

THE ORGANISED CRIME ECONOMY

Managing crime markets in Europe

THE ORGANISED CRIME ECONOMY

Managing crime markets in Europe

Petrus C. van Duyne

Klaus von Lampe

Maarten van Dijck

James L. Newell

(editors)



THE ORGANISED CRIME ECONOMY, Managing crime markets in Europe. *Petrus C. van Duyne, Klaus von Lampe, Maarten van Dijck and James L. Newell* (Eds.). Wolf Legal Publishers (WLP), 2005, ISBN: 90 5850 144 2.

This volume contains a selection of the papers presented at the 6th Cross-border Crime Colloquium, held in September 2004 in Berlin, Germany. The project was supported by the University of Tilburg (the Netherlands) and the Friedrich Ebert Stiftung (Berlin, Germany). For more information on the Cross-border Crime Colloquia visit the website at <http://www.cross-border-crime.net>.

Copies of this volume can be ordered at:

Wolf Legal Publishers

Postbus 31051

6503 CB Nijmegen

The Netherlands

+31 24 355 1904 (phone)

+31 24 355 4827 (fax)

wlp@hetnet.nl

<http://www.wlp.biz>

Table of contents

Crime and commercial activity: an introduction to two half-brothers <i>Petrus C. van Duyne</i>	1
The vulnerability of economic sectors to (organised) crime: the case of the European road freight transport sector <i>Tom Vander Beken, Karen Verpoest, Annemie Bucquoye, and Melanie Defruytier</i>	19
Controlling the flow of money or satisfying the regulators? <i>Jacky Harvey</i>	43
Electronic payment systems and money laundering: beyond the internet hype <i>Ton Schudelaro</i>	65
An assessment of prospective changes in cross-border crime after Estonia's accession to the European Union <i>Anna Markina and Jüri Saar</i>	91
The crusaders: Swedish companies in Russia and the Baltic states handling uncertainty and criminal threats <i>Nils Bagelius</i>	107
Adventure capitalism and economic crime in the countries of transition: the case of the Czech Republic <i>Miroslav Scheinost, Vladimír Baloun and Drahuše Kaderabková</i>	143
Criminal sub-contracting in the Netherlands: the Dutch 'koppelbaas' as crime-entrepreneur <i>Petrus C. van Duyne and Mark J. Houtzager</i>	163
Organised crime, Norwegian style <i>Per Ole Johansen</i>	189
Explaining the emergence of the cigarette black market in Germany <i>Klaus von Lampe</i>	209
The ecstasy industry in the Netherlands in a global perspective <i>Tom Blickman</i>	231

Drugs and organised crime in Bulgaria <i>Tihomir Bezlov</i>	261
Trafficking in women in Bosnia and Herzegovina <i>Almir Maljevic</i>	277

List of authors

Nils Bagelius

Management Consultant at the Stockholm International Banking Institute, Sweden

Vladimir Baloun

Senior Researcher at the Institute of Criminology and Social Prevention, Prague, Czech Republic

Tom Vander Beken

Professor of Criminal Law and Director of the Institute for International Research on Criminal Policy, Ghent University, Belgium

Tihomir Bezlov

Senior Analyst at the Center for the Study of Democracy, Sofia, Bulgaria

Tom Blickman

Researcher with the Crime & Globalisation project of the Transnational Institute, Amsterdam, the Netherlands

Annemie Bucquoye

Researcher at the Institute for International Research on Criminal Policy, Ghent University, Belgium

Melanie Defruytier

Academic Assistant at the Institute for International Research on Criminal Policy, Ghent University, Belgium

Petrus C. van Duyne

Professor of Empirical Penal Science at the University of Tilburg, the Netherlands

Jacky Harvey

Principal Lecturer in Finance at the Newcastle Business School, Northumbria University, United Kingdom

Mark J. Houtzager

Doctoral student at the University of Tilburg, the Netherlands

Per Ole Johansen

Professor of Criminology at the University of Oslo, Norway

Drahuse Kaderabkova

Senior Researcher at the Institute of Criminology and Social Prevention,
Prague, Czech Republic

Klaus von Lampe

Researcher at the Faculty of Law of the Freie Universität Berlin, Germany

Almir Maljevic

Academic and Research Assistant at the Faculty of Criminal Justice Sciences
of the University of Sarajevo, Bosnia and Herzegovina

Anna Markina

Lecturer at the Institute of Law of the University of Tartu, Estonia

Jüri Saar

Associate Professor at the Institute of Law of the University of Tartu, Estonia

Miroslav Scheinost

Director of the Institute of Criminology and Social Prevention, Prague,
Czech Republic

Ton Schudelaro

Former Researcher at the Faculty of Law of the University of Tilburg, the
Netherlands

Karen Verpoest

Researcher at the Institute for International Research on Criminal Policy,
Ghent University, Belgium

Crime and commercial activity: an introduction to two half-brothers

*Petrus C. van Duyne*¹

Economic half-brothers and banalities

Commercial activity and (organised) crime have an awkward relationship – like two half-brothers, one of whom is born out of wedlock. They are different but also have too much in common for them to be able to deny their relationship, though the legitimate brother attempts in vain to do so (or is obliged, grudgingly, to admit to it). Time and again their paths cross: often times the legitimate economic brother finds himself victimised; sometimes he obtains an advantage from his half-brother, and at other times he behaves in ways similar to those of his relative. After all, they are family and share a legal-illegal interface (Passas, 2002). On the other hand, his criminal half-brother will brag about his upperworld relationship, claiming that he is just a businessman too. However, despite their similarities and the relationship between them, they still are illegitimate relatives. While the legitimate entrepreneur may be victimised, the illegitimate one is either a ‘victim’ of the law or of one of his fellow crime-entrepreneurs. That makes a fundamental difference: the criminal half-brother has to devote more energy to the search for means of survival than does the legitimate one.

The criminal part of the family, the crime-entrepreneurs and their crime-markets, have, under the heading of ‘organised crime’, for some time captured ‘global attention’. Recently this attention has been heightened by increasing use of the qualifier, ‘transnational’, though the trade in contraband has taken place across borders since time immemorial. So-called ‘transnational organised crime’ is considered such a worldwide threat that it has even been the subject of a United Nations convention (2000). The imagery behind it is that of the police fighting a formidable and sophisticated foe operating in well-thought out criminal organisations in highly complex markets. This image, which has been advanced to justify the claim for more investigative powers, has found little support from independent researchers (Reuter, 1983; Weschke and Heine-Heiss, 1990; Paoli *et al.* 2000; Van Duyne, 1995).² Hence it remains a hypothesis, albeit one not strictly formulated as such.

¹ Petrus C. van Duyne is Professor of Empirical Penal Science at the University of Tilburg, the Netherlands.

² It should be noted that assessment research commissioned by the authorities does not lend much support to the hierarchy model either.

Let us pose an alternative, counter hypothesis, taking Greek philosopher Protagoras' adage – "Man is the measure of all things" – as a starting point. What is the human measure of the 'organised-crime' phenomenon and its related crime economy? To answer this question we will follow Euclid's simple method, positing a few axioms and seeing what can be deduced from them. Let us assume that our protagonists are not more complicated as human beings than their law-enforcement antagonists, and see what mundane picture we obtain as compared to the one conjured up by the law-enforcement rhetoric.

Beneath the misleading garments draped over and around 'organised crime' by politicians, policy makers, law-enforcement officers and hundreds of scholars, there are a number of related 'banalities', or simple behavioural principles. The first one is:

- the illegal half-brother wants to get rich too but does not want to be caught using illegal means;
- the second banality is that for much of the time he needs the cooperation of one or more like-minded, but trustworthy persons;
- the third banality is that following their initial successes they are likely to stay together (for a while);
- the fourth banality is that they simply start with what they have at hand, socially and economically: commercial opportunities, social and economic skills, tools and people with which to pursue their economic aims. Or, in a more dignified formulation: they need 'human and economic capital'.

Apart from the first principle, the other three apply to the legitimate enterprises of the family too. Do we need any additional basic principles to describe the more complex manifestations of criminal entrepreneurial conduct? Staying out of the grip of the law is a very basic drive, giving rise to most observed organisational conduct, ranging from that of an accomplice on the look-out for cops, to more professional counter measures, to sophisticated forms of money laundering. On top of that come the social and economic requirements of the entrepreneurial surroundings, which have to be heeded for survival. To the extent that these are complex, they are reflected in the nature and structure of the criminal enterprise, rather than being a reflection of a complex criminal human mind. One can consider these forms of organisational conduct as reflections of the basic imperative: 'don't get caught'. They are a form of criminal risk management. This is one of the circumstances that impact on group and network shaping (Bruinsma and Bernasco, 2004). As such it is of more importance than the oft-quoted imperative of 'profit maximisation'. The latter, rather than revealing a kind of deeper insight, is merely the legitimate dream of every entrepreneur. Getting caught, locked up, sentenced and stripped of hard-earned assets, are very real negative prospects.

How plausible is this counter hypothesis? If most of the entrepreneurial conduct of organised crime is so shallow why are the images of 'organised-

crime' that have been most salient in recent decades so full of threatening sophisticated criminals? The answer to this question is perhaps simple too, though we have to dig beneath a muddled political surface covering other banalities. In the first place, we have the most interesting case of how the US successfully turned domestic penal policy into foreign policy by means of public fear management (Van Duyne and Levi, 2005; Woodiwiss, 2001, 2003, Bewley-Taylor, 1999). It goes without saying that large-scale political objectives cannot be pursued but on the basis of imagery that is 'larger than life'. The US' working formula consisted of a rough but highly effective form of international public fear management. Its success can be measured in terms of its global impact: most national governments, and in the end the UN, took over the simple fear formula. Indeed, why should the basics of penal policy be less banal than the criminal targets themselves?

In the second place, criminal entrepreneurs grow up and learn together with their legitimate half-brothers. The organisation of the crime trade must keep pace with social, economic, technical and legal developments, which usually imply more complexity. Criminal entrepreneurs who fall behind such developments soon get caught and disappear from the 'organised crime registers' unless they learn from their mistakes. This turns the phrase, 'organised criminals become increasingly more sophisticated', into a tautology or a piece of political rhetoric of which there is too much already.

If things are really that simple, why have the authorities failed to eliminate this renegade entrepreneurial 'organised-crime' relative? Is he just a bit smarter after all, or are the proprietors of the legitimate family business somewhat ambiguous in their attitude?

Vulnerable to crime and crime-fighters

Judging from the many assessments that have been produced in the recent past, the authorities seem to be awe-struck by the 'organised-crime' phenomenon, notwithstanding the fact that the awful image was of their own making. As the threat described in the repeated annual situation reports failed to recede, and as the reports failed to bring any really new insights, many experts realised that a new methodology was required. If the 'organised criminals' were not actually alien invaders but the hushed-up part of the social and economic family, why not focus attention on the family as a whole and assess its vulnerability? In this refocusing of attention the *University of Ghent* has played a pivotal role, as described in the first chapter of this book (Vander Beken, 2005).

Taking the economic angle as their point of departure, *Vander Beken*, *Verpoest*, *Bucquoie* and *Defruytier* give a thoughtful account of their vulnerability approach. The vulnerability approach is not a competing methodology, but an X-raying of an economic sector to find out its degree of receptiveness to crime. High vulnerability does not necessarily imply that the sector concerned is

infected by ‘organised crime’ or even victimised. The sector may even profit from crime, as do the real-estate or yachting markets when wealthy criminals buy the expensive objects traded in these markets in times of recession. The vulnerability study may be complemented with other investigations more directed at criminal groups for example. Vulnerability analyses start with broad descriptions at the level of the total environment before focussing on the micro level of economic entities and business processes.

The economic sector whose vulnerability to crime (and by implication ‘organised crime’) was investigated by the authors is the road freight transport sector. This sector was not selected because the key to success in the trafficking of contraband is to hide the transportation activities. That would lead to a self-fulfilling prophecy. The selection criteria were derived from *sector* and *market* features, that is, the industry’s relative importance in the economy, the low entry thresholds, and aspects such as low transparency. The detailed evaluation of the entrepreneurial landscape and the in-depth analyses of business processes show that the industry’s vulnerability to crime (whether as victim or perpetrator) is, generally, substantial. The authors are modest in their claims concerning the strength of the instrument used for their assessment. Even though much of the procedure is still an ‘art’ – a not uncommon situation in organised-crime research – it provides a rank-order of the indicators, which facilitates decision-making.

That one can speak not only of vulnerability to organised crime, but also of vulnerability to organised crime-fighters, can be deduced from the paper by *Jackie Harvey* of the University of Northumbria. The author poses some intriguing questions, and assesses the validity of politically motivated estimates concerning the extent of money laundering, in the light of macro-economic data. In the first place, the production of money laundering figures looks very much like price rigging at an auction. A few organisationally connected main players drive up the figures while, through mutual cross-referring, they provide the appearance of validity to these numbers (which are then taken by the scholarly community at face value). In the second place, the objectives of anti-money-laundering policy have gone far beyond those of keeping the bad half-brother with his dirty money out of the house. Though the author does not say so in so many words, it has become a rich man’s financial foreign policy (Stessens, 2000, 2001). The power the Financial Action Task Force (FATF) exerts on money laundering exceeds anything one would expect from an informal club. It can blacklist countries and territories for not complying with its recommendations, though this treatment (without appeal) appears to be meted out only to those who are not members. Together with the other auction bidders, such as the OECD, the FATF has directed its attention to the off-shore financial sectors, small territories that once heeded the advice of the World Bank to divert their meagre economic resources to financial services. Interests changed and the rich countries’ officials returned to complaining about these services.

As Protagoras' adage also applies to the goodies of the family, the reader may share the author's puzzlement about the overlap between the various bodies and organs that have some role in protecting the world's finances from bad relatives. Jackie Harvey is most moderate in pointing to the fact that the OECD scratches the back of the FATF (and the other way round: both share the same office facility). As a favour, FATF has included tax evasion in its definition of laundering and focused on the ostracised offshore tax havens. In this way the tax interests of the US and its industrialised allies are served at the same time as the legitimate economy is purged of the influence of tainted offshore relatives.

However, what is the evidence that the targeted 'opaque' countries are actually money-laundering centres? As the financial crime-fighters' zeal has never extended to the collection of valid empirical evidence, the author had to scrape together whatever meagre facts she could find. The outcome should be considered indicative, particularly as the list of countries where money laundering takes place, or that are vulnerable to it, is composed by US bodies. Nevertheless, side by side with countries like Panama we find respectable FATF members like the UK, which is spared the FATF's wrath, however. The evidence of money laundering is inconclusive. Large economies with active financial markets, favourable corruption-index scores and all the anti-laundering measures in place are as vulnerable to money laundering as countries that score lower on these indexes. At any rate there is little statistical evidence that there is much difference. Nevertheless, they are (financially) browbeaten (Stessens, 2001).

It is fascinating to observe how crime fighters in general and an informal crime-fighting body like the FATF (though officially backed by the great powers) are able to carry on virtually unopposed. The story about the hype surrounding the new Internet technologies, and the potential money-laundering opportunities supposedly provided thereby, is recounted by *Ton Schudelaro*. As soon as opportunities arose for making financial transactions more efficient by using Internet technology, great concern was voiced. It is remarkable that everyone simply repeated and quoted whatever the FATF thought fit to assert. For years the fear of Internet-related money laundering was disseminated broadly, while nobody raised the simple question: how many cases of Internet-based laundering do we actually have?

