls the germ theory of disease. It was useful in the late 19<sup>th</sup> century in initiating modern curative medicine. But we have to be careful not to repeat the errors of early chemical and later anti-microbial antidotes to “germs” which often did more damage to the host than did the disease itself, as well as breeding drug-resistant strains. In modern medicine, the focus has shifted away from evil invaders to an effort to understand the environmental and genetic reasons why otherwise relatively inconsequential or even benign flora and fauna, many natural cohabitants of the human body, turn malign. A similar shift of perspective applied to economic crime would help us to better understand the problem, to form more reasonable expectations of the results of our interventions, and to allocate to various components of civil society – national governments, international agencies and business organizations – an appropriate role.

## Part I: Problems of Conventional Discourse

This Forum seeks to illuminate how businesses, governments and international organizations like the OSCE can best address the problem of trafficking in three commodities: drugs, light weapons, and exploitative labor (though perhaps this last category is better designated as “illegal labor”, see p. 9). These are certainly important. At the same time it is useful to note some tendencies that tend to muddle the discussion: interpreting correlation, which might be entirely spurious, as causation; substituting faith for fact; and relying on “data” of little or no value to bolster a claim. These can misdirect debate, misinform policy and over-inflate expectations. Let us take one example of each.

(1) *Confusing correlation with causation.* In the background documents on drugs, the following statement appears: “Those countries with high levels of organized crime have low levels of human development.” First, some G-7 countries also have high levels. Second, it is not obvious that “organized crime” causes underdevelopment: poverty, poor nation-building, and weak or strong-but-corrupt governance can feed its growth. We neglect at our peril informal political and economic structures for security and material means of survival, lack of which leaves those populations vulnerable to exploitation – as stressed by the keynote speaker at the human trafficking symposium. Third, with respect to human trafficking, it is employers in the G-7 countries which give both otherwise legal jobs (saving on minimum wage and social security payments) and illicit jobs (such as the sex industry) to illegal immigrants – no one forces them to do so. To take another example, sometimes the correlations themselves are debatable. Statements in the Sofia deliberations linking the supply of small arms and light weapons with social instability are certainly not something people in Texas are likely to take seriously.

(2) *Faith in place of fact.* Consider the claim that “money laundering destabilizes economies.” What money laundering does is give illegal money the ability to act as if it is legal money. The result is that a pool of black funds which might otherwise be genuinely destabilizing – it can finance capital flight, encourage the trading of smuggled and stolen goods, facilitate loan-sharking and be plowed back into refinancing criminal activity – gets attracted into the legal financial system and becomes available for normal business use (if there is the demand for legal business in the country). It is immoral for criminals to so benefit from their crimes in this way, but it is scarcely destabilizing unless the funds are used for political finance to ensure that criminal-friendly public officials are elected or appointed; are used to undercut and put out of business genuine firms; or in some other way are used to exert a high degree of influence over part or all of the socio-economic system.

(3) *Badly flawed data.* Consider the claim in the drugs discussion in Tashkent that: “In Afghanistan, 19% of GDP is drugs-related.” First, what does it mean to be “drugs-related?” This could include everything from camels to Camels, the first to transport and the second to barter for opium. Second, the notion of a reasonable approximation to a GDP-GNP calculation for Afghanistan is dubious, to say the least. Third, there are major disputes about the basis for calculating the monetary value of the world drug trade. In any case, the social damage caused by trafficking cannot simply be measured in money terms,

a point which we elaborate later in this paper.

There is a more fundamental concern that we would like to put on the table. Drugs, guns and illegal labor are clearly not the only commodities being smuggled across borders. It is therefore legitimate to ask just what is it that makes them special. The question is far from “academic.” It is a mistake to assume that the public automatically agrees that certain types of behavior are wrong, particularly when they involve personal moral choices. Yet for restrictive policies, no matter how well conceived and implemented, to have a reasonable chance of success, it is essential that the public be on side. Nor is business likely to be strongly supportive of an anti-trafficking initiative, at least in the long term, if the general public is not.

There are a number of criteria that could be used to justify these choices. The most common is how much money is involved. That would seem to immediately qualify drugs for special priority since, we are so often told, it is worth \$500 billion per year and is by far the most valuable form of contraband: it even ranks ahead of most legitimate commodities in world trade. However, even if such an aggregate number had any validity, given the multiplicity of products and routes in the world drug business, it is not clear how useful for assessing priorities or judging policy such a number might be. (This figure is also used incorrectly to lend support to the popular notion that the traffic is controlled by great criminal “cartels.”<sup>3</sup> The size – about which economists disagree - is also likely to make us feel more depressed than we should about the impact that our interventions make.)

In any event, if a heroin addict, for example, is rendered dysfunctional and a burden to society, it is because of the impact of the drug on the person, including lost productivity and costs of care, not primarily because of the money the person may have spent on the drugs. If one uses that last criteria, how much the drugs cost, as an indicator of social significance of the drug problem, the logical deduction would be that the cheaper and therefore more available are banned drugs, the lower the cost to society and the less of a problem trafficking in them represents.

Use of such numbers distorts discussion of policy options in another way. Prices for most drugs are high, not because of raw material or production costs, but because of enforcement - the ultimate measure of enforcement success is its ability to induce scarcity and drive up price. Since demand for drugs is “inelastic,” any decrease in total consumed is less than proportionate to the rise in price. As a result, when prices rise in the face of better enforcement, total expenditure rises. It is then absurd to argue that a high estimated value for world drugs indicates a crisis which demands more resources and tougher laws be committed to enforcement.

With arms, there are also major problems in trying to assess social impact from global data on market value. First, weapons (like drugs) are highly variable in nature, and equally variable in impact, without that impact being necessarily correlated with market

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<sup>3</sup> See R. T. Naylor, *Wages of Crime: Black Markets, Illegal Finance and the Underworld Economy*, Ithaca, New York: Cornell University Press, 2002, Chap. 1.



value. Furthermore market value is price times quantity. Over the last decade or more, the indications seem to be that prices have been falling, sometimes drastically. It may be possible to pick up an AK-47 factory fresh from Russia for \$200; it might be just as possible to pick one up for the cost of a chicken in southern Africa. Yet they kill equally effectively. Thus, if the trend in most drug numbers has been upward, due to tighter enforcement driving up the price and therefore total market value, with guns it is more likely the opposite, with market glut driving down the price and, probably with it, total market value. Yet it would clearly be quite wrong to conclude that the adverse social impact of illegal arms is therefore diminishing.

However the opposite conclusion may also be unwarranted. Unlike drugs where the point of possession is use, with guns possession and use are not so reliably correlated. Some societies have little problem of illegal possession; others have a widespread problem of illegal possession but not necessarily of use; and others have a problem both. The difference depends on internal factors, not primarily on what the traffickers do.

If it is difficult to get a good handle on the size of the global drugs economy, and perhaps harder to do so with arms, or to deduce much from aggregate numbers even if they were credible in either case, cheap labor trafficked across borders presents even greater difficulties. What figure is used to estimate the overall impact, in monetary terms, of trafficked human beings? Obviously just looking at price charged by the trafficker for crossing the border times the number of people, will produce a fairly trivial result. On the other hand, the aggregate earnings of trafficked labor on the other side of the frontier is not much guidance. Using alien cheap labor has many economic and financial repercussions: earnings lost directly by legal workers, earnings lost by legal workers indirectly by any effects the pool of cheap foreign labor has in driving down overall wage rates, losses to the government through taxes and social security charges evaded. On the other side it is necessary to factor in gains to consumers from cheaper goods and services and/or some calculation of the direct and indirect effects of improvements in corporate profitability. All in all this is a messy basis on which to launch an appeal for public understanding and cooperation.