Schudelaro took the trouble to go through all the sources and found one case in which criminals established a bank in Antigua, advertised their financial secrecy services on the Internet and absconded with \$10 million after a public warning from the authorities. However, this was not a case of money laundering but embezzlement and deceit. Some of the victims hoped perhaps for a neat laundering service. As no new evidence of Internet-related laundering emerged, the FATF simply stopped mentioning it in its annual reports. However, the lesson that was learned from this crime-fighter's conduct was not that the responsible broadcasting of serious warnings must be accompanied by fact-finding and proper expert analysis. Rather, some expressed the opinion that the

absence of evidence actually demonstrated the cleverness of the criminals. This reminds us of Church Father Tertulian's saying, 'Credo quia absurdum'. Crime-fighters are true believers indeed. Beware of true believers.

Half-brothers in transition

The relation between the licit and illicit economies is flexible, and is determined more by the surrounding entrepreneurial landscape than by cunning and planning. This applies to the evildoers as well as to those on the good side of the thin blue line. The entrepreneurial landscape in Central and Eastern Europe has changed considerably and is far from consolidated. The Baltic republics have just entered the European Union, the Russian Federation is still groping for some economic order, while the Czech Republic has experienced the naïve rush toward a market economy without professionalising the control side – a circumstance that has opened the gate to many get-rich-quick fortune-seekers. Not all of them are irredeemable felons, neither are they repentant lost sons in a sinful economy; rather, most are ordinary individuals who simply take advantage of criminal opportunities as they present themselves.

Naturally one cannot generalise about a territory that stretches from the Baltic Sea to the Danube. Estonia faces the wealthy Scandinavian countries while it has the huge and unruly Russian hinterland at its back. It is not surprising that the law enforcement experts, whose opinions are presented in *Anna Markina's* chapter on the changes that were predicted to take place in Estonia after its accession to the EU, expected an increase in crime across the country's borders. This concerned not only the next-door Russians, but also Asians, who also have an interest in the global (crime-) trade and the movement of goods. Would criminals from the East converge on Estonian territory? The experts expressed their concern that this would happen, assuming a fusing of interests, for example, concerning export (smuggling) facilities. True, the Estonians have their criminal entrepreneurs too: the fleshpots of Brussels are coveted by licit as well as illicit entrepreneurs. In addition, price differences due to differential tax and excise rates have contributed to a thriving cross-border trade in alcohol and tobacco (Van Duyne, 2003). More changes are expected after Estonia's accession to the Schengen countries, though one may wonder whether crimes between the Schengen countries should still be counted as 'cross-border' crime.

Licit entrepreneurs are risk takers to no lesser a degree than their illegitimate relatives, though they must observe different rules of the game, even when they have to carry on their activities amidst criminal entrepreneurs and have to deal with them on the same footing. The difficulties encountered in this interaction are reported by *Nils Bagelius*, who tells us the saga of the Swedish 'business crusaders' in Russia and the Baltic states. It involves the management of risks and uncertainties, questions about the persons with whom to deal, trust and control, and realising in time when the moment has come to draw the curtains and leave

the economic stage on which criminal and non-criminal players are so difficult to distinguish. Even if one can tell the good from the bad brother, it may sometimes be more efficient to engage the bad brother if this neutralises his intentions or makes him useful by allowing one to delegate to him management of the risky conflict situations.

The thirteen Swedish companies that ventured into the Baltic countries and Russia were exposed to various contingencies and pressures, which do not easily fit a single pattern. Hence the experience of the management of the companies also differed. Of course, the prospects for enterprises seem attractive: a large market and low production costs. But these are offset by the costs of enforcement of contracts, bureaucratic uncertainties and unpredictable informalities, which may weigh heavily financially and morally. In order to get a hold on the insecure environment eight companies resorted to local 'wise guys' for negotiations. Though a causal relation is not clear, the engagement of the 'wise guys' did not result in a happy outcome: five of the firms closed down nevertheless. The assistance of the police and security services, resorted to six times, proved more effective: only one of the firms concerned had to terminate its activities. Of the five firms that were liquidated because of criminal interference, four also turned to the 'wise guys' for support. Criminal pressure was not only exerted in Russia: three companies were pressurised in Sweden, where one employee was gunned down. It is difficult to generalise from these small numbers, though Bagelius' observations are in line with the study of Varese (2001).

The relationship between crime and commercial activity in the transition countries depends too much on historical backgrounds and the actual cultural landscapes to enable it all to be captured in a single pattern. Empirically this implies that it is wrong to assume a kind of organised economic crime 'population' about which we can formulate general statements. Does every country have its own kind of licit-illicit half-brother relationship? An affirmative answer is given by *Miroslav Scheinost* and his colleagues *Vladimir Baloun* and *Drahuse Kaderabkova*, as far as financial and economic crime in the Czech Republic is concerned. The picture they sketch looks highly idiosyncratic. The hasty privatisation, the lack of professionalism, deficient legislation and the get-rich-quick greed of many naïve entrepreneurs whose improvisations led them to cross the thin blue line alongside shrewd criminals: all this looked like an open-air financial-economic crime-experiment. As an experiment it was a costly success, though lacking the grim Russian component of violence, which reduced its international media attractiveness. What is organised crime without blood?

While the picture of financial and economic crime in the Czech Republic contains many features pertaining to the local situation, there are yet some points that can be recognised in other contexts. The criminal economic profiteers, most of them in their thirties and older, have no criminal records, or records of economic crime only, and certainly no violent backgrounds. Also, their *modus*

operandi, such as ‘borrowing’ from their own firms, or constructing pyramid frauds, is not uncommon in other jurisdictions. Nevertheless, the unique historical combination of privatisation of large state industries, the clumsy way in which this was handled, and the absence of informal rules of commercial conduct, turned many once law-abiding socialist citizens into criminal capitalist adventurers. In the awkward relationship between the two half-brothers with which we started (‘family, yet different’), it became increasingly difficult to tell one from the other. Where does one draw the line between delaying payments to keep a company afloat, and long firm fraud? The transition zone between legal and criminal behaviour becomes ever larger when the practise of delaying payments becomes widespread commercial policy. Likewise, awarding oneself as the general manager of a bank an undeserved salary increase, granting a loan to a related firm and a more substantial loan – which, against initial intentions, is never paid back – to one’s own firm, are not distinct behavioural categories associated with different types of person.

The havoc created by the ‘respectable’ brothers of the Czech financial community was staggering. The banks were bled white as a result of loans to firms (partly) owned by the bank managers themselves. Cleaning up this sector cost the Czech government 22% of its 2004 budget, though this covered not only criminal damage. The impact of the financial crime that took place during the transition period is still being felt. The murky dealings on the financial market, though they do not qualify as ‘transnational crime’, had an international impact nonetheless: the hope that Prague would become the main stock exchange in Central and Eastern Europe went up in smoke.

While economic crime amounts to only 10% of recorded crime, the financial damage it inflicted was 67% of the total criminal damage in 2002. It is interesting to observe how this is valued from a ‘traditional’ organised-crime perspective – something we can ascertain from the volume, *Organised crime in Europe* (Fijnaut and Paoli, 2004). In the chapter about organised crime in the Czech Republic, Nozina (2004) describes criminal activities deriving from a number of (foreign) quarters, but economic crime is scarcely mentioned. Domestic high-level financial conspiracies are not even noticed. Of course, not all forms of economic crime should be equated with organised crime: many offences succeed not because of the high level of organisation but because of the gullibility of the victims. Another finding – one that may explain the scale of the damages caused – is the re-offending rate: one fifth of the convicted economic criminals return unrepentant to their economic niche. Apparently they learn the wrong lesson and continue their business, as usual.

Business as usual

Legitimate markets, legally structured by dense networks of rules designed to protect a multitude of interests, provide an equally large number of criminal

opportunities. Such opportunities arise not always at the margin, but often right in the middle and often with the full knowledge (if not complicity) of to-be-protected market participants, whether entrepreneurs or consumers. Part of the protection consists of making consumers pay more for certain coveted but potentially dangerous articles, through the state imposed *price wedge*. As many consumers hate being overcharged for things they want, crime-entrepreneurs able to offer these things at reduced prices by skimming the price wedge find a wide-open market of 'accomplices'. In Europe this mainly concerns tobacco and alcohol. The price wedge not only serves to protect health but also to finance collective goods like unemployment insurance, pensions and the social and economic fabric of society. This price wedge is also imposed on a more dynamic commodity: labour, the mobility of which was recently given an enormous boost all over the continent.

The cost of labour is a general concern in the industrialised countries: high labour costs mobilise firms and labourers alike, though in different directions. Firms move to 'cheap' countries in order to buy cheap labour, and the cheap labourers move to expensive countries to get more pay for their work. Here we find an interesting difference in criminal labelling: firms on the move, 'globally' shopping for cheap labour are not considered criminal; labourers on the move for better pay may be illegal, those who help or employ them criminal.

It would be incorrect to say that this 'imbalance' as Passas (2001) would call it, represents the whole story. As a matter of fact, the activity of skimming the tax on wages, consisting of income tax and social security contributions, is quite old, though it has not entered the annals of the 'organised-crime' literature. The chapter by *Petrus C. van Duyn*e and *Mark Houtzager* gives an account of the waxing, waning and recent resurrection of the Dutch *koppelbaas*, as the illegal subcontractor is called in the Netherlands. During the 1970s, the *koppelbaas*, the 'boss' coupling labour demand to manpower supply, became a prominent figure in the Dutch construction industry, though his range of operation also covered West Germany and Belgium. The imposition of a fiscal liability on main contractors and principals broke the symbiosis of licit and criminal entrepreneurs. Did the phenomenon disappear? It disappeared in the media at any rate, while the police (disliking the investigation of complicated labour-fraud schemes) found during the 1990s a new, more prestigious topic: organised crime. At that time economic crime was defined in such a way as conceptually to remove it from the field of organised crime (unless committed by 'certified hoodlums'). So the *koppelbaas* could emerge again unseen as soon as market conditions became favourable again.

Market conditions in the late 1990s drove licit and illicit entrepreneurs together once more. Labour costs and shortages provided a competitive edge to those who succeeded in economising by hiring from a *koppelbaas*. The latter could recruit new labourers from the EU countries as well as from Eastern and Southern Europe. 'Old', veteran *koppelbazen* were joined by new Turkish and Kurdish entrepreneurs in the horticultural areas. A good example of how closely

the legitimate and criminal half-brothers can cooperate was the creation of *koppelbazen* by legitimate constructors to do their dirty fiscal job. They dismissed their staff, established a *koppelbaas* who became the new employer, and hired back the same staff from him. The *koppelbaas* was assumed to take care of the fiscal obligations, which he predictably neglected. It was the near-perfect ‘legitimate’ organisation of crime: the upperworld creating and managing its own crime-enterprises. Is the dichotomy of upperworld and underworld not wrong after all?

The dichotomy may be wrong in some social and economic fields and correct in others, which demonstrates that broad generalisations are to be avoided. Organising labour fraud is different from organising excise fraud on the basis of untaxed cigarettes and alcohol. Labour fraud takes place right in the upperworld; trading untaxed goods is an activity of the underground economy and does not need any upperworld involvement. Cigarette fraud, its short history and unfolding in Germany, is narrated by *Klaus von Lampe*. It is a surprising history, because it shows that an underground market does not necessarily spread over a country evenly, even if the economic incentives are everywhere the same. The most important incentive is the price wedge, which is the same all over Germany. Given the assumed mobility of people, consumers and criminal traders alike, one would expect the illegal market to emerge everywhere on a comparable scale. And if the consumers did not go to the traders, the latter would go to the consumers. Indeed, that should follow from one of the most frequently quoted dogmas in the organised-crime literature: that of ‘profit maximisation’. However, this is not what Von Lampe discovered. Around 60% of the cigarette cases discovered in the first half of the 1990s were found in the three north-eastern Länder, which together account for only 10% of the German population.

What is the reason for this imbalance? Are consumers in the other regions happy with the high-taxed cigarettes? That is not very likely. Is there a monopolist syndicate that restricts the contraband trade to these Länder? Von Lampe did not find crime syndicates with hardened felons. Actually most offenders had no criminal record at all. Only a few traders had previous convictions, but not for serious offences. The author also observed that, with the passage of time, the organisation of this crime became more sophisticated, but as a result of the unfolding of this underground market, not as a driving force. Of course, people learn, criminal entrepreneurs too. Hence, purely (criminal) economic factors do not fully explain the geographical structure of this crime market. The (tentative) explanation has, rather, a social feature: the interaction of Polish suppliers and local Vietnamese distributors. This is (again) a highly idiosyncratic situation, which cannot be generalised to other markets or regions.

This conclusion is underlined by *Per Ole Johansen’s* study of the Norwegian illegal alcohol market. After the First World War not only the US but also Norway took part in the ‘open air’ experiment of alcohol prohibition. The backgrounds were also not dissimilar: moral (Christian) fundamentalists, in

addition to socialists who considered alcohol the enemy of the labourer (this was not a feature in the US). The prohibitionists got their way and also the comparable and predictable underground economy. But unlike the US, the Norwegian authorities ended this unfortunate experiment sooner (1927) and kept prices high by various measures such as the imposition of high taxes and the maintenance of a state monopoly. So there was every reason to expect the continued existence of an 'organised-crime' market, such as the one that developed in the US during prohibition. But there the comparison ends: no Norwegian version of Al Capone or Lucky Luciano emerged during the long and continuous period in which old hands taught new comers the craft. In all other respects, the smugglers and wholesale distributors remained what they were: tradesmen and Norwegian citizens praising the Christian Party for keeping prices high and Norway out of the EU.

Importers, distributors and illegal distillers, together keep the illegal alcohol market going as a kind of *supplementary* economy and demonstrate few problems with the half-brother relationship. Wholesale importing has always been accompanied by the presence of legal firms to provide the proper documentary coverage and handle the illegal revenues. These 'company smugglers' work alongside a motley crowd of professional smugglers and those who have normal jobs with illegal business as a side-line activity designed to provide a supplementary income. Meanwhile the illegal alcohol business has become an integral part of the mainstream culture, notwithstanding the fact that it is officially denied. Though it may easily be defined as 'organised crime', it is not considered a threat to the democratic nature of Norway. This is also due to the apparent lack of bribery. Actually, the smugglers do not need to bribe.

Is this organised crime-trade, Norwegian style, another idiosyncrasy? Not necessarily. We find the same flexible network features that are usually found in underground markets: a delta-like entrepreneurial landscape in which, through a multitude of mutually connected creeks, the trade flows downstream to eager customers. But still, this socio-economic crime-landscape does have peculiarly Norwegian features.

Drugs and sex

From the upperworld perspective, exploiting (or satisfying commercially) the basic human needs for psychotropic substances and sex is fundamentally far removed from the respectable family business. Economic criminals too look down on these criminal branches. Historically, the preferred denotation for these activities has been 'organised crime'. Leaving aside such moral stands, the traders are likewise criminal entrepreneurs who must heed the same risk-management principles as the alcohol and cigarette traffickers. It goes without saying that the entrepreneurial environment – partly determined by the commodity, the related

international penal regime and the local social and cultural circumstances – is very different.

The three contributions contained in this volume cover very different local and commercial landscapes. The ecstasy industry in the Netherlands is described by *Tom Blickman*. For good reasons the author describes the Dutch market against a global background, as Dutch production is mainly export directed. But what is the Dutch share of the global traffic? The author first introduces us to one interesting aspect of the global ecstasy (and drug) trade, namely the global bickering about numbers, particularly with the US and the UN (United Nations Office on Drugs and Crime). The US authorities complain that the lion's share (42%) of the ecstasy pills seized in the US originate from the Netherlands. But using other parameters, the Dutch authorities present lower figures. Without siding with the Dutch, it is fair to remind the reader that the UN as well as the US have a reputation for engaging in statistical inflation when to do so serves their need to suggest the existence of *big* problems (Van Duyne and Levi, 2005; Reuter and Truman, 2004). Nevertheless, even according to the UN figures, the worldwide market for the consumption of stimulants (amphetamine type substances, including ecstasy) consists of 8.3 million users. About 73% is accounted for by Europe and North America, while Asia is catching up quickly. Production facilities too are shifting away from the Netherlands, diminishing its unwanted prominence.

The causes of the Dutch prominence in this market are not clear yet. According to the author's interpretation, the main cause is the presence of 'routine socio-economic activities' – or, as we mentioned at the beginning of this introduction, the fourth 'banality' of having social, economic and commercial opportunities close to hand: facilities, like-minded people, skills and tools. These are not in all respects unique, but their combination, together with certain purely accidental circumstances contributed to the rise in prominence of the Netherlands in the market for stimulants in general and ecstasy in particular.

From the 1980s, the Netherlands developed into an export and transit country for drugs, particularly for cannabis products. This sector of the drug market had low priority and many smugglers developed their social and technical infrastructure undisturbed while tapping many of the facilities of legitimate industries. Later, the rising ecstasy industry tagged along with the broader illegal drug industry, which is to a large extent centred in Amsterdam. Accidental personal initiatives were also of influence: in the southern provinces of the Netherlands there was much illegal distilling, and hence laboratory skills were available. These were used for cooking amphetamines, mainly exported to Sweden. This was also an accidental development, due to the prison friendship of a Dutch criminal with Swedish fellow criminals who introduced him to the lucrative Scandinavian market. The step from amphetamine to ecstasy production was not great.

Meanwhile, around 1990, ecstasy became a new, and popular element in the youth culture in the Netherlands, Belgium and Spain (Ibiza), and it spread

rapidly to other countries in Europe. This broad demand side (which with 8.3 million users worldwide should not be exaggerated) is supplied by a broad array of criminal enterprises, reflecting the network-like structure, with top and lower-level traders, found elsewhere (Hobbs). This autonomously developing entrepreneurial activity was given an accidental boost from an unexpected quarter: the police. In their zeal to catch the most senior criminals they allowed criminal infiltrators to 'grow' towards the higher echelons, which meant that many known bulk shipments were left untouched. Another criminal informer learned the craft of amphetamine cooking and after the arrest of his criminal mentor, spread the technique by teaching others. The prosecutions to which these breaches of the code of criminal procedure gave rise, were all nullified (Huskens and Vuijst, 2002). The producers and traders concerned are still at large and are assumed to have contributed to the saturation of the Dutch market. These are the vicissitudes of any market and certainly the criminal ones, making inroads on the researcher's neat structural patterns and generalisations.

Another example of such vicissitudes in the shaping of the crime economy is to be found in the Bulgarian drug market. In the early 1990s, following the change of regime, Bulgaria soon found a place on the criminal map of Europe – but with an interesting variation. While organised-crime researchers (re)‘discovered’ the applicability of a network model of interpretation, and (partly) did away with the criminal hierarchies, the Bulgarians started with them: the criminal bosses operated top down. *Tihomir Bezlov* describes how the bosses structured and divided the drug market among themselves in an orderly fashion. Each boss got or conquered his territory over which he ‘ruled’. This deviation from the prevalent model is not a strange Balkan caprice of the Bulgarians, but is likely to be a derivation of the developments in the criminal ‘protection industry’, which by its very nature is territorially bound (Gambetta, 1993). Market organisation was horizontal as well as vertical: beneath each boss there was an orderly ramification of tasks and territories, a bit the way Cressey (1969) described syndicated crime in America. This orderly conduct (which was not, however, without bloodshed) may be attributed to the circumstance that a score of security service officers drifted into criminal waters.

After 2000 the surrounding landscape changed. The number of young criminal entrepreneurs increased while the black markets could not absorb all the growing human and financial capital. In addition, the cross-border trade in *all* sorts of contraband increased making top-down management inefficient. The bosses did not disappear but, as befitted the dynamics of the European crime-markets, they adapted to the more informal and flexible network structures. These markets do not only comprise prohibited goods, but also licit commodities traded in the ‘grey commercial zones’, which provided the bosses with more coverage and investment potential within the licit economy. At the time of writing the situation is still unclear. Are the crime bosses about to settle down in the licit economy relinquishing their hold on their traditional wards, or

do they continue to straddle two worlds? Crime entrepreneurs are difficult to gentrify.

The sex market is one that is difficult to conceptualise in terms of the tense family relationship of the licit-illicit half-brothers. Depending on the legal system, providing commercial sexual services is not criminal. However, making someone do so against her (his) will through the use of force or deceit is universally considered a serious crime. So, we are right in the underworld. Nevertheless, the upperworld-underworld dichotomy is weakened here as well. The research findings presented by *Almir Maljevic* show that upperworld light penetrates this dark corner of the crime market too.

The forced provision of sexual services is closely connected to trafficking in humans, mainly women. The forces driving women to leave hearth and home are abundantly present in Southern and Eastern Europe. 93% of the women investigated came from economically depressed countries like Moldavia (44%), Romania (37%) and the Ukraine (12%). The dead-end situation they run away from is not only economic. The desperation can also be psychological and social: domestic violence and abuse as personal push factors increase gullibility and the likelihood that alluring job offers are believed. Only a small minority (said they) realised that their jobs would be sexual ones.

Summarising the abuse and ill treatment would not add much to what has already been learned from other European studies on human trafficking (Aronowitz, 2001). It is more interesting to observe that more than a quarter of the women stated that they were treated well and had good relationships with their ‘owners’: they were paid and could visit the doctor, or their families at home. This correlated with the level of education of the victim and the economic status and integrity of the family. Bad family conditions were an important factor in explaining later ill treatment: those who were already victims at home were more likely to be victimised abroad. Women who were better treated became often recruiters: one third of the women had been recruited by friends and acquaintances.

What about the ‘upperworld light’ that penetrates this market? Does it consist only of the use of (corrupt) facilities concerning documents, border crossings or attitudes of tolerance on the part of the police? In fact there is more to it: law enforcement pressure has increased in recent years, making the sex bosses more risk averse and careful in their treatment of the women, leading to a decrease in requests for help. The author also observes a shift of the locations of work places to private premises. Is the sex industry, in serving upperworld needs, moving upwards itself? This is not very likely: not only because of the risk of victimisation in this area, but also because of the nature of the needs that are serviced. Despite his greed, an economic criminal is more easily reunited with the family than a murky sex entrepreneur.

Back to human size

The introduction began by placing criminal entrepreneurs in a ‘true-to-life’ perspective: the criminal merchants whose organisational manifestations are manifold but usually a function of the commodity that is traded, and the commercial and cultural surroundings. If things are so simple, how has the threatening image of sinister complexity arisen? Transnational organised crime! Maybe the feature ‘complexity’ is too often attributed to constructions that on closer inspection range from incomprehensible chaos to a series of half-improvised clever projects. In addition there are unpredictable contingencies and the vicissitudes of law-enforcement priorities and the licit market itself, all adding to a disorderly but fascinating crime-economy. Few would like to admit that we are fighting criminal chaos. Hence, retrospectively the police, the media and policy makers call it ‘complex’ and ‘organised’ instead (Hobbs, 2004). Granted, in the area of economic crime complicated schemes do exist. But most fraud schemes consist of a multitude of improvised makeshift paperwork constructions. These take much effort to unravel, not because they are based on ingenious systems, but because of the lack thereof. The police will call this ‘semi-organised disorder’, ‘complex’, and so will many researchers who have interviewed police officers.

Returning to the half-brother metaphor, if the basic human entrepreneurial traits are shared, then the difference lies in criminal risk-management, which is usually not characterised by strategically ‘looking ahead’ but rather by short-term tactics. Are crime-entrepreneurs so stupid or short sighted that they are at best capable of leaving behind only a trail of short-term professional disguises? Not necessarily, because they may realise that they are just illegitimate half-brothers with no real title to their criminal wealth. So, why should they do more? Why organise more, and more thoroughly, for the sake of an uncertain inheritance, normally only obtained by the very few fellow criminals who already have one and a half foot in the respectable upperworld economy? Crime and commercial activity are a complicated family indeed.

References

- Aronowitz, A., Smuggling and trafficking in human beings: the phenomenon, the markets that drive it and the organisations that promote it. *European Journal on Criminal Policy and Research*, no. 9, 163-195, 2001
- Beken, T. Vander, *Organised crime and vulnerability of economic sectors*. Antwerpen, Maklu, 2005
- Bewley-Taylor, D.R., *The United States and international drug control*. London, Pinter, 1999
- Bruinsma, G. and Bernasco, Criminal groups and transnational illegal markets. *Crime. Law and Social Change*, no. 1, 79-94, 2004
- Cressey, D., *Theft of the Nation*. New York, Harper & Row, 1969
- Duyne, P.C. van and M. Levi, *Drug and money. Managing the drug trade and crime-money in Europe*. London, Routledge, 2005
- Duyne, P.C. van, R. Kouwenberg and G. Romeijn, *Misdaadondememingen. Ondernemende misdadigers in Nederland*. Den Haag, Gouda-Quint, 1990
- Fijnaut, C., and L. Paoli (eds.), *Organised crime in Europe, Concepts, patterns and control policies in the European Union and beyond*. Dordrecht, Springer, 2004
- Gambetta, D., *The Sicilian mafia. The business of private protection*. Cambridge, Harvard University Press, 1993
- Hobbs, D., Nature and representation of organised crime in the United Kingdom. In: C. Fijnaut, and L. Paoli (eds.), *Organised crime in Europe, Concepts, patterns and control policies in the European Union and beyond*. Dordrecht, Springer, 2004
- Huskens, M. and F. Vuijst, *XTC smokkel*. Amsterdam, De Boekerij, 2002
- Nozina, M., The Czech Republic: a crossroads for organised crime. In: C. Fijnaut, and L. Paoli (eds.), *Organised crime in Europe, Concepts, patterns and control policies in the European Union and beyond*. Dordrecht, Springer, 2004
- Paoli, L., N. Güller and S. Palidda, *Pilot report to describe and analyse local drug markets. First phase final report: illegal drug markets in Frankfurt and Milan*. Lisbon, EMCDDA, 2000
- Passas, N., Cross-border crime and the interface between legal and illegal actors. In: P.C. van Duyne, K. von Lampe and N. Passas (eds.), *Upperworld and underworld in cross-border crime*. Nijmegen, Wolf Legal Publishers, 2002
- Reuter, P. and E.M. Truman, *Chasing dirty money. The fight against money laundering*. Washington, Institute for International Economics, 2004
- Stessens, G., The FATF 'black list' of non-cooperative countries and territories, *Leiden Journal of International Law*, no. 14, 199-208, 2001
- Stessens, G., *Money laundering: a new international law enforcement model*. Cambridge, Cambridge University Press, 2000
- Varese, F., *The Russian mafia: private protection in a new market economy*. Oxford, Oxford University Press, 2001
- Weschke, E. and Heine-Heiss, K., *Organisierte Kriminalität als Netzstruktur-kriminalität*. Berlin, Fachhochschule für Verwaltung und Rechtspflege, 1990

- Woodiwiss, M., Transnational organised crime: the strange career of an American concept. In: M. Beare (ed.), *Critical reflections on transnational organised crime. money laundering and corruption*. Toronto, University of Toronto Press, 2003
- Woodiwiss, M., *Organised Crime and American power: a history*. Toronto, University of Toronto Press, 2003

The vulnerability of economic sectors to (organised) crime: The case of the European road freight transport sector

Tom Vander Beken

Karen Verpoest

Annie Bucquoye

Melanie Defruyter¹

Introduction

The fear of so-called organised crime and its perceived threat to society dominates the agendas of many national and international policy makers. Significant amounts of money have been invested in the fight against it, and numerous special counter measures have been taken (Levi, 2004). The fear of organised crime is based on two basic assumptions: first, that it is something that exists and can be identified as such; second, that it is something dangerous and poses a significant threat to society as a whole. Although these basic assumptions are, at least implicitly, present in most discussions about organised crime, their empirical and theoretical foundation is not undisputed as both the concept, and assumptions about 'its' threat to society, have been subject to substantial scientific critique (See e.g. Van Duyne, 2002, 2004; Von Lampe, 2004).

This chapter focuses on the second, 'dangerousness', assumption. It will therefore deal with the assessment of 'organised' crime threats and will propose a methodology to address the issue of how these may be more adequately measured. The debate about the concept of organised crime and its usefulness in social science is not addressed here as such. This does not mean that the importance and the consequences of this discussion are not recognised. Rather, for the purposes of this chapter, it is accepted that some activities are *labelled* as 'organised' crime and that, at least in this sense, 'organised crime' 'exists'. From this point of view, discussion of the assessment and measurement of organised crime remains relevant.

More specifically, this chapter acknowledges the existence of various reports and assessments of 'organised' crime and presents a methodology to improve such assessments. The starting point is that a risk-based approach can assist the drafting of better, or at least more transparent, reports about the threat or risk

¹ Tom Vander Beken is Professor of Criminal Law and Director of the Institute for International Research on Criminal Policy, Ghent University, Belgium. Karen Verpoest and Annie Bucquoye are researchers at the same institute. Melanie Defruyter is Academic Assistant.

posed by certain criminal phenomena. In earlier research, the general methodological framework of this approach was described, referring to methods to assess: threats stemming from criminal groups and from their use of counter strategies; the vulnerabilities of economic sectors, and the involvement of criminal groups in illicit markets (Vander Beken, 2004; Vander Beken and Defruytier, 2004). This chapter reports research focusing on 1) the further development and refinement of the methodological framework through measurement of the vulnerability of licit economic sectors (Vander Beken, Defruytier, Bucquoye and Verpoest, 2005), and 2) the results obtained by applying this framework in a study of the European road freight transport sector (Bucquoye, Verpoest, Defruytier and Vander Beken, 2005). The chapter consists of two major parts. First the background to studies of the vulnerability of economic sectors is described. In the second part, a method for such studies is proposed and applied to the case study.

Towards a risk assessment approach to (organised) crime Belgium pioneering in Europe

The importance attached by the Belgian law enforcement authorities to good data on 'organised' crime was stressed in June 1996 when the National Action Plan Against Organised Crime was issued.² One of the key goals of the Action Plan was to obtain a better view of the phenomenon as the basis for an appropriate response to it.