Of course, there are many other, non-monetary criteria that can be used to justify priorities. Drugs, for example, can be judged in terms of numbers of users. But here there is an immediate difficulty. It is only if users of cannabis are aggregated with users of cocaine, heroin and dangerous synthetic drugs that in most countries a large enough number can be produced to give the impression that there is a serious social crisis. If, as good sense suggests, cannabis users are removed, the user population drops so sharply that the issue quickly becomes a social-cum-medical rather than a law enforcement problem. At that point public support for an anti-trafficking program which may involve longer lines or more intensive searches at borders, or more invasive surveillance technology, may well disappear.

However, there are other possible indicators of the harm drugs do. Drugs have obvious consequences for public health; drug money *might* on occasion infiltrate and corrupt legitimate businesses; and drug gangs *might* at some times in some places, though by no

means universally, use their proceeds and infrastructure to diversify into other contraband commodities. However, that approach is also not very convincing. Not only are cigarettes the most widely smuggled commodity in the world, and have been for at least fifty years, but unlike with drugs, the contraband in cigarettes would not exist without the active complicity of the major international tobacco companies (though, arguably, at least in part, to reduce competition from counterfeit tobacco)<sup>4</sup>.

Alternatively one might argue that arms, for example, are at or near the top of an anti-trafficking priority list because they produce death, destruction and social disorder. Leaving aside the fact that, unlike the case of drugs, with arms, possession and use do not automatically go hand in hand, there are many things that move through illegal trade channels that are potentially even more dangerous. One obvious example is hazardous (radioactive, poisonous, carcinogenic, infectious, explosive, corrosive and inflammable) wastes, both those produced directly by industry and those left over after meeting consumer demands. Here criminal entrepreneurs line their own pockets at the expense, not just of particular countries and communities, but of the entire biosphere. Light weapons are destructive of certain groups in certain communities; toxic waste trafficking directly threatens the future of humanity as a whole.

One might argue, too, that human trafficking is to be especially deplored because it robs the persons involved of their dignity. In some cases, particularly sex slavery and certain types of child labor in underground sweatshops, this is certainly true. Obviously weapons, drugs, and victimization, especially of women from poorer countries for purposes of sexual exploitation, are subjects worthy of concern. But surely the great majority of those moving in clandestine channels from country to country are consenting adults, who, far from feeling themselves victims, are happy to have the opportunity. Even if the conditions they face are far worse than labor norms for legal workers in the host country, they are probably better off than those prevailing at home, assuming any jobs could be found there. Again, this is not to disparage or deny the seriousness of the problem, but rather to suggest that invoking the supposed victimhood of the “trafficked beings” as a reason for stepping up measures to block them, is in most cases wrong. As well as traditional national-security-and-law-enforcement issues, we need to develop a newer and more complex human-security-and-sustainable-development agenda. Obviously the choices – drugs, guns and illegal labor - have been made. However we introduce these qualifications in the belief that if we also bear in mind other commodities, this will also help keep expectations of what different policy options can accomplish within reasonable bounds.

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<sup>4</sup> A recent European study of tobacco smuggling suggests that tobacco smugglers are unlikely to be involved in smuggling other illicit contraband such as drugs, at least at that time. See P. van Duyne, “Organizing cigarette smuggling and policy making, ending up in smoke”, *Crime, Law and Social Change*, 39, 285-317, 2003. In our view, this does not mean that some drugs smugglers did not start off as tobacco smugglers, nor that there no possibility of switching between commodities. But the reputational and penal risk of involvement in drugs is far greater.

## Part II: Changing the Discourse

The primary task of Working Group A is to elucidate the potential role of the business community in the effort to tame, if not eliminate, the problems that economic crimes pose for the larger society. Of course, there is something a little artificial about the division between the roles of business, national governments, and international organizations like the OSCE. In particular it is impossible to define properly a role for business without paying some attention to various agencies of government involved in regulating business. Furthermore, before we can reasonably ask the business community to take any particular action, we ought to make an effort to understand how it is affected, both by crime and by counter-measures.

Economic crime can adversely affect legitimate business on two distinct levels. The first is at the level of the firm itself - here a business may (or may not) be a direct victim (or in some cases beneficiary). The second, which is less understood but perhaps more important, is at the level of the economy as a whole - even if a business firm is unaffected directly by economic crime, indeed even if it is in some ways benefited by it, there may be adverse feedbacks from consequences felt within the economy as a whole. These consequences in turn can manifest themselves in two distinct ways. One is in terms of macro-economic variables - changes in tax codes, impact on bank lending patterns, fluctuations in exchange rates, etc. The second is in terms of the legal infrastructure - the recent proliferation of costly and intrusive reporting requirements to inhibit money laundering is an obvious example.<sup>5</sup>

Economic crimes take many forms. Some involve force or fraud; others involve free-market exchange. Some have victims and some have clients. Some are plotted by men with black eye-patches in smoky bars and some by people in the latest brand-name sportswear on the golf fairway, whether in one of our own countries or in some sun-drenched offshore finance centre. The only thing they have in common, apart from the motive of money (which may be only a partial explanation) is that they violate statutes which prescribe criminal sanctions for certain acts. If the objective is simply to haul malefactors before the courts and secure convictions (a difficult enough task in most OSCE countries), then that fact may suffice. If the objective is to understand the underworld economy, and evolve policies that are uniquely effective against specific forms of economic crime, policies that might involve us stepping outside the constraints of the traditional justice system, it is not very helpful.

The particular form of economic crime cited in this Forum is “trafficking.” However, as we explain in more detail below, we prefer to talk about “market-based crimes” of which “trafficking” (the process of moving illegal goods and services from supplier to customer) is only one, albeit important, dimension. And to ensure policy prescriptions are focused on and appropriate to the problem, it is important to distinguish “trafficking” from other forms of economic crimes. That, too, argues for a clear taxonomy which will

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<sup>5</sup> For a critique of anti-money laundering initiatives, see R.T. Naylor “Washout: Follow-the-Money Methods in Crime Control Policy” *Crime, Law & Social Change* 32, 1999 and *Wages of Crime*, Chap. 6

also permits us to deduce the likely part played by business in or against various forms of economic crime, the impact they may have on the economy at large, and the possible role of non-traditional participants in dealing with them.

### *An Alternative Perspective for Understanding Economic Crime*

Basically economically-motivated crimes can be divided into three main categories: (a) predatory, (b) commercial, and (c) market-based.<sup>6</sup>

(a) Predatory crimes take every form from purse-snatching to ransom kidnapping to extortion. What they have in common is that they all involve redistribution of *existing wealth* from one party to another using force or fraud. As a result, they produce readily identifiable victims (individual, institutional or corporate) who suffer easily calculable losses, restitution for which is a major objective of the justice system. Generally the public is on the side of any anti-crime measures: for the crimes are easy to understand and someone has clearly been wronged by someone else. Predatory crimes also have reasonably clear implications for: 1) the involvement of business; 2) the impact on the macro economy; and 3) the possible role of other branches of governance besides the traditional criminal justice system.

1) Predatory crimes take place outside normal business channels. Although businesses may be, and frequently are, victims, they are rarely involved in the perpetration. Granted, those who commit predatory offenses might from time to time use an apparent business as a front – but its purpose is purely to mislead and defraud, not to conduct business *per se*. From this it follows that it is usually in the best interests of businesses to be alert to such incidents and cooperative with efforts to curb them, even though collective action in their mutual interests may be inhibited by poor crime data collection or an unwillingness to share data and experiences.<sup>7</sup> Even if only a few business enterprises are direct victims, many more might suffer reputational damage as a consequence of predatory crimes, especially if a business front is used to perpetrate the offense.

2) Since the objective of a predatory crime is involuntary transfer of wealth from one pocket to another, it has no direct impact on the economy as a whole. At first glance this may seem surprising. But in a predatory crime, wealth is neither created nor destroyed – it is merely redistributed. Therefore the impact on GDP or GNP is nil. Obviously there might be indirect effects if incidents are sufficiently numerous to require a large transfer of resources from productive use to enhanced security. But that impact will depend on the presence or absence of unemployed resources in the economy. If the economy is more or less at full employment, increased security expenditures might have a negative effect on

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<sup>6</sup> This is summarized from R. T. Naylor, “Towards a General Theory of Profit-Driven Crime” *British Journal of Criminology*, 43, No. 3, 2002.

<sup>7</sup> M. Levi, J. Morgan and J. Burrows “Enhancing Business Crime Reduction: UK Directors’ Responsibilities to Review the Impact of Crime on Business” *Security Journal*, forthcoming 2003; M. Levi and J. Handley, *The Prevention of Plastic and Cheque Fraud Revisited*, London: Home Office Research Study 182, 1998. Sometimes, fear of being suspected of operating a business cartel can inhibit businesses from getting together into a crime reduction forum.

national income. But predatory crimes tend to be contra-cyclical – they grow when the economy is in decline. Therefore a reasonable presumption is that increased expenditure on security is most likely at times when there are unemployed resources. Unless predatory crimes are truly rampant, there is little reason to expect any serious negative impact on the overall business environment, though there may be redistributive effects within it, from the most vulnerable to the least vulnerable sectors.

3) Combating this form of economic crime has been, and remains, the preserve of the traditional criminal justice system. Since the perpetrators are from outside the normal flow of business, there is little if any call for the involvement of the regulatory (as opposed to the criminal justice) arms of the state. Since the crime redistributes wealth rather than creates new incomes, there are few, if any, fiscal implications, removing any reason for revenue authorities to be involved.

(b) The second set of economic crimes is commercial in nature. Committed *by* entrepreneurs, investors and corporations, they involve production and/or distribution of *inherently legal* goods and services using *illegal means*. Although they apparently function through the standard forms of bilateral, even multilateral voluntary exchanges typical of normal business, there is an illusion. While a predatory crime involves an involuntary redistribution of wealth, a commercial crime involves a fraudulent redistribution of income. As a result, in principle there are definable victims, but because it is sometimes difficult to determine where fraud begins and sharp but legal business practice ends, they are sometimes hard to identify in practice.

(1) These crimes intimately involve businesses (or business people) as perpetrators and, quite often, as targets. They could be committed at the expense of suppliers of inputs (for example, in bankruptcy frauds), buyers of output (for example, defrauding customers through substandard and defective products), or the society at large (for example, illegal disposal of toxic wastes.) Thus, some businesses may be adversely affected directly as victims; others may be harmed indirectly through reputational damage; yet others may be impacted negatively through the regulatory system to the extent that malpractice by a few leads to rigid and expensive new standards imposed on all. With commercial crimes, the business sector as a whole has a strong interest in policing the activities, even though any individual firm might profit from them. That, of course, suggests an active role of things like industry associations to increase scrutiny of member firms.

(2) The impact of commercial crimes on GDP (or GNP) is ambiguous. If the offense involves defrauding a supplier by underpaying or not paying for inputs, it redistributes income, leaving GDP unchanged. If the offense involves cheating a customer who overpays for value not received, GDP, adjusted for quality of goods, falls – the customer will have to divert extra income into making up the shortfall in quality or quantity, therefore reducing that available for other expenditures. If the offense involves a firm cutting costs at the expense of a non-transacting party – the environment, for example – the same supply of goods and services becomes available to the market at a lower cost, or a larger supply at the same cost. In such cases conventionally measured GDP actually increases – though that is obviously a flaw in conventional measures which understate

environmental costs. Since it is not clear if commercial crimes respond to stages of the business cycle, it is equally unclear what the impact might be on the macro economy from increased security expenditures. On balance (with environmental accounting), commercial crimes are probably either neutral with respect to the economy as a whole, or negative. That might affect the attitude of the business community collectively towards measures to cope with them.

(3) Although in most countries the traditional criminal justice system remains the primary factor in dealing with commercial crimes, arguably it is ill suited to the job. In most cases the frontier between the truly fraudulent and the simply “shady” is fuzzy. Hence these matters are usually best treated as regulatory issues. The relevant regulatory agencies, with ample consultation from the affected business, probably should have the primary, sometimes exclusive responsibility: criminal sanctions make sense only as a last resort. In some instances, taxes might be evaded; in others taxes may be paid, even on illegally earned profit. Hence there is no *a priori* expectation of a proactive role for the revenue authorities. On the other hand, unlike predatory crimes where the responsibility for ordering restitution lies with criminal courts, with commercial crimes, there may well be a bigger role for civil courts to reverse unfair redistribution of income.

(c) Now we come to the most complex, and, from the point of view of this Forum, the most pressing form of economic crimes. In contrast to commercial crimes, market-based ones involve production and/or distribution of new goods and services which are *inherently illegal* using, ironically enough, fundamentally legal means, namely free-market consensual exchanges: it is the good or service, not the mode of transaction, which is illegal. Therefore, in these crimes it is often difficult, sometimes impossible, to define a victim to whom restitution is due. This is the crucial distinction between market-based and other forms of economic crime. While predatory and commercial crimes result from the schemes of the perpetrator (they are, in a sense, supplier-driven), market-based crimes are demand driven. (Though people trafficking is more complex than the others, being driven supply side by economic and sometimes cultural ‘push’ factors from the country of origin, while also providing an important labor source for first world countries with low population growth and – though variable even within the EU - social protection for workers.) That has major consequences in terms of the potential role of business, the impact on the larger economy, and the optimal choice of which agencies of the state take the lead in dealing with them.

(1) With predatory crimes, businesses appear either as neutral parties or as victims. With commercial crimes, some businesses are perpetrators; others may be victims, either directly or indirectly through reputational damage. With market-based offenses, the issue is messier – it depends on what a legitimate business might gain from economic transactions with black-market dealers, on what black-market dealers might gain from transacting with legitimate business, and, something distinct, on what criminal entrepreneurs might gain from infiltrating and taking over legitimate business.

As to the first, some businesses no doubt gain from purchasing tax-free or smuggled inputs and from using cheap labor acquired through people-trafficking rings; some might

gain from selling their output to trafficking rings for black-market distribution. But rarely are such instances found to be endemic to a particular business sector. Such practices are usually confined to marginal operators in shady sectors. Therefore it is not at all clear that business in general, even in a vulnerable sector like tourism and entertainment, has much to gain from linking to traffickers, while, in reputational terms, it has a great deal to lose.

As to the second, contrary to widespread belief, the nature of market-based crimes does not automatically lend itself to formal business-type operations. What is required for success is usually an informal network based on trust (and sometimes, for that reason, ethnically based). That network can sometimes insert itself into an apparently normal business context, using it as a front for handling transactions or laundering money. That works best if the product is sometimes legal, sometimes illegal, and can therefore be laundered through regular business channels. Illegal wildlife, for example, starts with poachers and underground traffickers; but it is eventually sold overtly in things like pet stores or Chinese traditional pharmacies. Guns, however, might start with legal suppliers, licensed dealers or gun-shows, and enter black market chains to be sold covertly on the street. Jewelry, by contrast to both, starts in a legal manufacturing operation (even though the materials may be smuggled) and is traded through regular channels (though often with no paper), to be sold through apparently respectable shops (with the jeweler either making the client a cash deal or selling the item for full price and himself pocketing the tax money). Thus, it is difficult to generalize about the existence or nature of these inter-relations.