Consequently, it was decided that the Minister of Justice would issue annual reports on the organised-crime situation, and that these would be followed up by meetings to consider them. Drawn up on the basis of information supplied by law-enforcement agencies and other information sources, the reports were not, however, satisfactory. Although the reports were extensive and detailed, experts were of the opinion that they could not serve as a basis for the presentation of a realistic picture of the organised crime situation as they were too vulnerable to distortion caused by perceptions of the resource needs of the agencies responsible for supplying the information on which they were based. Therefore it was recognised from the outset that there was need for a more comprehensive methodology, based on more sources and other forms of analysis.

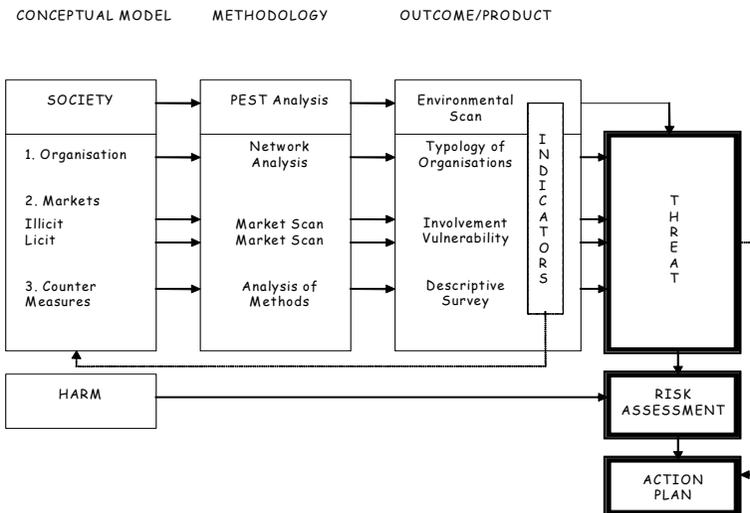
Since such a methodology was unavailable in Belgium, project 28 of the Federal Safety and Security Plan, presented by the Belgian government in 2000, stressed the importance of research on the phenomenon of (organised) crime and the development of a methodology that was comprehensive. In response to these policy requirements, two studies were carried out by Ghent University (Black,

² Action Plan of the Government against Organised Crime, 28 June 1996, Parliamentary Inquiry Commission on organised crime in Belgium. Final Report by Coveliers en Desmedt, *Gedrukte Stukken*, Senaat, nr. 1-326-9, 1998-1999, pp. 563-565.

Vander Beken and De Ruyver, 2000; Black, Vander Beken, Frans and Paternotte, 2001). In 2001, the minister of justice decided that the resulting methodology would be used in the future. It would be implemented gradually and give rise to a holistic strategic analysis, thereby inducing a shift in crime analysis such that the annual reports would take the form of risk/threat assessments directed at the future, rather than being situation reports describing existing circumstances and therefore merely focusing on the past.

The starting point of the methodology employed is a *risk-assessment* approach. The aim is to measure risk or threat, and the analysis is based on various kinds of data. As a consequence, the concern is not merely to examine law enforcement activities, but also to focus on the criminal phenomenon itself and to demonstrate what might happen, doing so in such a manner that appropriate action can be taken. The assessment is performed on four different levels: criminal groups, counter measures, illicit and licit economic sectors. These four analyses are preceded by a so-called ‘environmental scan’ identifying main trends in the external environment and the overall objectives of the agencies involved (Vander Beken, 2004). The aim is eventually to perform this risk/threat analysis on a nationwide level in Belgium. In an initial stage, a ranking of criminal groups according to the threat they pose, as well as an analysis of appropriate counter measures, will be undertaken.

Figure 1. Conceptual model and methodology



Assessments of (licit and illicit) markets

As assessments of the vulnerability of markets have been scheduled to be conducted in the near future, further methodological work on this issue was carried out. This has led to a first methodological framework to measure the vulnerability of economic sectors (Vander Beken, Cuyvers, De Ruyver, Hansens and Black, 2003) and an application to the Belgian diamond sector (Vander Beken, Cuyvers, De Ruyver, Defruytier and Hansens, 2004).

The European Union goes for threat assessments

At the European level it became clear that the methodology used for the Organised Crime Situation Report (OCSR) also needed improvement. During the German³ and Swedish⁴ presidencies it was proposed to develop a threat assessment methodology that could shift the focus of the report from a description of current and historical situations, to an account of the threats and risks deriving from likely future developments, and their implications for law enforcement within the EU.

In the autumn of 2001, the Belgian presidency proposed an Action Plan to convert the OCSR into an annual strategic report for planning purposes, primarily focussing on the assessment of relevant threats and risks, as well as recommendations related to combatting and preventing organised crime.⁵ The starting point was the Belgian conceptual model and methodology mentioned above. This Action Plan has been further discussed and the intention is to implement the different parts of it gradually. The 2002 Organised Crime Report already had a different structure and has offered more detailed explanation of certain phenomena through its use of two complementary methods – namely, PEST (Political, Economic, Social and Technological) and SWOT (Strengths, Weaknesses, Opportunities and Threats) analyses – and more data sources. Of the four parts of the action plan, the criminal group analysis and the counter-measure analysis were considered to be the most feasible in the short term (Vander Beken, Savona, Korsell, Defruytier, Di Nicola, Heber, Bucquoye, Dormaels, Curtol, Fumarulo, Gibson and Zoffi, 2004). Additional research on the vulnerability of economic sectors was asked for.

Besides this, the relevance of the research on the vulnerability of economic sectors to crime was also addressed in another context. After the Tampere European Council of 1999⁶ called for the integration of crime-prevention

³ Council of European Union, 8469/99, Crimorg 55, Brussels, 19 May 1999.

⁴ Council of European Union, 6628/01, Crimorg 19, Brussels, 13 February 2001.

⁵ Council of the European Union, 14959/01, Crimorg 133, Brussels, 10 December 2001.

⁶ Conclusion 41, Presidency Conclusions, Tampere European Council, 15-16 October 2001.

aspects into actions against crime, the importance of the crime proofing⁷ of legislation was taken up in various EU documents. The first programme of the European Crime Prevention Network established crime proofing as a top priority⁸ and OLAF, the European Anti-Fraud Office, has been entrusted with the establishment of a system of fraud proofing in order to strengthen the preventative aspects of protection of the Community's financial interests.⁹ Although there is very little scientific information to guide the process of crime and fraud proofing and only some member states have best practices in that respect (Albrecht, Kilchling and Braun, 2002), the European Forum for the Prevention of Organised Crime concluded that crime and fraud proofing cannot be carried out without knowledge of the context in which the legislation to be proofed was passed, and it was recognised that studies of the vulnerability of economic sectors are the necessary framework within which crime proofing must be performed.

With this objective in mind, the European Commission asked for research on the development of a European methodology for the assessment of the vulnerability of economic sectors and an application of it in two case studies: European road freight transport and music.¹⁰

Measuring the vulnerability of legal sectors to crime

There have been few attempts to apply a systematic methodological framework to studies of the vulnerability of licit sectors. There are academic attempts to predict high-risk business conditions (Albanese, 1987 and 1995), historical analyses of markets and crime (Reuter, Rubinstein and Wynn, 1983) and studies of the relationship between organised crime and legitimate industries (Van Duyne, 1993; Levi and Naylor, 2000; Williams and Savona, 1996; Naylor 2002). Economic sectors themselves carry out vulnerability studies (see e.g. Van de Voort and O'Brein, 2003). Although these studies can be valuable sources of sector information, their scope is mainly economic (business interests) and they are not always methodologically useful as the methods used are mostly not

⁷ See e.g. *Joint Report* from the Commission and Europol of March 2001 'The scanning of loopholes and crime facilitating opportunities has a particular virtue when applied to the legislation making process . . . risk assessments and diagnosis should be further developed within it'.

⁸ European Crime Prevention Network, First Programme: Setting priorities and objectives for the period July 2001 – December 2002.

⁹ Commission Communication of 7 November 2001 concerning the fraud-proofing of legislation and contract management, SEC (2001) 2029 final.

¹⁰ The research was financed by the European Commission's Agis programme and is known by the acronym MAVUS (Method for and Assessment of the Vulnerability of Sectors). Coordination: T. Vander Beken (IRCP, Ghent University); partners: the Universities of Trento, Amsterdam, Freiburg and Cardiff. The study will be published in Vander Beken (2005).

disclosed. Moreover, many of these studies start from a rather unilateral approach to the relationship between crime and the legal economy, focusing on security and the sector as a victim of crime only. As a clear-cut methodological framework to assess the vulnerability of legal sectors to crime has hitherto not existed as such, we have tried to develop one.

In order to define the landscape upon which organised crime typically operates, we have employed Dwight Smith's (1980) 'spectrum-of-enterprise' idea along with its further developments in other studies (see e.g. Beare and Naylor 1999; Edwards and Gill, 1999; Schloenhardt, 1999; Paoli, 2002). Consequently, we have chosen to approach organised crime from an economic perspective, considering it a profit- and opportunity-driven phenomenon. The focus of analysis is thus on the context that potentially provides the opportunities for criminal entrepreneurship. For this reason, contrary to the practice of traditional organised crime analyses, we have chosen to focus the analysis on the task environment, i.e. the legal economy, rather than on actors or specific (organised) crime groups.

A method for assessing the vulnerability of legal sectors should thus be directed at detecting those weaknesses of the sector that can be exploited by criminals, and that result in opportunities for organised crime (Albanese, 1987).

As an understanding of a predominantly economic environment is required, the method draws, to an important extent, on concepts and theory developed in the field of economics. The foundation of the methodology is thus undeniably multi-disciplinary. On the one hand, the methodology aims at providing a systematic approach to the acquisition of insight into the dynamics of specific legal markets. Therefore, Michael Porter's concept of 'clusters' in the legal economy (Porter, 1980 and 1990) and the concept of 'business processes' (Rozenkrans and Emde, 1996), used in management science, are both integrated into the methodology. On the other hand, concepts and theory from sociology and criminology are used in order to keep the economic paradigm in perspective and avoid an approach that is exclusively economic in nature. Von Lampe rightly states that:

[...] the enterprise paradigm does provide a basis for the cumulative generation of knowledge. Economic concepts, however, have only a limited value . . . the enterprise paradigm is at risk of disregarding criminal structures that exist or emerge, due to other circumstances than the dynamics of illegal markets' (von Lampe, 2002).

Therefore, concepts like 'criminal networks' (see e.g. Paoli, 2002; Kleemans, Van den Berg and Van de Bunt, 1999; Levi, 2003) and 'the nature of the legal-illegal interface' (Passas, 2002) are reflected in the methodological framework as well.

Use of the term 'vulnerability' as a conceptual focal point for economic-sector scanning necessitates some indication of how to interpret it. Focusing on the vulnerability of licit sectors has preventive objectives above all, as it must also

allow problem areas that have not yet been affected by organised crime to be identified. The general idea is thus to provide coverage of the activities of organised criminality within the legal market place in which such organised activity is suspected, known and may possibly be expected to take place (Vander Beken and Defruyter, 2004).

What needs clarification at this point is that the relationship between crime and economic sectors is multi-directional and not simply one-way, as the concept of vulnerability might suggest. Economic sectors cannot always be considered as the victims of crime only. Their products and services may be attractive to criminals for reasons other than theft or forfeiture. That is, products and services might be vulnerable (attractive to criminals) because they can be used or misused as instruments or facilitators of crime. Thus, vulnerability studies not only look for situations in which crime might directly harm the sector (sector as the mere victim), but also for situations in which the sector itself creates, inadvertently or on purpose, opportunities for organised crime.

Finally, with regard to the conceptual model employed as part of the EU's new methodology for measuring organised crime, it should be stressed that assessments of the vulnerability of economic sectors are only one part of an organised-crime threat-assessment, and that their results have to be read (and, if necessary, corrected) together with the output of analyses of criminal groups, counter strategies and illegal markets. If a vulnerability study demonstrates that a given sector is particularly exposed to crime, then this in itself is insufficient to justify the conclusion that the sector should be made a top priority. If analysis of the relevant criminal groups and their activities shows that criminal activity in the sector is unlikely – perhaps because the groups in question lack the will, or the means, or both to (mis)use the vulnerabilities – the threat posed by the latter are to be adjusted accordingly.

The proposed methodology for vulnerability studies consists of two parts. The first part involves three phases, each of which is descriptive. By means of information gathering and processing, the phases are meant to generate knowledge about all aspects of the task environment in which criminal behaviour takes place. The second part, consisting of the fourth, fifth and sixth phases, is analytical in nature and involves applying to the information obtained during the preceding phases, a set of indicators in order to draft a vulnerability profile of the economic sector concerned.

In order to avoid 'self-fulfilling prophecies', the first three phases of the study are conducted without specific reference to the sector's vulnerability. Their purpose is limited to the necessary preparation of the analytical phases in which the information is evaluated. These first three phases can in turn be split into two parts. The sector analysis and the analysis of the wider environment relate to information gathered on a meso-level (sector) and macro-level (cluster). The third phase, namely, the analysis of the reference model, relates to in-depth, micro-level information gathered on the task environment (business processes). Although all three steps are similar in purpose, they differ in terms of the economic level on which information is gathered.

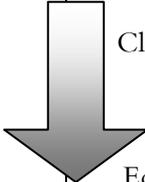
The fourth and fifth phases are the most important steps, as the information that is compiled and processed during the preceding phases is evaluated and analysed on the basis of a set of indicators. A common scaling technique is used to assign to the sector being studied a vulnerability score in terms of each of the indicators. Because the information gathering is performed on two distinct economic levels, this weighing exercise has to be performed twice: once in width and once in depth. What needs clarification at this point is that, in practice, the weighing exercise is less the result of a purely statistical operation in which in- and output are numerically/mathematically linked, than it is the outcome of balanced decision-making and transparent choices based on context variables, known criminal cases and case studies.

In practice, the scoring exercise is the outcome of balanced decision-making in which context variables, known criminal cases and case studies all play an important role.

Once all these phases have been gone through, the outcome is a vulnerability profile of the sector (both in width and in depth). Finally, the profile is made up of a list of vulnerabilities which, in a conclusion, can be ranked according to their importance. By way of a summary, Figure 2 offers a diagramatic representation of the different levels of analysis, the economic units on which they are focussed and each of the methodological steps taken.

Figure 2. Levels of analysis, economic units and methodological steps taken

Level	Economic Unit	Methodological steps
Macro	Cluster, Network	Environmental Scan
Meso	Sector	Sector Analysis
Micro	Economic entity Business processes	Reference Model Analysis



In the following sections the methodology is further illustrated by applying it to the case of the European road freight transport sector.

Sector analysis

A first step in the sector analysis is to define and delineate clearly what the sector includes. As at present there exists no suitable definition of ‘road transport of

goods', we decided to define the sector in terms of 'core activities' and their position in the business structures of the legal entities that belong to the sector. We therefore used 'NACE Rev. 1'¹¹ to define which economic activities are included, and which are excluded from the sector. Code 60.24, 'freight transport by road', corresponds most closely with the core activity of what is meant by 'road transport of goods'.¹² For the purposes of our study, only licit entities that are professionally engaged in the haulage of goods on behalf of third parties are considered.