As to the third, the prospect that criminals might actually take over and corrupt legitimate businesses is a source of considerable fear, perhaps correctly so in some places. However, the issue involved is not the generation of criminal income so much as the subsequent laundering and/or investment outside the sector where it was earned. While that is an important subject in its own right, it is not directly germane to the issue of market-based crime – the same danger exists (or not, as the case may be) no matter what sort of crime generated the investable surpluses.

The analogy is frequently made between market-based crime and legitimate business, not in terms of their interrelations, but their similarities of operation. Discourse by police, politicians and mass media is replete with comparisons of criminal cartels and powerful multinational firms. Such analogies were also voiced at several points during the three OSCE preparatory seminars. Our point is that no cartels in the proper economic sense are needed to supply illicit commodities effectively within or across borders: indeed, networks are the modal form of crime enterprise.

(2) The impact of market-based crimes on the economy as a whole is clearer. *In the strictest economic terms*, market-based crimes are net benefits to the economy! The reasons are simple. GNP (or GDP) is a measure of income flows. The more new incomes are created through the provision of additional goods and services, whether legal or illegal in nature, the higher is GNP (or GDP). That is why some countries (and some international organizations) now try to add to national income accounts a component that approximates the value of illegal but consensual exchanges. Even if entrepreneurs switch

energy and resources away from legitimate commerce and towards criminal, the result is likely a plus - if the income gains from trafficking in contraband goods did not exceed the income losses from switching out of legitimate trade, why would anyone do it?

This is NOT to suggest that market-based crime is a good thing – obviously there are a myriad of anti-social consequences which, in a rational world, more than offset any GNP gains. But those gains can be real; and they serve as a warning that, however well a macro-economic case might be made against other forms of economic crime, it is a treacherous argument to use against trafficking offenses. This is particularly true when combined with the fact that there may be popular disagreement (not always self-serving) with decisions to criminalize some of these goods and services. Contrary to what the germ theory (and much of the background material for this Forum) might suggest, trafficking offenses are fundamentally driven from the demand side. Therefore rather than microbial infections, they are more analogous to fatty degeneration of the cardiovascular system, for which it would be foolish indeed to place the blame largely, let alone exclusively, on the ice-cream vendor.

(3) The question of which government agencies, instead of or in addition to the criminal justice system, can logically play a role in policing market-based crime can only be answered by a further subdivision. Market-based crimes exist because of and in spite of three distinct types of government interventions: regulations (which affect prices, quantities or permitted classes of consumers), taxes, and prohibitions.

Regulations create parallel markets in which *conditional contraband* (where the good or service is inherently legal, but the choice of customers is not) is made available at a *higher price* than that on the legal-but-controlled market. This is the case, for example, with illegally-sold steroids or Viagra diverted from the legal pharmaceutical distribution system. It is also true of some forms of firearms. In such cases it might be expected that members of the legitimate business community – pharmaceutical wholesalers or weapons retailers – might be active in supplying the parallel market along with, or sometimes in competition with, smugglers. Since the commodities have legal equivalents, in fact *are* legal under certain circumstances, there is an obvious role for the industry associations to help monitor and curb such trafficking.

Taxes also create parallel markets - for *fiscal contraband*. The key distinction is that the goods or services subject to excise or import taxes are available on the parallel market at a **lower price** than on the legal one - the difference is largely (though not exclusively) a function of evaded tax. The most obvious cases of fiscal contraband involve tobacco, alcohol and fuel. Here the vast majority of the contraband is handled by networks that are either embedded in the legitimate industry or work hand in glove with some elements of it. With fiscal crime, by definition, primary responsibility rests, not with the criminal justice system, but with the fiscal authorities.

Prohibitions create a class of goods and services that are *absolute contraband*. The illegal market stands alone – there is, by definition, no corresponding legal price against which to compare. That is why it is commonly referred to as a “black” rather than a parallel



market. This is clearest in the case of recreational drugs. In such cases both direct and indirect participation of legitimate businesses is likely rare. And the business community as a whole will have greater willingness to participate in combating the crimes. Still, black markets in absolute contraband have been, and likely will continue to be, principally the province of the traditional criminal justice system: any role of other government agencies or of business associations is likely to be auxiliary at best.

These differences in the various types of contraband are important, not just for the different agencies which might be used to help control and combat offenses, but also for methods of evaluating success or failure of such policies. For example, a policy which is successful against conditional contraband (in regulated goods and services) will work by restricting the amount that leaks onto the parallel market and thereby increase the spread between legal and illegal prices. A policy successful against the fiscal contraband will also reduce the supply on the parallel market, but that will reduce the spread between the prices. A policy successful against absolute contraband cannot be evaluated by reference to price alone – a point to which we return later. Furthermore, with no legal source or substitute, price hikes as a result of increased enforcement against absolute contraband may do more to increase the amount of income spent on the banned item than to reduce the quantity consumed.

#### *Anti-Trafficking: Problems of Conventional Approaches*

Thus trafficking is a sub-set of the category of market-based crimes which, as a class, are based on consensual market exchange. There is a demand side, which drives the formation and operation of the particular black-market; there is a supply side which responds in order to provide the good or service in demand; and there is an apparatus of dealers, brokers, merchants, wholesalers, retailers etc. through which the transactions are intermediated. On top, there are certain infrastructural services offered by those who provide security, legal assistance and money-management skills, all of which have legal economy counterparts.

In terms of importance, demand comes first; supply responds; trafficking in its various manifestations is an intermediate function; while the final set of actors perform strictly derivative services. That order of priority in the creation and operation of an illegal market presumably has relevance as well for strategy to control that market.

In formulating such a strategy, it is important to keep in mind that the true objective is *not* to eliminate illicit goods and services – if that were ever possible, it would require such sweeping measures as to inflict serious damage on the legal economy and society. A more reasonable objective is to restrict availability to some presumably well-understood and broadly accepted degree. Hence one must be wary when law-enforcement or regulatory agencies cite numbers of traffickers arrested or values of assets seized as indicators of success. These are merely means to the larger end, not ends in themselves.

However it is not obvious what alternative criteria ought to be used. Granted, the objective is to reduce the quantity of illicit goods or services available to the market. But

figures allegedly attesting to amounts taken off the market are meaningless without reference to the total actually on that market; and no one knows how much that might be. For that reason it is common to use price as a surrogate – if the price of the restricted or banned (or even taxed) item goes up on the parallel or black market, then presumably enforcement has achieved some success in restricting supply. Of course, that price hike could also be an indicator of increased monopoly power exercised by a few suppliers. But, detective-novel fantasies notwithstanding, monopoly in real world black markets is very rare.

However price is still not a fully reliable indicator. If the item is fiscal or conditional contraband, it is necessary to compare the trend of the parallel market price to the trend of the legal market price before assuming a price change is indicative of law enforcement success. Only with a prohibited commodity (absolute contraband) is the black market price alone of interest. Even then there is a problem. Are the price changes really representative of “market” reality? In general, black markets (more so than parallel markets) are highly segmented – so there is really no such thing as a “market price.” And even if a general upward movement of prices does occur, it may still be premature to declare victory.

Leave aside the obvious – that price may go up, not because the quantity arriving is restricted by a crackdown, but because regulators are imposing their own form of covert taxes on suppliers. The real problem is that if price changes truly reflect supply interruptions, they may be self-correcting. Short-run supply-price hikes are usually followed in the longer run by increased supplies which flood the “market” and return price to or below its previous level. It is therefore also necessary to carefully specify the time horizon over which any criterion for success is going to be applied.

Furthermore, even with a defined time period, it is misleading to always equate price increases with success in curbing the illegal traffic. For different goods and services respond differently to price changes on both their demand and supply sides.

Banned recreational drugs are produced solely for the illegal market. Almost every stage of their supply chain involves illegality. Farmers grow illegal crops; underground manufacturers create illegal chemical combinations. They obtain raw materials by illegal diversion; and they illegally acquire chemicals for processing. Then they sell finished products through a network of brokers, exporters, importers, wholesalers and retailers, each of whom is in violation of the law, and each of whom can easily attract unwanted attention. Although raw material costs are very low – the crops in question are robust weeds and usually highly compatible with the ecology of the producing area – costs of either subterfuge and/or corruption can be substantial. And payment flows must be laundered at each and every step – a single leak can lead to the regulators rolling up the entire chain. With all these points of vulnerability, it is striking that supply-side enforcement in the form of anti-trafficking campaigns, even when backed up by military muscle and cheered on by countless meetings such as this one, has been quite ineffective: billions have been spent and tens, perhaps hundreds of thousands jailed; yet there is no evidence of any sustained impact on availability or consumption. That does not hold out

much hope for the effectiveness of traditional anti-trafficking measures against goods and services where the products may be at least partially legally and/or the supply chain at least partially embedded in legitimate business structures handling legal counterpart products.

Since drugs are produced exclusively for an illegal market, the price on the market and the target price for purposes of assessing the success of anti-trafficking policy are presumably the same. As the price rises, that will presumably have some impact on both demand and supply sides. However demand for recreational drugs is inelastic – it falls relatively little in response to price changes. Supply, on the other hand, is highly elastic – given the facility of production, it responds remarkably well to price hikes. There is so much material available at any time, even dramatic seizures have little or no market impact, except in a very ephemeral way. Even if stocks are, by some fluke, temporarily insufficient, production flows can be quickly accelerated. This combination of highly inelastic demand and highly elastic supply is the worst possible set of circumstances faced by an anti-trafficking policy which relies on market responses.

With guns, the situation is different, but not much more reassuring. It is true that a crackdown on the supply entering a country will raise the price. And those who buy arms are (usually) not trapped by addiction or habit. However weapons, unlike drugs, are not consumer goods. They are more like producer goods – they are in demand because of the uses to which they can be put. If the objective is to commit crimes purely of violence, then even substantial price increases are not likely to have any serious impact on decisions to use them – only substantial changes in physical availability will do so. And if the intent is to use the weapons in profit-based crimes, either to commit a predatory offense, or to protect turf and profits in a market-based one, not only is weapons acquisition likely to be a trivial factor in cost calculations, but returns to their use bear no definable relationship to the price paid to acquire them. Therefore demand is unlikely to be seriously affected by increases in market price. Success or failure, in the short run, can be measured only by physical numbers, which in turn raises the problem of comparing the data on seizures to the total numbers that exist, something which no one has so far been able to compute with any degree of accuracy.

As to supply, the situation is also not very reassuring. If price rises in response to a crackdown, then, after a lag, the supply of arms, like drugs, will once again increase. In fact the corrective increase in supply may come even faster. Drug flows can respond quickly, but not immediately, to shortfalls. The response of weapons may be almost immediate. This is because arms are supplied from two distinct sources. They can come out new flows direct from manufacturers – as prices on the black market go up in response to anti-trafficking successes, more legitimate manufacturers might be tempted to divert their wares to the illegal market. But the bulk of weapons entering illegal channels seem to come from underground stocks – weapons, unlike drugs, are durable, and once consumed in one place, can be easily recycled for sale in another. The result is there are enormous caches in many places, just ready to enter international marketing channels.

They have, in effect, a virtual zero cost of primary production.<sup>8</sup>

With human beings the situation is messier still. Drugs are produced for the market in a continuous flow, and they disappear off the market at the point of consumption. Guns are produced for the market, but the market is usually fed from stocks; and, once consumed, guns can reappear on the market time after time. By contrast, human beings are not a commodity produced for the market and only very indirectly is their supply subject to economic influences. Granted the issue here is not total population, but the subset ready to move illegally in search of improved economic conditions (which can be worsened by internal conflicts and wider strategic changes). Thus, total supply of potential illegal workers grows regardless of market conditions – and what the market signals will do is convert potential into actual from a virtually infinite pool. Once again, supply elasticity, as in flows of drugs and to some degree stocks of arms, is very high.

If the response to increased inflows of illegal labor is to attack intermediation, which almost always means tighter border controls, the policy will, as with drugs and guns, drive up a price. But the affected price will be the price traffickers charge to convey people across the border. Whether or not an increase in that will serve to curb the number of people making the trip depends on two things.

From the point of view of supply of labor, it depends on how willing people are to pay more for their passage<sup>9</sup>. (Ability to pay is not as important, for the money can be borrowed from family, friends or even from trafficking organizations.) Willingness to pay is a function mainly of the disparity between incomes they can earn (or believe they can earn) in the target country and their standard of living at home. On the demand side, how much underground employers will offer depends on wages and working conditions that would prevail in their industries if they had to use legal workers instead. That is a price variable over which traditional anti-trafficking methods can exercise very little control.

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<sup>8</sup> On these issues see R. T. Naylor, “Loose Cannons: Covert Commerce and Underground Finance in the Modern Arms Black Market” *Crime, Law & Social Change* 22 1995 and Chap. 3, *Wages of Crime: Black Markets, Illegal Finance and the Underworld Economy*, Cornell University Press, 2002.

<sup>9</sup> We are not arguing that the search for a better economic future is the only motive for migration: fear and the search for emotional and physical security plainly are important – for a recent review, see H. Crawley, *States of Conflict*, Institute for Public Policy Research, 2003. However, only people with funds are likely to be of interest to traffickers.

## Beyond Criminal Justice: Reducing Economic Crime

In the knowledge that Working Party B is focusing on law enforcement issues, we present here an overview of some of the most significant ‘non-traditional’ approaches to combating economic crime which have been developing in recent years, in Europe<sup>10</sup> and elsewhere. While these are at present diverse and scattered, they may point cumulatively to a ‘way forward’ that will eventually be followed more consistently on a wider scale. Table 1 represents the three main current ‘non-traditional’ approaches to the prevention of organized crime<sup>11</sup>. In setting these out, we stress the importance of more serious specification of objectives and impact evaluation than is commonly found in an arena where ‘mission creep’ and enforcement routines can be unconsciously perpetuated.

*Table 1 Non-traditional approaches to organized crime prevention*

<b>Community approaches</b>	<ol style="list-style-type: none"> <li>1. Community crime prevention</li> <li>2. Passive citizen participation: giving information about harms and risks, hotlines for reporting</li> <li>3. Active citizen participation: civic action groups</li> </ol>
<b>Regulatory, disruption and non-justice system approaches</b>	<ol style="list-style-type: none"> <li>4. Regulatory policies, programs and agencies (domestic and foreign, including the Council of Europe/EU/FATF/IMF/ OECD/World Bank)</li> <li>5. Faster customs &amp; other regulatory treatment (e.g. anti-laundering measures) for firms &amp; countries that have instituted approved internal compliance programs</li> <li>6. Routine &amp; suspicious activity reports as investigative triggers</li> <li>7. Tax policy and programs</li> <li>8. Civil injunctions and other sanctions (RICO, contract vetting)</li> <li>9. Military interventions</li> <li>10. Security and secret intelligence services</li> <li>11. Foreign policy and aid programs (certification, Most Favored Nation, EU accession)</li> </ol>
<b>Private sector involvement</b>	<ol style="list-style-type: none"> <li>12. Individual corporate responses</li> <li>13. Professional and industry associations</li> <li>14. Special private sector committees</li> <li>15. Anti-ID fraud and money laundering software</li> <li>16. Private policing and forensic accounting</li> </ol>

<sup>10</sup> It may also be appropriate here to clarify why we have used the term ‘reduction’ rather than ‘prevention’. This is because although in continental European circles, ‘prevention’ is more common as a contrast with law enforcement of ‘repression’, we think that the linear term ‘reduction’ more sensibly and accurately represents what we practically should be aiming for and can see than the binary term ‘prevention’, which misleads us into thinking we have either eliminated crime totally or we have failed. When we refer to ‘in Europe’, agencies from non-European government, such as the US and, to a lesser extent, Canada, have played a very significant role as part of the internationalization of enforcement.