The sector analysis focuses on two aspects: sector features and market features. In relation to the *sector features*, it can be concluded that in economic terms road freight transport is an important European sector. Its economic relevance derives from the numbers it employs, its substantial turnover, its share of the Gross National Product of a number of member states, and its significant role in the global commodity chain. *Market features* refer to barriers to entry to the sector, and to market conditions. Barriers to entry to the sector are relatively low. Once an enterprise has been established within the sector, the main challenge confronting it is survival in a highly competitive environment. The consequences of this economic reality are a high bankruptcy rate, especially among the smaller market players, and the need to be able to offer flexible logistic solutions to increasingly exigent clients. The sector's client-oriented approach has led to highly differential, and non-transparent, pricing policies (Dullaert, 2002).

At the end of the first descriptive phase, analysis of sector and market features revealed frequent violations of the statute of self-employment, a shortage of qualified personnel, differences between the member states in terms of the control of access to the market, and complex and non-transparent processes of price setting.

Environmental scan and cluster analysis

Environmental scan

The environmental scan is a process in which the broader environment is scanned by means of collecting and analysing data concerning the external environment of the object studied, to determine relevant developments and trends at the macro-level. The idea is to define future developments which

¹¹ At the EU level, the NACE activity nomenclature refers to the statistical classification of economic activities in the European Community and has existed since 1990. From the outset, the European Commission intended that the new NACE (Rev.1) should be used by all member states for the compilation and presentation of statistical data. The NACE Rev. 1 can be consulted on the EUROSTAT Classification Server, http://europa.eu.int/comm/eurostat/ramon/nace_rev1_1/nace_rev1_1en.html.

¹² URL: http://europa.eu.int/comm/eurostat/ramon/geninfo/geninfo_en.html#nace.

might influence the sector, and more specifically the business choices of the entities belonging to the sector, and to enable policy-makers to develop an appropriate pro-active strategy.

Environmental scans are often structured through the use of an artificial device that distinguishes between specific elements constituting the environment. In this study, the PEST method is used to assess the environment. PEST is a standard acronym for the division of the environment into political, economic, social and technological domains.

The following sections give an overview of the main trends in these four domains in relation to the macro-level analysis of the transport sector.

Political trends show a balance between liberalisation of the transport market and harmonisation of market conditions. Initially, EU policy gave special emphasis to liberalisation. The latter reached its peak with completion of the single internal market. Harmonisation, however, is far from having been completed (Stevens, 2004). Recent political developments focus more on harmonising market conditions. These developments have put road transport under pressure insofar as it is no longer the only significant player in the transport of goods, and is losing ground to other transport modalities.¹³ So, in the future, road transport companies will have to compete, not only with each other, but also with these other modalities.

As mentioned, at the European level, the transport sector is of considerable economic relevance, while European road transport companies have to operate in an increasingly competitive environment. *Economic trends* – just-in-time delivery (Blauwens, De Baere and Van de Voorde, 2002), delocalisation¹⁴ and bipolarisation¹⁵ – must be understood in the light of this growing competition. These trends are alternative ways of coping with competition and are attempts to keep the sector viable. They function as short-term solutions, and do not offer a sustainable long-term answer. Moreover, these trends reinforce the competitive nature of the environment.

The *social trends* affecting the road freight transport sector are all derived from modern society's character as a 'global village', and it is they that are responsible for the most salient image of the sector. In modern society, all kinds of goods are demanded and delivered all over the world. Most of these deliveries require road transport to some degree.¹⁶ For environmental reasons, and as a result of the

¹³ European Commission, *White Paper. European transport policy for 2010: time to decide*, Luxembourg, Office for Official Publications of the European Communities, 2001, p. 2-3.

¹⁴ X., 'Délocalisations dans les transports', *CNT Rapport Social 2000*, URL: http://www.cnt.fr/rapports/RS2000_Délocalisation_dans_les_transports.pdf.

¹⁵ J. Burnham, 'A more European transport than ever!', *CNT Transport/Europe, Bulletin of the Observatory on Transport Policies and Strategies in Europe*, Issue No. 8, May 2003, 8 p., URL: http://www.cnt.fr/Commissions_Permanentes/Observatoire/Europe/bulletin_Transport_Europe/TE_Bulletin8-A.pdf.

¹⁶ OECD, *Delivering the Goods: 21st Century Challenges to Urban Goods Transport*, Paris, OECD Publications, 2003, p. 26-29.

pressure of public opinion, road transport is finding itself subject to increasingly stringent restrictions. Because of this increasing control, the former autonomy associated with the driver's profession is fading and the job is becoming decreasingly attractive. Transport companies are experiencing difficulties in recruiting motivated and skilled drivers. Therefore, they are often obliged to employ unskilled or inexperienced drivers, which reconfirms the negative image of the sector.¹⁷

In terms of *technological trends*, one can observe that the transport sector is being increasingly affected by technological innovations. Although these innovations can optimise the efficiency and security of the transport system, they cannot be utilised without the assistance of people. This essential human intervention in transport services operations has become a target for criminals testing the integrity of employees.¹⁸

Cluster analysis

In this phase the cluster concept serves to structure the information collection and analysis. This analysis focuses on the more immediate external environment of the road transport sector, describing all the relevant factors and players and their relationship with the sector.

Concerning *supporting and related sectors*, road freight transport firms are dependent on a wide range of suppliers. For the supply of fuel, transport companies are dependent on the supporting petroleum sector. In investigations and research on organised crime, the petroleum sector has more than once been reported as vulnerable to crime (van Duyne, 1995; Coveliers and Desmedt, 1999). Fuel fraud is a fast-growing part of the black market. Illegal fuel is all about evading excises, and most of the fraud is on diesel. In most European countries, the major part of the price of a litre of diesel is tax. Other fuels, like red diesel and kerosene, carry little or no tax. Anyone using those low-tax fuels on the road can save a lot of money. Because of the highly competitive environment in which the European road transport sector operates, companies may be inclined to (mis)use low-tax fuels to raise their profit margins. Suppliers of security are becoming increasingly important for the transport sector as well. As the sector is often the victim of crime, especially of crime against vehicles (e.g. theft of vehicles and cargo), transport companies are increasingly interested in tracking and tracing systems.

The element *government* occupies an important position in the cluster. The role of public authorities in regulating the market cannot be overestimated. The European road freight transport sector is subject to dozens of European regulations and directives (besides a number of UN conventions). However, due

¹⁷ European Foundation for the Improvement of Living and Working Conditions, *EU Road freight transport sector: Work and employment conditions*, Luxembourg, Office for Official Publications of the European Communities, 2004, p. 55-56.

¹⁸ Council of Ministers, *Improving Security for road freight vehicles*, CEMT/CM (2001), p. 11-15.

to the fact that most aspects of the sector are regulated by European directives rather than regulations, few elements are dealt with in a harmonised way. Moreover, control and enforcement of policy towards the main aspects of the transport sector, and customs regulation, remain national competences, although many initiatives designed to enhance co-operation between the member states have already been taken. Although there is a growing awareness on the part of the authorities of the need for a more comprehensive enforcement policy, the latter remains in the hands of a range of control authorities, creating problems of coordination between member states.

For the road freight transport sector, a relevant *financial player* is the insurance sector. Insurance is important for two reasons. On the one hand, insurance premiums form part of the costs a transport company has to bear. Premium costs are a function of the goods that are transported and the contracts concluded. On the other hand, insurance can be a source of revenue for transporters. In theory, payments by insurance companies are limited to the value of replacement and cannot be considered as sources of additional income. In practice, however, insurance policies can be and are misused in ways such that insurance payments sometimes provide additional income.¹⁹

The European transport sector is represented by international *sector organisations*, for both employees²⁰ and employers.²¹ As these organisations operate on a European level, and as they represent so many companies and employees, they are able to bring pressure to bear on governments. Besides these organisations, the European Foundation for the Improvement of Living and Working Conditions also has influence on policymakers.

Finally, *crime* is also considered a cluster element. After all, criminals and criminal groups form part of the context in which sectors function. The transport sector is subjected to different forms of crime because of certain intrinsic characteristics, among which are the competitive nature of the market, and the essential role the sector plays in criminal circuits. Depending on the specific nature of the criminal activity concerned, firms in the sector can act as victims, facilitators of crime, or accomplices. As victims, transport firms' main concerns lie in the theft of goods and vehicles, and in smuggling. Regarding the latter type of crime, firms are not only potential victims as sector players can knowingly facilitate or commit such crimes. Regarding corruption and fraud, sector players can act as offenders.²²

¹⁹ Confirmed by the Secretary General at BVT, interview on 1 April 2004.

²⁰ European Transport Workers' Federation, *About the ETF*, URL: http://www.itf.org.uk/itfweb/etf/be/eabout_1.htm.

²¹ International Road Transport Union, *Mission, Objectives, Priority Issues*, <http://www.iru.org/Presenting/Organisation/section2.E.html>.

²² The data gathered and processed for this cluster element come from earlier reports on crime and the transport sector, from public and private sector bodies, and interviews with customs and law enforcement authorities, and with security sector representatives.

Reference model analysis

With this third step we descend to the micro-level of the analysis. The information processing on this economic level is focused on defining and discussing the concrete corporate culture and functioning of the entities that are found in the road freight transport sector. The micro-level analysis ultimately leads to the possibility of evaluating business processes on a level detached from the individual business entities they belong to, allowing conclusions to be drawn on a sector level.

The basic elements in the analysis are six relevant business processes: purchasing, sales, book-keeping, administration, personnel management and services operations. For business entities in the road freight transport sector, two of these business processes, 'services operations' and 'personnel management', are highly relevant, certainly in relation to vulnerability assessments.

In relation to the reference model of a transport company, '*services operations*' constitute the most important business process. Their importance stems from the fact that they are responsible for the core output, namely, offering transport services.

Because the service offered by a transport company is for the most part situated on the road and thus away from the main site of the business, tracking and controlling the production process is problematic. Although in recent years new technological expedients (e.g. tracing and tracking systems) have been developed, the risks in relation to the production process remain high, certainly for small companies for which these new technologies appear to be too expensive.

In terms of '*personnel management*', the characteristics of the corporate culture (compliance and business ethics) affect the integrity of drivers in particular, increasing or decreasing the risk that they act as the accomplices of criminals or avail themselves of criminal opportunities on their own account.

Moreover, the neglect of proper screening procedures, and less-than-thorough background checking, enhance the risk of employing members of criminal groups. There have been indications that organised-crime groups send out their members as temporary employees, for instance, so that they are able to operate from inside transport companies.

Analytical phases

At this stage the information gathered, processed and ordered in the three preceding phases is used to perform the actual vulnerability assessment. The analytical exercise is carried out both in width and in depth, each time using a set of indicators (Rozenkrans and Emde, 1996).

In the broad scan, the information that is collected and processed on the meso and macro levels (the sector analysis, the environmental scan and the

cluster analysis) is used to award the sector a score in terms of a number of indicators in order to ascertain the importance of the relevant feature to the overall vulnerability of the road freight transport sector. In the depth scan, the information that is collected on the micro level (the reference model analysis) is used to pinpoint those business processes within the road freight sector entities that create opportunities for (organised) crime. Therefore, each business process is awarded a 'score' which expresses the level of vulnerability of that business process.

Broad scan

The indicators developed for this exercise have been grouped and structured following a diagram. This diagram consists of four major branches, made up of indicators that are in some cases broken down into sub-indicators, drawing on information from earlier research into the vulnerability of legal sectors (Vander Beken, Cuyvers, De Ruyver, Hansen and Black, 2003). The four branches are: 'nature of the product', 'threshold', 'alternative markets' and 'international context'. Each branch is scored in terms of each of the indicators, the set of scores making up the vulnerability profile of the branch.

Nature of the product

The nature of the product refers to a series of qualities²³ of the product that can make it particularly attractive to criminals looking to exploit it to their advantage. Although the indicators produce varying vulnerability scores in road freight transport, the overall score of the branch is labelled 'high vulnerability'.

In terms of three of the vulnerability indicators, 'integrity of the product', 'product mobility' and 'elasticity', the sector scores low to very low. The road freight transport sector offers a high level of '*integrity*' of the product/service: either there is transport (physical movement of goods by road) or there is no transport at all. Although there is a high level of '*mobility of the product*' in the transport of goods by road, this does not equal a high level of vulnerability, as mobility is a quality of all service sectors and as such mobility is not a feature which increases sector-specific opportunities for (organised) crime. In relation to '*elasticity*' it can be stated that, as a result of the broad range of possible substitution services, the road freight transport sector is very elastic. The consequence is a very low vulnerability score.

Apart from that, in terms of the three remaining indicators, 'compatibility', 'product differentiation' and 'stability of the value', the sector has high to very high vulnerability scores. The occurrence of phenomena such as smuggling and

²³ These qualities are: 'integrity of the product', 'product mobility', 'elasticity', 'compatibility/flexibility', 'product differentiation' and 'stability of the value'.

‘Euro fraud’²⁴ illustrates the very high ‘compatibility’²⁵ of road transport, resulting in a very high vulnerability score in terms of this indicator. In terms of ‘*product differentiation*’, the sector is characterised by homogeneity. This offers interesting opportunities for crime, for criminal methods that are successfully used in the service of one market player can easily be transposed to another. This increase in opportunities results in a high vulnerability score. Finally, ‘stability of the value’ is high in road freight transport: as long as there are products produced, there will be a need to transport these products. Therefore, vulnerability is high at this point, as stability in the demand for (illicit) transport renders infiltration of the sector very attractive to criminals.

Threshold

The branch ‘threshold’ consists of indicators which express the accessibility of the sector to new-comers. Accessibility is determined by ‘regulation and enforcement’ on the one hand, and the ‘economic aspects: the market’ on the other.

Regulation and enforcement

The indicator ‘*regulation and enforcement*’ is further broken down into two sub-indicators, which aim to assess both the *quantity* and the *quality* of regulation and enforcement. Concerning ‘regulation’, a very low vulnerability score is given in terms of *quantity* (as there is sufficient and specific legislation dealing with various aspects of the sector) but a very high score is given in terms of *quality* (since many issues on the European level are regulated by directives – which are binding only in terms of the results to be achieved. Therefore, few aspects will be dealt with in a harmonised way and criminals can and will abuse this lack of harmonisation).

In terms of ‘*enforcement*’, on the other hand, the sector is considered highly vulnerable in relation to quantity (since market liberalisation and the opening of European borders have resulted in a reduction in the number of controls, thus increasing the opportunities for criminal activity owing to a reduced risk of exposure). It is also considered highly vulnerable in terms of quality (since control and enforcement are still national-level competences, with the result that enforcement is not at all transparent). As a result the sector receives high vulnerability scores in terms of the indicator ‘regulation and enforcement’.

²⁴ ‘Euro fraud’ refers to all those types of fraud that are related to the misuse of European regulations concerning subsidies and taxes.

²⁵ Compatibility refers to the degree to which the qualities of the product are compatible with other illegal activities.

Economic aspects: the market

The indicator ‘economic aspects: the market’ is also broken down into two sub-indicators. These are, ‘market structure and market concentration’, and ‘required capability’.

The sector is given a high score in terms of the sub-indicator ‘*market structure and market concentration*’ owing to the high scores it receives in terms of the indicators, ‘market type’ (an open market with large numbers of small companies without the power to influence prices and which deliver rather homogeneous services) and ‘competition’ (the market for the transport of goods by road is very competitive, with thousands of companies of various size, each representing only a small percentage of the total supply) and the very low score for ‘market saturation’ (access to the market is difficult and unattractive for criminals as much as for anyone else due to the high level of saturation).