<sup>11</sup> This is extended and adapted from Schneider, S. ‘Alternative Approaches to Combating Organized Crime: A Conceptual Framework and Empirical Analysis’, *International Journal of Comparative Criminology*, 1(2), 2001, pp.144-179.

The actual use and potential viability of these different approaches depends on the context. In particular, there is a risk of excessive homogenization in the use of the term ‘business’ when it is clear that businesses vary widely in their motivations both for compliance to the law and for the wider exercise of Corporate Social Responsibility, a term whose salience in corporate life has been enhanced in recent years, stimulated by scandal but also by consumer and media pressures for transparency. At one end of the business spectrum are (a) ‘fly by night’ companies set up for fraud or money-laundering with no aim of long-term prosperity and (b) ‘amoral calculators’ whose owners and managers respond to their legal environment only when they expect laws and regulations to be applied (which varies between countries and type of offence and over time). At the other end of the spectrum are those multinationals whose dealings with the general public and with governments and with international institutions such as the World Bank for contractual and other purposes are significantly affected by reputation, including *but not restricted to* the absence of criminal convictions or ‘serious’ regulatory penalties<sup>12</sup>. Businesses themselves may face harm as individual enterprises; reputational harm as individual enterprises or as part of a collectively stigmatized group (such as ‘investment banks’ in the current climate); and infrastructural risks through having their liberties to trade severely curtailed by legislation if they do not get their own houses in order. One way of expressing this is to divide business involvement in organized crime reduction as follows:

1. measures that businesses would do for themselves, individually and/or collectively, in their own as well as the public interest, without any prospect of government or international intervention;
2. measures that businesses would carry out because they fear government intervention and wish to avoid it; and
3. measures that businesses would carry out because they fear and/or have observed actual or likely enforcement action<sup>13</sup>.

But there are some general policy principles – many drawn from observation of ‘what works’ in practice - that seem to us to be appropriate and that fit in with our approach of market-oriented crime reduction interventions in the dynamics of globalized enterprise economies:

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<sup>12</sup> The administrative or regulatory sanction issue is particularly important in those jurisdictions that do not have or do not implement corporate criminal liability. We are not arguing that multinationals all behave lawfully all the time: if all the financial institutions that had been sanctioned for complicity in fraud against clients or money-laundering were prohibited from doing business, there would be few international banks left. The accounting firm Andersen is the most dramatic example in modern times of reputational harm obliterating corporate value: it should not be forgotten, however, that the key trigger of the collapse was the prosecution of the firm, which conviction would have disqualified it from audit work in the US.

<sup>13</sup> Passage of laws – for example, requiring reports when business suspect money laundering or that their chemicals are to be used as precursors for illegal drugs – does not guarantee that businesses (or, for that matter, organized crime) will find sanctions credible. However, most businesses and many people obey the law irrespective of sanctions, unless they can rationalize law-breaking, for example as ‘necessary to stay in business’ or ‘if I don’t do this deal someone else will, so the policy won’t work anyway, so I’ll do it’.

1. **Encourage policy ‘buy-in’ from business and the citizens.** If civil society feels committed to the courses of action and understands the relationship between action and the values they care about, then the chances of longer-term success after the closure of ‘seed corn’ and other initiatives are greater. This is consistent with the European Union principle of subsidiarity, that is, leaving social regulation to the least centralized effective unit of control.
  
2. **Build in co-operative arrangements between business and law enforcement agencies, where ver feasible.** In the organized predatory crime sector, in addition to payment card fraud, good examples include co-operation over contraband and counterfeit products. It is in the interest of the branded goods and software industries to protect their corporate value, and therefore, it is in their interests to supply information to trustworthy law enforcement agencies to take action against counterfeiting factories and distributors (though in some countries, law enforcement considers that this is not the best use of their own limited resources). Even though product counterfeiting is not one of the specified offences for this OSCE meeting, it should not be forgotten that to the extent that crime groups are involved in multiple economic offences, bringing to light crime group involvement in counterfeiting may generate evidence for other offences too<sup>14</sup>. In contraband, though tobacco multinationals sometimes export unrealistic quantities to low-tax countries, arguably knowing that they will smuggle them to higher tax countries, this can be a defensive response to the fact that otherwise, counterfeit tobacco will be sold and their reputation as well as market share will be harmed. Consequently, under threat of administrative and criminal sanctions, there is scope for co-operation (as in the UK) between customs and multinationals.

The involvement of business also applies to the transportation industry – crucial to all smuggling operations, whether of licit or illicit products – where severe fines and forfeiture of vehicles have encouraged larger firms to buy and use equipment that can detect human breathing inside vehicles as a way of preventing people smuggling. (The technology does not yet let us do this for drugs and arms, other than by expensive x-rays machines.) Legislation usually allows the possibility of a defense where the carriers can show that they took all reasonable steps to check that their loads were secure from penetration and followed (at least in the UK) a Code of Practice developed after industry consultation: but soft-sided vehicles are inherently porous and cannot take advantage of this defense in practice

In other areas, such as precursor chemicals and even light weapons supplies in which business has nothing short-term to gain financially, there is variable but still valuable voluntary co-operation between business and law enforcement, based often around confidence-building outreach programs.

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<sup>14</sup> There is a distinction to be drawn between counterfeits, some of which are also inferior products for consumers, and the ‘grey market’ of parallel trading in which because of price differences between countries, legitimately imported genuine goods are exported from ‘low price’ countries to higher priced ones: the role of law enforcement in the latter cases is more questionable.

## Arms

Informal co-operation does exist in some circumstances to ensure that light arms are not exported to some destinations. However, the focus on people trafficking means that hauliers pay less attention to weapons and haulage firms need some awareness training in this respect.

### **Co-operation among arms suppliers: an example**

In the UK, one of the key problems is the supply of 'blank' firearms that can be activated subsequently to make them usable. Although the export to the UK of such weapons is lawful, educational visits by UK officers led to some manufacturers agreeing not to supply them in future, and this was monitored and confirmed by the fact that subsequent seizures showed no arms coming from those firms. Unfortunately most other firms did not co-operate and even one overseas firm that did (purely out of social responsibility) was taken over by another business that then recommenced sales to the UK (presumably to hit profit targets promised by the new owners).

## Drugs and Precursor Chemicals

Attempts to regulate precursors go back effectively to the 1970s, though differences between countries in which drugs (and therefore precursors) should be the priority inhibited any common approaches for many years. Many nations and firms lack the capacity to determine whether the import or export of precursor chemicals is related to legitimate needs or illicit drugs. The problem is complicated by the fact that many chemical shipments are either brokered or transshipped through third countries in an attempt to disguise their purpose or destination.

In a European context, Article 5 of the COUNCIL DIRECTIVE 92/109/EEC of 14 December 1992 on the manufacture and the placing on the market of certain substances used in the illicit manufacture of narcotic drugs and psychotropic substances states:

“Member States shall take the necessary measures to establish close cooperation between the competent authorities and operators, so that operators:

- notify the competent authorities immediately of any circumstances, such as unusual orders or transactions involving scheduled substances, which suggest that such substances to be placed on the market or manufactured, as the case may be, may be diverted for the illicit manufacture of narcotic drugs or psychotropic substances,
- provide the competent authorities in summary form with such information about their transactions involving scheduled substances as the competent authorities may require.”