In terms of the sub-indicator ‘*required capability*’, on the other hand, the sector receives a high vulnerability score as few ‘knowledge’ (contacts and experience) or required ‘production’ factors are needed (labour, capital and raw materials) to obtain access to the market. As a result, the indicator ‘market’ is given a high vulnerability score.

Alternative markets

A high vulnerability score is given for the branch ‘alternative markets’, which is evaluated in terms of two indicators: ‘legal alternative markets’ and ‘black market’.

Legal alternative markets

Criminal groups do not necessarily focus all their activities on one specific market, but can, for instance, engage in poly-commodity trafficking etc. Involvement in different domains and markets limits their risk of getting caught. On the other hand, the more alternatives open to crime there are, the lower the chances that the sector under study will eventually be chosen for exploitation.

Although few vulnerability studies currently exist, there are some indications that other transport sectors are equally susceptible to crime. For the road freight transport sector, various alternative legal markets can be thought of, such as short-sea-shipping, transport by inland waterways, and rail transport. Information from the environmental scan, in particular from the White Paper, reveals that there is a felt need, as well as the political will, to reduce the share of road transport in favour of these alternative transportation modes. An increase in the importance of these modes is likely to be accompanied by a growing interest in, and infiltration of, these sectors on the part of criminals. Therefore, in terms of the indicator ‘*legal alternative markets*’ the sector is given a high vulnerability score.

Black markets

Illegal markets tend to be subjected to the same market principals as legal business activities, except that transactions on the black market are informal and have no formal dispute-settlement procedures at their disposal. The black market for the transport of goods by road can be supplied by private passenger transport. The expansion in passenger transport by car thus creates many opportunities for black-market operators. Although these black markets are interesting objects of study in their own right, they are not really related to the sector under study: the road transport sector is interpreted as a licit commercial sector, whereas these possible black markets are part of the private sphere. More relevant for our study is the so-called 'grey economy'. In road transport, 'grey' activities are mainly undeclared work and unregulated or undeclared self-employment. Because of the high frequency of these activities, the step towards other criminal activities is a small one. Especially in a highly competitive environment like the transport sector, where companies experience difficulties in remaining viable, it is tempting to gain extra profits from illegal activities. Therefore in terms of the indicator '*black markets*' the sector receives a very high vulnerability score.

International context

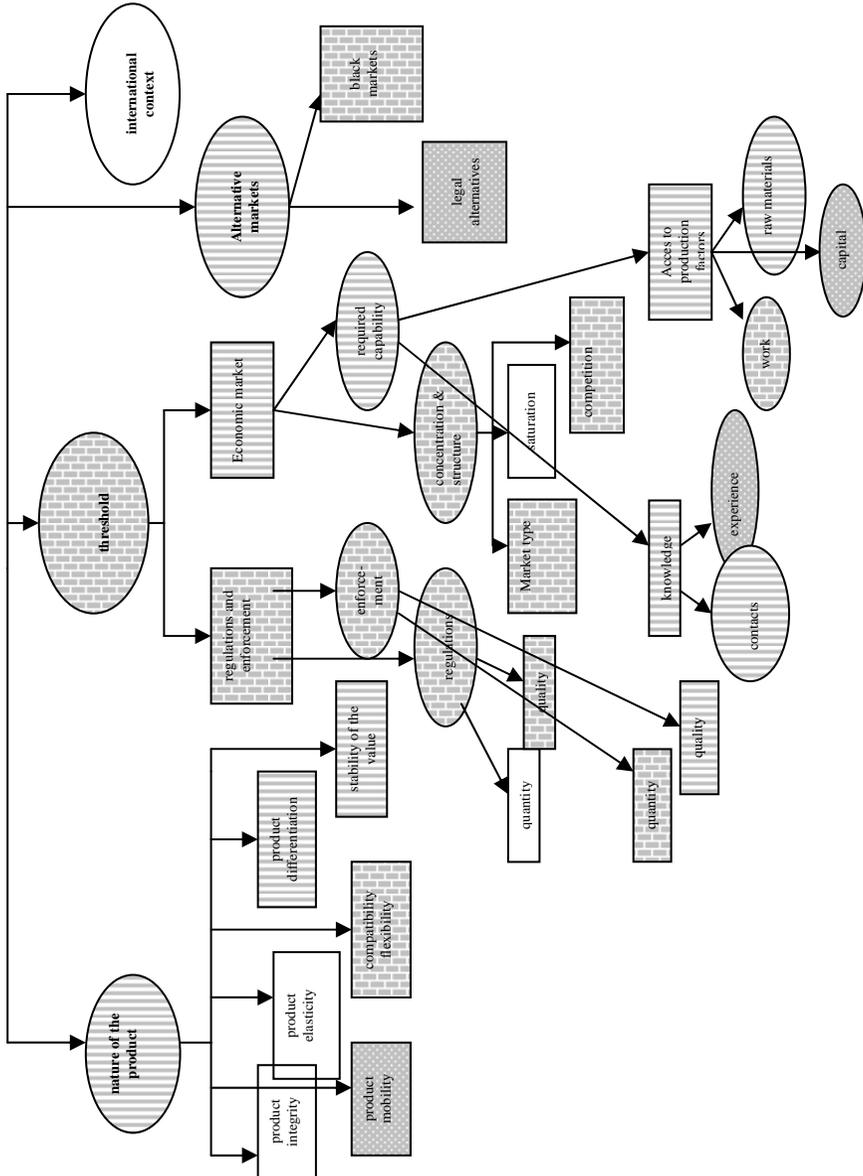
'*International context*' serves primarily as a policy indicator. Concretely, the indicator is assessed using, on the one hand, relevant data on policy aspects such as regulations and control, and on the other hand, data on economic aspects. European road freight transport however is mostly influenced by EU and national regulation. Other superpowers, like the US, have a minimal interest in, and influence over, how the sector is organised and controlled. Road freight transport is not likely to be intercontinental and therefore, in terms of the indicator 'international context', the sector is given a very low vulnerability score.

Depth scan

At this stage, the information gathered, processed and meaningfully ordered in the preceding reference model analysis, is used to perform the vulnerability assessment in depth. Again, the exercise is performed using a list of indicators. However, instead of evaluating the sector in terms of one indicator based on information from different sources (width scan), in the depth scan each of the selected business processes is evaluated in terms of one or more indicators.

The business process '*purchase*' has been given a low vulnerability score as in terms of the indicator, 'costs', it scores low (very limited opportunities for fraud) and in terms of the indicator, 'transparency', it scores very low (the possibility of leasing vehicles detracts from clarity in terms of ownership and can make control more difficult).

‘Sales’ attracts a high score since, among other things, it is very highly vulnerable in terms of the ‘transparency’ criterion. As sales policies are mostly influenced by each customer’s specific requirements, and as these each have their own very specific features, one can hardly speak of a transparent sales policy. A high score has also to be given for the indicator, corporate culture. Due to the highly competitive nature of the transport market, and low wages, there is a growing tendency of drivers and/or transport companies to engage in illegal activities to a certain extent.



The business process ‘*book-keeping*’ also attracts a high vulnerability score due to the high scores for the indicators ‘transparency’ (cost data are pretty vague within most transport companies, due to the stochastic character of demand and the resulting price differentiation) and ‘solvency’ (with many companies being unable to pay their debts).

The business process ‘*administration*’ has been given a low vulnerability score based on the limited risks in terms of the indicator ‘transparency’.

BUSINESS PROCESSES	Vulnerability score
<ul style="list-style-type: none"> • PURCHASING 	LV
<ul style="list-style-type: none"> ○ Costs ○ (transaction) Transparency 	VLV LV
<ul style="list-style-type: none"> • SALES 	HV
<ul style="list-style-type: none"> ○ (transaction) Transparency ○ Corporate culture 	HV HV
<ul style="list-style-type: none"> • BOOK-KEEPING 	HV
<ul style="list-style-type: none"> ○ (transaction) Transparency ○ Solvency 	HV HV
<ul style="list-style-type: none"> • ADMINISTRATION 	LV
<ul style="list-style-type: none"> ○ Transparency 	LV
<ul style="list-style-type: none"> • PERSONNEL MANAGEMENT 	VHV
<ul style="list-style-type: none"> ○ Costs ○ (transaction) Transparency ○ Corporate culture 	HV VHV VHV
<ul style="list-style-type: none"> • SERVICES OPERATIONS 	VHV
<ul style="list-style-type: none"> ○ (transaction) Transparency ○ Chain integration 	VHV HV

‘*Personnel management*’, on the other hand, is given a very high score as the scores in terms of the indicators, ‘costs’, ‘transparency’ and ‘corporate culture’ are, respectively, high (many opportunities for activities characteristic of the ‘grey economy’ and for fraud) very high (lack of standardisation in relation to the checking and screening of potential employees) and very high (the corporate culture, among both employers and employees, is not characterised by an aversion to cheating and avoiding control).

Finally ‘*services operations*’ scores high owing to the very high score in terms of ‘transparency’ (though new technologies make it possible to track and trace cargo and vehicles, the techniques are expensive and therefore unavailable to many companies, especially the small ones) and the high score in terms of ‘chain

integration' (the orientation to the needs of each individual customer, together with the increasing competitiveness of the environment in which transport companies have to operate, offer many opportunities for crime).

Conclusions

Studies of the vulnerability of economic sectors arise from the need to complement existing crime analyses focusing on perpetrators and groups by analysing the risk or opportunities provided by the economic task environment in which these persons and groups act. Such vulnerability studies are also considered to be an instrument with which to support policy discussions due to their capacity to reveal potential malpractices and counter-productive regulations, or the need for additional rules.

At the same time, the future- and risk-oriented character of vulnerability studies is to be considered their most important weakness. The collection and the analysis of information using a set of indicators cannot be considered as an exact science providing quantifiable results. Vulnerability studies are instruments to be used to order and rank information and to facilitate decision-making, nothing more and nothing less.

The case study of the road freight transport sector reflects the strengths and weaknesses of such an approach. Much relevant information on the sector was collected and ranked in order to give a clear insight into the operation of the sector and its context. In the width and depth scan, the information was used to score the sector in terms of a set of indicators. On that basis, a vulnerability profile, which led to the conclusion that the sector was highly vulnerable on a number of points, was drawn up. Although the specific scores allocated can undoubtedly be questioned, we believe that vulnerability profiles can function as a guide to the actions and initiatives that are appropriately taken by governments, law enforcement agencies and the sector itself.

References

- Albanese, J., Predicting the incidence of organised crime: A preliminary model. In: T. Bynum (ed.), *Organised crime in America. Concepts and controversies*. New York, Criminal Justice Press, 1987
- Albanese, J., Where organized and white collar crime meet: Predicting the infiltration of legitimate business. In: J. Albanese (ed.), *Contemporary issues in organised crime*. New York, Criminal Justice Press, 1995
- Albrecht, H.J., M. Kilchling, and E. Braun, (eds.), *Criminal preventive risk assessment in the law-making procedure*. Freiburg Im Breisgau, Max-Planck-Institute For Foreign And International Criminal Law, 2002
- Beare, M., and R. Naylor, *Major issues relating to organised crime: Within the context of economic relationships. A paper prepared for the Law Commission of Canada*. 1999, available at:
<http://www.lcc.gc.ca/en/paers/rapport/nathan/nathan.html>
- Beken, T. Vander, L. Cuyvers, B. de Ruyver, J. Hansens, and C. Black, *Het meten van de kwetsbaarheid van legale sectoren voor georganiseerde misdaad*. Gent, Academia Press, 2003
- Beken, T. Vander, L. Cuyvers, B. de Ruyver, M. Defruytier, and J. Hansens, *Kwetsbaarheid voor georganiseerde criminaliteit. Een gevalstudie van de diamantsector*. Gent, Academia Press, 2004
- Beken, T. Vander, E.U. Savona, L. Korsell, M. Defruytier, A. Di Nicola, A. Heber, A. Bucquoye, A. Dormaels, F. Curtol, S. Fumarulo, S. Gibson and P. Zoffi, *Measuring organised crime in Europe. A feasibility study of a risk-based methodology across the European Union*. Antwerp/Apeldoorn, Maklu Publishers, 2004
- Beken, T. Vander and M. Defruytier, Measure for measure. Methodological tools for assessing the risk of organised crime. In: P.C. van Duyne, M. Jager, K. von Lampe and J.L. Newell (eds.), *Threats and phantoms of organised crime, corruption and terrorism*. Nijmegen, Wolf Legal Publishers, 2004
- Beken, T. Vander (ed.), *Organised crime and vulnerability of economic sectors, Transport and music sector*. Antwerp/Apeldoorn, Maklu Publishers, 2005 (forthcoming)
- Beken, T. Vander, M. Defruytier, A. Bucquoye, and K. Verpoest, Road map for vulnerability studies. In: T. Vander Beken (ed.), *Organised crime and vulnerability of economic sectors, Transport and music sector*. Antwerp/Apeldoorn, Maklu Publishers, 2005 (forthcoming)
- Beken, T. Vander, Risky business: A risk-based methodology to measure organized crime, *Crime, Law & Social Change*. vol. 41, 471-516, 2004
- Black, C., T. Vander Beken, and B. de Ruyver, *Measuring organised crime in Belgium. A risk-based methodology*. Antwerp/Apeldoorn, Maklu Publishers, 2000
- Black, C., T. Vander Beken, B. Frans, and M. Paternotte, Reporting on organised crime. A shift from description to explanation. In: *The Belgian*

- Annual Report On Organised Crime*. Antwerp/Apeldoorn, Maklu Publishers, 2001
- Blauwens, G., P. de Baere, and E. van de Voorde, *Transport economics*. Antwerp, Uitgeverij De Boeck, 2002
- Bucquoye, A., K. Verpoest, M. Defruytier, and T. Vander Beken, The European road freight transport sector. In: T. Vander Beken (ed.), *Organised crime and vulnerability of economic sectors, Transport and music sector*. Antwerp/Apeldoorn, Maklu Publishers, 2005 (forthcoming)
- Coveliers, H., and C. Desmedt, *De impact van de bestrijding van georganiseerde criminaliteit*. Parlementaire commissie van onderzoek naar de georganiseerde criminaliteit in België, zitting 1998-1999, Stuk Senaat, no. 1-326/9, 1999
- Dullaert, W., *Scheduling flexibility and pricing in road freight transport*. Antwerp, s.n., 2002
- Duyne, P.C. van, *Het spook en de dreiging van de georganiseerde misdaad*. The Hague, SDU Uitgeverij, 1995
- Duyne, P.C. van, The creation of a threat image. Media, policy making and organised crime. In: P. van Duyne, M. Jager, K. von Lampe and J.L. Newell (eds.), *Threats and Phantoms of Organised Crime, Corruption and Terrorism*. Nijmegen, Wolf Legal Publishers, 2004
- Edwards, A., and P. Gill, *The politics of 'transnational organised crime': discourse, reflexivity and the narration of threat*. Paper presented to the UK Economic and Social Council Research Seminar Series on Policy Responses to Organised Crime on 8 September 1999, University of Leicester, 1999
- Kleemans, E., E. van den Berg, and H., van den Bunt, The social embeddedness of organized crime. *Transnational Organized Crime*. vol. 5, 19-36, 1999
- Lampe, K. von, Afterword: Organised crime research in perspective. In: P.C. van Duyne, K. Von Lampe and N. Passas (eds.), *Upperworld and underworld in cross-border crime*. Nijmegen, Wolf Legal Publishers, 2002
- Lampe, K. von, Measuring organised crime. A critique of current approaches. In: P.C. van Duyne, M. Jager, K. von Lampe and J.L. Newell (eds.), *Threats and phantoms of organised crime, corruption and terrorism*. Nijmegen, Wolf Legal Publishers, 2004
- Levi, M., The organization of serious crimes. In: M. Maguire, R. Morgan and R. Reiner (eds.), *The Oxford Handbook of Criminology*. Oxford, Oxford University Press, 2003
- Levi, M. and R.T. Naylor, *Organised crime, The organisation of crime and the organisation of business*. Paper published by the UK DTI's Office of Science and Technology Foresight Directorate Crime Prevention Panel, 2000
- Naylor, R.T., *Wages of crime. Black markets, illegal finance and the underworld economy*. Ithaca/London, Cornell University Press, 2002
- Paoli, L., The Paradoxes of organised crime. *Crime, Law & Social Change*, vol. 37, 51-97, 2002
- Passas, N., Cross-border crime and the interface between legal and illegal actors. In: P.C. van Duyne, K. von Lampe and N. Passas (eds.), *Upperworld and underworld in cross-border crime*. Nijmegen, Wolf Legal Publishers, 2002