The mode by which this ‘close cooperation’ was to be achieved was left open, however, and different European countries have different regulatory approaches, which may continue even after the new Regulation – which makes reporting of suspicions mandatory - is put into practice<sup>15</sup>. What must be appreciated by all OSCE member states is the vast number and variety in the size of chemicals purchasers (though the number of producers and wholesale distributors is obviously much smaller). This has major implications for education and intervention strategies, whether reporting is voluntary or, as under the new Regulation, compulsory *once it is suspected*. It is appropriate to look at what generates suspicions and to ensure a higher and preferably uniform awareness among large firms and SMEs if the aims of these measures are to be translated into a reality. As with the experience of money laundering controls, the passage of regulations is not self-implementing on the ground.

#### **Co-operation in the Precursor Chemical Industry: An Example**

In the early 1990s, the UK National Criminal Intelligence Service, in collaboration with the industry and the Home Office, developed guidelines to assist companies identify suspicious orders. This provided relatively successful, especially when supplemented by Force Chemical Precursor Officers who operated in every region of England and Wales and found it easier to deal with smaller companies in their areas.

A decade later, the UK policing authorities noticed that they had experienced a significant fall over a period of years in the number of suspicious transaction disclosures they were getting from the chemicals industry. They reviewed the nature of the problem and identified a number of reasons, including changes of industry personnel; the shift to call centre operations in which clerical staff simply punched in product codes without understanding their chemical significance; and more devious orders by criminals. They then embarked upon an education outreach program which more than doubled the number of reports of suspicious orders, which they could rapidly investigate and follow up before offenders were alerted to this risk. This has enhanced their ability to disrupt some synthetic and non-synthetic drugs trafficking firms.

<sup>15</sup> At the end of 2002, the European Parliament agreed on a **Proposal for a regulation of the European Parliament and of the Council on drug precursors (COM(2002) 494 – C5-0415/2002 – 2002/0217(COD))**, replacing the directive – which had to be translated into national legislation in all Member States - with a more flexible Regulation which will be directly binding on all Member States. Furthermore “the projected close cooperation between the competent authorities and operators is to be organized in such a way that the latter will be *required* [italics not in the original] to notify the former immediately of any unusual orders or transactions. Competent authorities will be empowered to obtain information about any orders for or transactions involving scheduled substances and enter the business premises of operators with a view to gathering evidence of irregularities.

Cooperation between authorities and operators is to be extended to cover precursors not scheduled so far. The Commission will have the task of drawing up guidelines specifying how to recognize and notify suspect transactions and a list, to be updated at regular intervals, of non-scheduled substances commonly used in the illicit manufacture of narcotic drugs and psychotropic substances. The industry will thus be in a position to monitor trade in such substances on a voluntary basis.”

High staff turnover and changes in business technology may require changes to outreach strategies. Not just telephone, postal and fax but also internet orders to unskilled staff in call centers with no expert training and who tend to become 'burned out' & leave relatively quickly present enormous challenges for traditional suspicion based methods of communicating precursors, especially outside the scheduled precursors for which reporting is mandatory and in relation to which reporting can be automated. This suggests to us that staff education & training have to be updated regularly if reporting is not going to decline in quality, even if the mandatory nature of reports creates more formal reports than previously<sup>16</sup>. There are also difficulties due to the tendency of governments and supranational bodies to list ever larger numbers of chemicals (a problem since the beginning), which leads to a mechanical response from companies and could potentially flood the authorities with reports that they will be unable to follow through<sup>17</sup>. Finally, in cases that then lead to criminal justice responses (i.e. prosecutions), there are problems over disclosure to the defense of how the information came about: businesspeople may be afraid (reasonably on occasions) of their involvement leaking to defendants, as in the UK, for example, they are classified as Covert Human Intelligence Sources and may need protection for their role or, potentially, to give evidence in court. These 'downstream' implications of reporting systems have to be carefully thought through.

### People trafficking

Apart from carrier liability and measures such as electronic scanning of travel documentation prior to departure as well as at the point of arrival (in non-Schengen countries), business involvement in people trafficking has been modest. The recent exception to this has been in child sex tourism where, stimulated by Scandinavia as well as the US, efforts have been made under the aegis of ECPAT (End Child Prostitution, Child Pornography and Trafficking) to develop a clear Code of Practice ([www.thecode.org](http://www.thecode.org)), backed up by published annual reports from private sector partners in Austria, Denmark, Germany, Finland, Italy, the Netherlands, Norway, Sweden and the UK such as TUI Thomson, MyTravel, DRV, ORV, OVT. A recent evaluation of the Phuket Model Project<sup>18</sup> points up the difficulties of translating these objectives into practice on the ground in a high staff turnover environment. However, we were informed of schemes such as in Katmandu, where a Nepalese women's NGO is able to check for signs of

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<sup>16</sup> In the UK, Force Chemical Precursor Officers exist (as a part-time role) in each police area, with the task of communicating with the industry. However the shift to regional call centres makes the physical location of the factory less relevant to this inspection task. Likewise, where small arms are sent by post following Internet orders, the presence of the gun supplier's name and address on the parcel can be used to pick it out; conversely, except to reduce theft in transit risks, the absence of any identifier suggests that the gun supplier may suspect that the weapon may be for an illicit purpose.

<sup>17</sup> There are parallels here with suspicious activity reports in money laundering, though far fewer reports tend to be made by chemicals suppliers.

<sup>18</sup> M. Hallberg, *Corporate Social Responsibility in the Tour Operating Industry*, Lund University, Sweden, 2002.

discomfort among female passengers all departing flights before the planes leave, especially (but not exclusively) those traveling alone, and receive support from local staff if they consider that the passenger is an unwilling victim of the sex trade. Particularly where the police and customs are suspected of corruption (and indeed, many traffickers tell their transportees gruesome tales about the risks of rape etc. from the officials), there may be scope for getting private or public sector staff from airlines, tour operators, etcetera to look out for the signs and to intervene. This may be politically easier to do with children than with adults because of social norms of intervention, but there is some potential for action in countries of origin as well as in countries of destination. Wider questions of exploitation of women, for example as lapdancers at corporate functions, do not currently command a high degree of social concern universally, but they may become an area of corporate action in some countries in the future<sup>19</sup>.

### Money laundering reporting

Money laundering is a generic phenomenon that runs across all crimes. Some countries enjoyed some limited communication between financial institutions and law enforcement before the widespread criminalization of money-laundering from the mid-1980s onwards. However, elsewhere, the existence of strong banking secrecy and common law confidentiality laws & norms made such voluntary co-operation more difficult than in other sectors. Nevertheless, even where there is compulsion to report suspicions of customers and clients, training – some of it video interactive – is needed, and it is good practice to involve the industry in the drafting of guidelines, so that drafters can be take note of practical consequences in their cost-benefit judgments. (Sometimes, dire warnings can be overdone, but unintended effects of well-intentioned policies are commonplace in crime control.) As early as the 1980s, the UK banking industry actively co-operated in the development of anti-money laundering guidelines that are to be taken into account as best practice when institutions and individual compliance officers are challenged to account for their inadvertence/willful blindness or for their decisions not to report transactions to the National Criminal Intelligence Service.

In financial services, outside of formal Know Your Customer requirements, similar difficulties as in precursors have led to a boom in electronic products aiming at predicting – on the basis of (very imperfectly) known data – transaction patterns that have a relatively high probability of being proceeds of crime and/or funds used for the purposes of terrorism. Funds generated by the sex industry and associated business such as massage parlors and saunas do not appear to be widely reported, perhaps because there is no obvious way in which the trade and income levels thus generated can be differentiated between the ‘suspicious’ and

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<sup>19</sup> It is not our role in this paper to address the profound moral issues of what constitutes ‘exploitation’: a subject upon which reasonable people can disagree intensely. But though the corporation may choose not to pay or even to make such a conduct a disciplinary offense, demand exists for such displays irrespective of corporate approval

the ‘normal’: greater attention might be paid to these businesses as well as to the art and motor trades that have been highlighted in the past.