- Porter, M., *Competitive strategy: techniques for analysing industries and competition*. New York, The Free Press, 1980
- Porter, M., *Competitive advantage of nations*. New York, The Free Press, 1990
- Reuter, P., J. Rubinstein, and S. Wynn, *Racketeering in legitimate industries: two case studies*. Washington DC, US National Institute of Justice, 1983
- Rozenkrans, R., and E.J. Emde, Organised crime: towards the preventive screening of industries: a conceptual model. *Security Journal*, 169-176, 1996
- Schloenhardt, A., Organised crime and the business of migrant trafficking: an economic analysis. *Crime, Law & Social Change*, vol. 32, 203-233, 1990
- Smith, D., Paragons, pariahs and pirates: a spectrum-based theory of enterprise. *Crime and Delinquency*, vol. 26, 358-386, 1980
- Stevens, H., *Transport policy in the European Union*. Hampshire/New York, Palgrave Macmillan, 2004
- Voort, M., van de and K.A. O'Brein, 'Seacurity'. *Improving the security of the global sea-container shipping system*. RAND Europe, 2003
- Williams, P., and E.U. Savona, (eds.), *The United Nations and transnational organised crime*. London, Frank Cass, 1996
- Witlox, F., and T. Noteboom, *Eerlijke concurrentie in het wegvervoer: realiteit of mythe*. Antwerp/Apeldoorn, Garant, 2003

Controlling the flow of money or satisfying the regulators?

Jackie Harvey¹

Introduction

Money laundering has been in existence for a very long time. It involves ‘*the processing of criminal proceeds to disguise their association with criminal activities*’ (Boorman and Ingves, 2001: 3). Concern over money laundering (heightened by its association with financing terrorism) arises because it is seen as facilitating illegal activity: in theory, cutting off access to the funds, combined with the legal seizure of the proceeds of criminal activity, removes the financial incentive to commit organised crime.

A major problem for researchers within the field is that limited data and the resultant lack of understanding of the criminal fraternity, hamper the development of academic analysis of the true extent of money-laundering activity. In consequence, the ‘alarmist’ notion of it being of major significance cannot be objectively challenged. Unable to measure the true extent of money laundering means that it is equally difficult to determine the effectiveness of policy measures advocated to deter money launderers. It is proposed that there has been a shift away from reducing opportunities for money laundering (and predicate crime) towards an emphasis on the demonstration of compliance with systems and procedures (the ‘tick-box’ culture) put in place with the expectation that they will prevent money laundering from occurring.

Internationally, the fight to contain money laundering has focused attention on countries identified as ‘weak links’, primarily because of their inability (whether or not voluntary) to demonstrate internationally acceptable standards of compliance. This chapter considers the impact and cost of money laundering regulation and looks at the rationale and implication of the focus on ‘weak links’ in the international financial system. In particular, a preliminary investigation is carried out into the specific characteristics of countries that have been targeted by the international community.

For the purposes of this research, information has been compiled from a range of recognised international sources for some 224 countries and territories for which data was available. Within this, countries have been grouped into three different classifications according to whether they have been identified as:

¹ Jackie Harvey is Principal Lecturer in Finance at the Newcastle Business School, Northumbria University, United Kingdom.

‘opaque’; as an identified money laundering country; or, as neither of these. Various economic, financial and political characteristics of these groupings are then considered in order to identify common features. It is recognised that this is very much an initial survey and that the level of analysis remains superficial; however, the intention is to identify areas that might warrant more detailed investigation in the future.

Money laundering – estimates or guesses

The economic analysis of money laundering is academically challenging: launderers and their activity are not captured through normal statistical techniques. It is argued, therefore, that global ‘estimates’ are little more than informed ‘guesses’.

Thus we are faced with a fundamental problem that underlies all research into this field: there is very little empirical data on the overall magnitude of money- laundering activity. As can be seen from Table 1, various estimates of the size of the problem have been provided, with many of the international agencies quoting each other’s figures. These ‘guesses’ have then been reproduced in countless other papers and commentaries without either question or verification and in the process have undoubtedly acquired some form of statistical accuracy. The International Monetary Fund (IMF) is probably the most quoted source and they estimate that money laundering on a global scale is worth between 2% and 5% of world GDP, or in dollar terms, in 1999 prices, at between \$0.62 and \$1.55 trillion.

Table 1. Estimates of the scale of global money laundering

<i>Institution</i>	<i>Estimate</i>	<i>Year</i>
IMF	2% - 5% GDP; \$0.62 – 1.55 trillion	1999
UN	Up to \$1.5 trillion	1999
FATF	2% global GDP up to \$1.5 trillion	2001
OECD	\$1.1 trillion (drug money)	1995
IBRD	\$300 – US\$500 billion	1995

Sources: various

The important point to note is that in all cases, the scale of activity is assumed to be significant and a real problem for the financial sector. Indeed, van Duyn (2003: 68, 74) points to the tendency to assume that money laundering is of such a magnitude and scale that it is a ‘global menace’. He also draws attention to the ability of the authorities to expand the amount of laundering activity thought to be taking place by simply expanding the definition of what constitutes laundered funds, a point borne out by the introduction in the UK of the Proceeds of Crime Act 2002.

There is a clear assumption on the part of authorities that there exists a linear inverse relationship between the amount of regulation and the volume of money laundering. Constant tightening of the regulatory constraint will eventually remove any opportunity for laundering (irrespective of the economic inefficiency imposed by such a burden). This relationship is explained by Masciandaro (1998: 4, 6) as *ceteris paribus*:

“the costs of money laundering will, therefore, depend on the effectiveness of anti-money laundering regulation: the more effective the latter is, the more expensive it will be for criminal agents to undertake the activity of money laundering”

and

“If we assume anti-money laundering regulation to have a significant impact on the cost of carrying out a criminal activity, then an effective system of rules will in fact reduce the ability of criminal agents to launder their illegal liquidity”.

Of course, this assumed relationship does not take into account the actions of money launderers as they react to changes in legislation. As Harvey (2004: 335) points out, they may develop new methods of laundering to circumvent legislation, increase the amount of activity in order to restore underlying levels of profitability or become entirely barter based, removing the need to ‘clean’ funds. So, whilst it is possible to establish the purpose and rationale for money laundering regulation, its effectiveness remains open to question. Again, van Duynes (1998: 370), states that there is no evidence that increasing costs (via increased regulation) has a deterrent impact on the amount of crime. On the contrary, ‘it is business as usual’.

The international dimension

The main international body engaged in continuous and comprehensive efforts both to define policy, encourage best practice and promote the adoption of anti-money laundering measures is the Financial Action Task Force (FATF). This was set up by the G7 group of countries at the July 1989 Economic Summit in Paris and currently has representatives from twenty-nine member (primarily OECD) countries and governments, together with the Gulf Co-operation Council, and the European Commission.

A key component of its work concerns appropriate counter measures and these are set out in the ‘Forty Recommendations’ formulated in 1990 and

revised in 1996 and 2003.² These recommendations essentially set out the measures that national governments should take to implement effective anti-money laundering programmes and, in consequence, are used to evaluate the extent of compliance on the part of any country that the FATF chooses to investigate. The FATF requires the criminalisation of money laundering; the mandatory creation of a suspicious transaction-reporting regime; the establishment of a proper customer identification requirement; the elimination of excessive bank secrecy, and international co-operation. The stated purpose of these regulations is to reduce the vulnerability of the international financial system and to increase the worldwide effectiveness of anti-money laundering measures.

The work of the FATF obtained a far higher profile following the 1997 Asian Crisis that precipitated a global financial-market crisis and widespread international concern that financial abuse could undermine the credibility and efficiency of the international financial system. It participated in what amounted to a ‘three-pronged strategy’ focused on (i) money laundering, (ii) banking and (iii) tax evasion, the results of which were reported to the G7 Summit in July 2000 (Wechsler, 2001:44). This strategy saw, for the first time, cooperation between the FATF – which reviewed nations’ efforts in combating both offshore and onshore money laundering – the G7’s Financial Stability Forum (FSF)³ – which had been established to promote international financial stability, improve the functioning of markets and reduce systemic risk – and the OECD. The latter tackled tax evasion and identified tax havens that exhibited a lack of transparency, a lack of effective exchange of information, and discriminatory regimes (i.e. differential treatment between domestic and non-domestic residents) that combined to undermine the tax bases of other countries. Each of these three bodies had their reports and recommendations endorsed by the G7 finance ministers in July 2000, signaling the start of the ‘name and shame’ policy. Significantly, this was also the point at which the FATF started to look beyond purely member states to all nations’ efforts and, for the first time, specifically differentiated between on and offshore activity. It is suggested that this was, in part, driven by the heightened interest of the OECD (of which the FATF is operationally a part) in ‘tax havens’.

The FATF produced the first blacklist of non co-operative countries and territories (NCCT) in June 2000. This group of countries was considered not to have in place effective countermeasures against money laundering. Removal from this list is only possible after a country has provided practical evidence of effectiveness of their remedial action. Indeed, it has been observed that it is

² There are, in addition, eight special recommendations on terrorist financing, formulated in 2001.

³ This forum comprises finance ministers, central bankers and supervisory officials from 11 nations with advanced financial systems, along with representatives from the IMF, the BIS and other regulatory committees.

harder to get off the list than to avoid going on it in the first place. Basically, those countries listed as being non co-operative through either failing to participate, or indeed to improve, are subject to economic sanctions for non-compliance that are equivalent to being cast into commercial darkness by being ostracised from the world's financial system.

It is curious how the power of the FATF has evolved; indeed, van Duyn (2003:75) describes the FATF as a democratically unaccountable watchdog. There has also been the suggestion that the original development of the FATF was driven by the Clinton Administration who recognised it as an institution that could exert economic influence over countries normally beyond the influence of the US. It is, and remains, a voluntary organisation and thus implementation of the 40 recommendations is not mandatory although all 29 members do commit to implementing them (Boorman and Ingves, 2001:28). Currently, only 15 of the FATF members have managed to implement all of the 28 recommendations requiring specific action⁴ and this list does not include either the US (19 out of 28) or the UK (27 out of 28).

It is not surprising, therefore, that the FATF has been criticised for becoming more political and for seeming to operate dual standards, with more stringent requirements being placed on non-member than on member (OECD) states. This view is supported by Stessens (2001:208) who notes that the "credibility and success of the FATF's efforts would have benefited if the FATF had been more critical of its own members as well". Indeed, it has been pointed out that that chance of a country being targeted by the FATF is far higher if they are recipients of international aid, have small defence forces, and are not considered to be strategically important (Hampton and Levi, 1999: 2).

The effect of this 'name and shame' policy has been to focus attention on 'under-regulated' financial centres, those countries that are not considered to be doing enough in terms of deterring potential money launderers and that lack the necessary commitment to systems and procedures. These countries have been identified as the 'weak links' in the international financial system, it being argued that cash will be exported to these countries for integration and subsequent movement through the international financial system (Stessons, 2001: 200). However, let us not lose sight of the fact that being identified as a 'weak link' due to inadequate regulatory control is not the same as being a country in which money laundering is actually occurring. Indeed much of the initial targeting of countries, was driven as much by the agendas of the FSF and the OECD (with their concerns over financial stability and tax revenues) as by the FATF, with the consequence that Offshore Finance Centres (OFCs) have featured quite prominently, particularly those located in less developed countries.

Unsurprisingly, many OFCs are located in small island countries which face limited opportunities for economic development emanating from the fact that size may give rise to important differences in economic structure, social

⁴ Information taken from the FATF Annual Report 2002 – 2003.

organisation, administration and government activity with the consequence that they are often heavily reliant on a single sector or product. An important and significant point is that, at least until the mid to late 1990s, many former British colonies and dependencies (primarily the small island economies of the Caribbean and Pacific) were actively encouraged to establish offshore banking and other activity by the UK government as a means of providing critical income-generating activities, employment and government revenue. Whilst numbers of such centres remained limited they had been considered to provide a useful service. However, once communications and other technical developments provided the means to link these remote financial centres with major onshore global centres, concern amongst the international community grew and attention shifted to the potential vulnerability of OFCs to money laundering, fraud and possible financial sector failure arising from the less transparent and more anonymous operating environment.

It is generally argued that the very conditions that attract legitimate business activity to OFCs (relative anonymity, low levels of taxation and a reasonable degree of political stability) are those that will attract illegal activity. This vulnerability is arguably greater for those OFCs where the value added to the domestic economy remains unsubstantial (activity is confined to ‘brass-plate companies’) and capital flows tend to be engaged in speculative activity rather than being committed to long-term investment. Such centres are in price-competitive situations and suffer from any changing cost structure or change in demand. Indeed, profit-maximising banks and companies have engaged in fierce ‘arbitrage’ between different host governments putting them under pressure to lower costs, and in some cases standards.⁵ Thus, the characteristics that make them vulnerable may well have been encouraged by international profit-seeking organisations. That said, it has also been pointed out by Masciandaro and Portolano (2003: 311) that as most OFCs are small islands, prevention of “criminal infiltrations (might be) easier” thus making them less attractive to illegal activity.

Weak links – the findings

The first group of countries to find themselves classified in such a way were those that were identified as ‘secrecy or financial havens’ by the UN (1998: 78). Many of these countries subsequently featured in the offshore finance centre classification exercise undertaken by the Financial Stability Forum in April 2000. Again, many of these countries were also identified as tax havens by the OECD in the report it compiled during the same year, and either at the time or

⁵ An article in the *Economist* noted that American corporations make extensive use of OFCs, earning almost 1/3 of their profits in such jurisdictions.

subsequently, as NCCTs by the FATF.⁶ One wonders just how widely the FATF cast its net when drawing up the very first lists of NCCTs or whether they were influenced by the interest of the OECD in tax havens with its obvious bias towards OFCs.