There are developing global lists of public officials and their families and close connections, which can assist international private banks in identifying risks connected with Politically Exposed Persons: such lists are more problematic, however, in the case of illicit activity such as drugs and people trafficking and even illicit light weapons trafficking. Even more significantly, perhaps, is the fact that (assisted by Transparency International), the major international private banks have got together to try to develop collective global guidelines for client acceptance and monitoring, providing some public and collective private accountability for their actions, and reducing the risk that standards will be undercut by key players (though there are, of course, thousands of other banks that are not Wolfsberg group members)<sup>20</sup>. Later on, the Wolfsberg group developed relationships with law enforcement agencies, though there are always tensions involved in transforming private sector organizations into arms of law enforcement, especially where law enforcement bodies and regulators themselves have different, even conflicting, approaches.

3. **Avoid naivety.** The reason why business may wish to get involved in the policy process *may* simply be to weaken threats to profits or to delay interventions until the political motivation and impetus for them passes. On the other hand, initial hostility to regulation may change over time as businesses see the benefit for them directly or in reduced social anxiety and criminality. So be positive but require some independent evaluation of business initiatives, as one would also of government initiatives.
4. **Use reputational risk to create a virtuous circle**, where reputational risk is meaningful to the sector or to the particular firms. Bankers deal with individuals and the corporate public and they, like the pharmaceutical industry and some other large business sectors (including the precious stones sector), have a strong interest in maintaining the image of their firms and their products. In financial services, but not so much elsewhere, this is buttressed by the need to be licensed by governments as ‘fit and proper’ and by legal obligations to report suspicions of money-laundering. In the arms industry, by contrast, ethical reputation is far less important (except that the goods should be what they are contracted to be and should work), so less pressure can be applied without recourse to legal powers. Some transportation firms are more susceptible to social pressures than others. But think about where the leverage is most important to the companies in terms of their values and, where feasible, work with the grain.

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<sup>20</sup> See [www.wolfsberg.com](http://www.wolfsberg.com)

5. **Have reserve powers to deal with noncompliant business and to create a level playing field.** A virtuous circle is more difficult to sustain if other firms can undercut the costs of the virtuous by non-compliance without suffering economic penalties from the market or from regulators or criminal authorities. Exposure to international business brings the standards of aspiring business up, not least because due diligence enquiries may inhibit the sale of noncompliant and/or criminally owned/managed emerging market firms to transnationals and other Western businesses. However, if businesses (some of which are subsidized by economic crime groups) are allowed to intimidate existing firms or undercut them by lower consumer or worker protection standards, then a ‘race to the bottom’ can ensue, as we can see even in the tobacco industry, where (in addition to tax arbitrage) companies experience profit pressures to join the contraband market to avoid extra sales losses to counterfeit products.
6. **Minimise the scope for legal arbitrage and try to ensure some policy consistency, both internally and externally.** There are cultural differences in regulatory (and criminal justice) styles, and there should be a ‘margin of appreciation’ for these variations. A particular difficulty is that in market offences, there are genuinely different views about the liberty of individuals to harm themselves and to engage in consensual activities that may shock or disgust others. There are also pronounced differences in approaches to harm reduction versus criminal justice/disruption that fortunately are beyond the scope of this paper. However there are some areas that it is important to be consistent over, E.g. regularization of illegal workers and the non-deportation of illegal sex workers, at least if they are willing to testify against the traffickers and pimps<sup>21</sup>. Without this restraint by immigration authorities who may have their own targets to hit, there is little chance of disruption of criminal gangs, since other sex workers, drug mules and arms smugglers will be found to replace them. Other aspects of criminal protection more properly belong to the other Working Group, but prosecuting the firms who employ workers without proper social security and identification may have the support of larger firms who do not employ ‘black labor’ as well as of trades unions.

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<sup>21</sup> See, for an appropriately cautious view on the complexities of trafficking in women, J. Vocks & J. Nijboer (2000) ‘The promised land: a study of trafficking in women from central and eastern Europe to the Netherlands’, *European Journal on Criminal Policy and Research*, 8(3): 379-388. See also Kelly, L. & Regan, L. (2000) *Stopping Traffic: Exploring the extent of, and responses to trafficking in women for sexual exploitation in the UK*. Research and Statistics Directorate, Home Office: London (<http://www.homeoffice.gov.uk/rds/prgpdfs/fprs125.pdf>) For a broader and different sort of strategic overview, see A. Richard (2000) *International Trafficking in Women to the United States: A Contemporary Manifestation of Slavery and Organized Crime*. Washington, DC: United States Central Intelligence Agency

## Conclusion

We have sought to point the way towards a model of interventions beyond criminal justice that take account of the market nature of these offences. Huge economic inequalities as well as the profits to be made from crime mean that there is no ‘natural’ cessation of this set of serious social problems, and we incline towards a containment strategy that involves cultivating and harnessing business co-operation where possible, sometimes with the threat of administrative and criminal sanctions to encourage a level playing field and also including, where possible, some praise and operational benefits for compliance (such as less frequent checks and delays in processing transactions, at customs or in financial services)<sup>22</sup>. We also have to be honest about the limitations of both supply-side and demand-side strategies. There will, of course, always be socially irresponsible companies, and it is easier to be socially irresponsible if the people who are being harmed are not members of the same social group or nationality as oneself. The level of coercion over business that should be applied is an issue for debate, but even those who are hungry to get business to play a role far wider than that of a short term profit maximizer should appreciate that there is a cost attached to all forms of regulation, and that the people best placed (whether or not willing) to monitor corporate compliance are the businesses themselves. This is equally true of poorer countries with a relatively weak tax base and a shortage of competent administrators.

The elaborate methods of administrative control in the Netherlands, for example, with vetting of business and property owners in the ‘red light’ district of Amsterdam (and being rolled out in the rest of the country) represent an attempt to restrict abuses in key locations, and there is some evidence that it has had a containment effect<sup>23</sup>. But although reputable businesses welcome these measures, they require not just legislation but also an extensive commitment to integrity by the administrators of the scheme which may not be found universally. After all, in some countries, regulation can be a method of extortion by the authorities, stifling enterprise for far from appropriate purposes. What we are clear about is that if it is to have any significant effect, the regulation of business should take place within the framework of interventions aimed at getting to grips with the ways in which the business of enterprise crime are organized, from financing crime, obtaining the tools of crime, finding market opportunities for trafficked commodities, and disposing of (and sometimes saving and disguising) the proceeds of crime. This must be done in the knowledge that overlapping loose networks can supply arms, drugs and people just as readily as can Mafia-type associations. Removing ‘bad people’ may be a good thing in itself, but we have to be clear about what we are trying to achieve and about the current and potential impact of our interventions on those objectives. If one intervention shows no impact, this may be because it has to be combined with other interventions to work: however even under the best conditions, without support from civil society – of which businesses great and small are a key part – economic crimes cannot be expected to fall.

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<sup>22</sup> For a ‘work in progress’ on this, see the interesting US Customs -Trade Partnership Against Terrorism (C-TPAT). The benefits usually mean the reduction of regulatory pain.

<sup>23</sup> M. Levi and M. Maguire, “Prevention of Organised Crime: a Critical Review”, *Crime, Law and Social Change*, forthcoming 2003; Council of Europe *Best Practice Survey: Preventing Organised Crime*, forthcoming 2003.