Collectively there are some 59 ‘opaque’ countries and territories. 42 of these were ranked by the FSF in accordance with the perceived quality of their legal infrastructure and supervisory practices and/or level of resources devoted to supervision and co-operation relative to the size of their financial activities or level of co-operation with other authorities. On this basis, countries were classified as: Group I (good quality, although continuing efforts to improve the quality of supervision and co-operation should be encouraged in these jurisdictions); Group II being higher than III but lower than I; and Group III being lower than group II (FSF 2000). The UN also identified all of these 42 countries (together with Liberia) as being ‘Secrecy Havens’. In its report, the OECD identified 35 countries and territories as tax havens and finally, the FATF, between June 2000 and 2004, identified 23 individual countries as being non-cooperative. To facilitate an initial comparison, in Tables 2 and 3, these countries are categorised according to both income and geographical location.

Table 2. 59 ‘Identified opaque countries’ ranked by income group

<i>World Bank income group</i>	<i>number of countries</i>	<i>percentage of total</i>
High Income Non OECD	16	27.1%
High Income OECD	3	5.1%
Upper Middle Income	14	23.7%
Lower Middle Income	23	39.0%
Low Income	3	5.1%
Total	59	100.0%

Table 3. 59 ‘Identified opaque countries’ categorised by geographical region

<i>geographical region</i>	<i>number of countries</i>	<i>percentage of total</i>
America	21	35.6%
Asia & Pacific	15	25.4%
Europe & Central Asia	15	25.4%
Middle East & North Africa	4	6.8%
Sub-Saharan Africa	4	6.8%
Total	59	100.0%

⁶ For the purposes of this work all countries are shown that have been identified as NCCT (whether or not still on the list) from 2000 to date. This is because once identified, despite subsequent removal, a heightened level of interest will be shown.

In very broad terms, the initial emphasis was on a group of middle-income countries that were geographically close to the US (primarily Caribbean Islands). Within this overall group of countries and territories, some 10 countries had the distinction of featuring on all four international lists and these are shown in Table 4. It can be seen from this Table that all apart from Liechtenstein and Panama are island economies located in the Caribbean and the Pacific. Historically, they would have had a heavy reliance on copra, sugar and bananas as sources of export earnings. Details of the composition of GDP indicate the reliance that these countries have now placed on their services sector (financial and tourism) as a means of generating economic wealth. Possibly the most striking feature of this list is the small population size, with all the countries, apart from Panama, having populations of less than 300,000, although Panama, with a population of 3 million, is still classified as small by international standards. Clearly, the chances of a country being targeted are far higher if, in addition to the characteristics already identified, it has a very small population.

In order to look for further similarities, and in line with other studies, data has also been collected on the extent of cooperation exhibited by these countries. For this purpose, information was collected on whether or not the country had criminalised money laundering, the extent of cooperation with international law-enforcement agencies and membership of international organisations. Information has also been collected on the extent of integration with the international financial system by looking at gross private capital flows and foreign direct investment (discussed later) and at the size of the shadow economy, crime rates and corruption. Unfortunately, as can be seen from Table 4, much of this information is currently incomplete, primarily because the small size of these countries means that they are seldom included in international comparative data. For example, detail on the size of the shadow economy⁷ is only available for Panama (51.1%) whilst information on the total recorded crime rate, expressed as a percentage of the population for 1997 or the most recent year⁸ is only available for the Bahamas (6.69), St Kitts and Nevis (20.06) and St Vincent and the Grenadines (7.24). Despite the absence of data, it is worth noting that, notwithstanding their status as 'opaque' countries, all have criminalised money laundering and, except for St Vincent, cooperate with international law enforcement agencies. Further evidence of cooperation is that most are members of one or more relevant international agencies.

If these 'identified' countries and territories have been targeted due to perceptions of vulnerability arising from their opacity, it must be re-emphasised this is not the same as being identified as a country in which money laundering is taking place. Masciandaro and Portolano (2003: 313) make a similar point

⁷ Taken from Schneider and Enste (1999), using average data taken across a range of years and calculated using a variety of methodologies: thus there may be issues over consistency.

⁸ Data is for total recorded crimes and is taken from the UN Periodic Survey of Crime Trends, 1997.

where they note that the list of NCCTs “is neither a list of countries that offer money laundering services, nor a list of offshore countries”. They further draw attention to the fact that non-compliance might very well be involuntary arising from a lack of the resources that would be required to implement the systems and procedures needed to meet international standards.

So what evidence is there that money laundering is occurring within such countries and territories? Reliance has been placed on circumstantial information made public by the US State Department and by the US Central Intelligence Agency (CIA) – both of which produce extensive information on countries identified as facilitating money laundering. Both agencies classify countries according to perception of the risk of money laundering, and they have ranked some 181 different countries between them. The CIA uses two classifications, these being ‘Yes’ (implying that there is positive evidence of money laundering activity within the country) and ‘Vulnerable’ (implying that the country displays characteristics that make it vulnerable to laundering). On this basis, the CIA has rated 38 countries as ‘Yes’ and a further 31 as ‘Vulnerable’. The US State Department applies a broader classification in which it assesses ‘vulnerability’ as: primary (53 countries); concern (49 countries), and monitored (76 countries). Within the broad classifications that these agencies use, they include all of the identified 59 countries except for Andorra and the US Virgin Islands.

It is interesting, however, to look at the characteristics of the much smaller list of countries that have been identified both as Money Laundering Centres by the CIA and as being of Primary Vulnerability to Money Laundering by the US State Department. Table 5 comprises some 19 countries. It is instructive to note that of the 59 countries that have been targeted by the international community as ‘weak links’, only 8 have been identified (albeit only by US institutions) as ones where money laundering is taking place. These include: Hong Kong, Israel, Myanmar, Nauru, Nigeria, Panama, Philippines and Singapore. All but Hong Kong and Singapore have also appeared on the FATFs list of NCCTs, but only Nauru and Panama have the additional distinction of appearing as part of the group of countries in Table 4.

Table 4a. The 10 opaque countries featured on all 4 lists

<i>Country</i>	<i>population(1)</i>	<i>income group</i>	<i>geographical region</i>	<i>composition of GDP (2)</i>	<i>criminalised money laundering (3)</i>	<i>CLA money laundering classification (6)</i>
The Bahamas	300,000	High Income Non OECD	America	agriculture: 3% industry: 7% services: 90% (2001 est.)	Yes	Vulnerable
The Cayman Islands	43,100	High Income Non OECD	America	agriculture: 1.4% industry: 3.2% services: 95.4% (1994 est.)	Yes	Vulnerable
The Cook Islands	21,200	Lower Middle Income	Asia & Pacific	agriculture: 17% industry: 7.8% services: 75.2% (2000 est.)	Yes	Unclassified
Liechtenstein	40,000	High Income Non OECD	Europe & Central Asia	agriculture: NA% industry: 40% services: NA% (1999)	Yes	Vulnerable
The Marshall Islands	100,000	Lower Middle Income	Asia & Pacific	agriculture: 14% industry: 16% services: 70% (2000 est.)	Yes	Unclassified
Nauru	10,000	Lower Middle Income	Asia & Pacific	agriculture: NA% industry: NA% services: NA%	Yes	Yes
Niue	2,100	Lower Middle Income	Asia & Pacific	agriculture: NA% industry: NA% services: 55%	Yes	Unclassified
Panama	3,000,000	Lower Middle Income	America	agriculture: 7% industry: 17% services: 76% (2001 est.)	Yes	Yes
St Kitts & Nevis	50,000	Upper Middle Income	America	agriculture: 3.5% industry: 25.8% services: 70.7% (2001)	Yes	Yes
St Vincent & the Grenadines	100,000	Lower Middle Income	America	agriculture: 10% industry: 26% services: 64% (2001 est.)	Yes	Unclassified

Table 4b. The 10 opaque countries featured on all 4 lists

Country	US State Department classification (3)	Transparency international score (5)	Gross private capital Flows % GDP (4)	Gross FDI % GDP(4)	Cooperation with international law enforcement (3)	Membership of international organisations A, C, CE, O, OC, I, S (3)
The Bahamas	Primary	N/A	N/A	N/A	Yes	C, O, OC, I, S
The Cayman Islands	Primary	N/A	N/A	N/A	Yes	C, O, I
The Cook Islands	Concerned	N/A	N/A	N/A	Yes	A
Liechtenstein	Primary	N/A	N/A	N/A	Yes	CE
The Marshall Islands	Concern	N/A	N/A	N/A	Yes	NONE
Nauru	Primary	N/A	N/A	N/A	Yes	NONE
Niue	Concern	N/A	N/A	N/A	Yes	A
Panama	Primary	3.4	69.4	7.4	Yes	C, O, OC, S
St Kitts & Nevis	Concern	N/A	13.3	9.5	Yes	C, OC
St Vincent & the Grenadines	Primary	N/A	3.4	3.3	No	N/A

1. Population Data taken from Population Reference Bureau, <http://www.prb.org>
2. GDP Data taken from CIA World Fact Book: <http://www.cia.gov/cia/publications/factbook>
3. International Narcotics Control Strategy Report 2001 (Bureau for International Narcotics and Law Enforcement Affairs, March 2002)
4. IBRD 2004 World Development Indicators Table 6.1
5. Transparency International Corruptions Perceptions Index 2003 (where 10 is highly clean and 0 is highly corrupt)
6. CIA World Fact Book updated 11/5/2004

International Organisations: C = Caribbean FATF; A = Asia/Pacific Group; CE = Council of Europe Select Committee on Money Laundering; I = Offshore Group of Insurance Supervisors; O = Offshore Group of Banking Supervisors; OC = OAS/inter-American Drug Control Commission; S = International Organisation of Security Commissioners

Table 5a. Countries in which money laundering is taking place (identified by US authorities)

Country	Identified on original list of 59 countries	Population (X 1 million) (1)	Income classification	Geographical region	Composition of GDP (2)	Size of shadow economy (6)	Gross private capital flows % GDP (4)	Membership of international organisations (3)
Antigua & Barbuda	No	0.1	Upper Middle Income	America	agriculture: 3.9% industry: 19.2% services: 76.8% (2002)	N/A	2.0	C, OC
Brazil	No	176.55	Upper Middle Income	America	agriculture: 8.2% industry: 37.8% services: 53.9% (2002 est.)	33.4%	13.2	N/A
Greece	No	11.0	Upper Middle Income	Europe & Central Asia	agriculture: 8.1% industry: 22.3% services: 69.3% (2002 est.)	24.5%	22.6	N/A
HongKong	Yes	6.8	High Income non OECD	Asia & Pacific	agriculture: 0.1% industry: 12.9% services: 87.1% (2002 est.)	13.0%	92.4	A, O, S
Israel	Yes	6.7	High Income non OECD	Middle East & N. Africa	agriculture: 2.6% industry: 36.2% services: 61.2% (2001 est.)	29%	10.8	N/A
Italy	No	57.8	High Income OECD	Europe & Central Asia	agriculture: 2.4% industry: 30% services: 67.6% (2001 est.)	21.7%	13.7	N/A
Mexico	No	104.9	Upper Middle Income	America	agriculture: 4% industry: 26.3% services: 69.7% (2003 est.)	36.1%	6.3	N/A
Myanmar	Yes	49.5	Low Income	Asia & Pacific	agriculture: NA% industry: NA% services: NA%	N/A	N/A	N/A
Nauru	Yes	0.01	Lower Middle Income	Asia & Pacific	agriculture: NA% industry: NA% services: NA%	N/A	N/A	NONE
Nigeria	Yes	133.9	Low Income	Sub-Saharan Africa	agriculture: 41.2% industry: 15.7% services: 43.1% (2002 est.)	76.0%	0.03	N/A
Panama	Yes	3.0	Lower Middle Income	America	agriculture: 7% industry: 17% services: 76% (2001 est.)	51.1%	69.4	C, O, OC, S

Country	Identified on original list of 59 countries	Population (X 1 million) (1)	Income classification	Geographical region	Composition of GDP (2)	Size of shadow economy (6)	Gross private capital flows % GDP (4)	Membership of international organisations (3)
Philippines	Yes	81.6	Lower Middle Income	Asia & Pacific	agriculture: 15% industry: 35% services: 50% (2003 est.)	50.0%	41.2%	A, S
Singapore	Yes	4.2	High Income Non OECD	Asia & Pacific	agriculture: negligible industry: 30% services: 70% (2001 est.)	18.0%	47.8%	A, O, S
Spain	No	41.,3	High Income OECD	Europe & Central Asia	agriculture: 3.4% industry: 30.1% services: 66.5% (2002 est.)	16.1%	26.9%	N/A
Thailand	No	63.1	Lower Middle Income	Asia & Pacific	agriculture: 9% industry: 42% services: 49% (2002)	71.0%	13.6%	A, S
UAE	No	3.9	High Income Non OECD	Middle East & North Africa	agriculture: 4% industry: 58.5% services: 37.5% (2002 est.)	N/A	N/A	N/A
United Kingdom	No	59.2	High Income OECD	Europe & Central Asia	agriculture: 1.4% industry: 24.9% services: 73.7% (2000)	10.3%	60.3%	N/A
USA	No	291.5	High Income OECD	America	agriculture: 2% industry: 18% services: 80% (2002 est.)	9.8%	9.2%	N/A
Venezuela	No	25.7	Lower Middle Income	America	agriculture: 5% industry: 50% services: 45% (2001)	N/A	15.4%	N/A

1. Population Data taken from Population Reference Bureau, <http://www.brp.org>
2. GDP Data taken from CIA World Fact Book: <http://www.cia.gov/cia/publications/factbook>
3. International Narcotics Control Strategy Report 2001 (Bureau for International Narcotics and Law Enforcement Affairs, March 2002)
4. IBRD 2004 World Development Indicators Table 6.1
5. Taken from Schneider & Enste (1999) "Shadow Economies around the World – Size, Causes and Consequences", Working Paper No 196, CESifo Working Paper Series, Munich, using average data taken across a range of years and methodologies.

International Organisations: C = Caribbean FATF; A = Asia/Pacific Group; CE = Council of Europe Select Committee on Money Laundering; I = Offshore Group of Insurance Supervisors; O = Offshore Group of Banking Supervisors; OC = OAS/inter-American Drug Control Commission; S = International Organisation of Security Commissioners

Table 5b. Countries in which money laundering is taking place (identified by US authorities)

Country	Gross FDI % GDP (4)	Cooperation with international law enforcement (3)	Criminalised money laundering (3)	Transparency international score (5)	Total recorded crime rate (7)	Member of FATF	FATF compliant
Antigua & Barbuda	1.9%	Yes	Yes	N/A	3.35%	No	
Brazil	4.4%	Yes	Yes	3.9	N/A	Yes	28/28
Greece	1.0%	Yes	Yes	4.3	3.59%	Yes	28/28
HongKong	29.6%	Yes	Yes	8.0	1.07%	Yes	28/28
Israel	3.0%	Yes	Yes	7.0	6.28%	No	
Italy	2.7%	Yes	Yes	5.3	4.24%	Yes	28/28
Mexico	2.4%	Yes	Yes	3.6	N/A	Yes	12/28
Myanmar	N/A	No	Yes (drugs)	1.6	N/A	No	
Nauru	N/A	Yes	Yes	N/A	N/A	No	
Nigeria	0.03%	Yes	Yes	1.4	0.26%	No	
Panama	7.4%	Yes	Yes	3.4	N/A	No	
Philippines	1.5%	Yes	Yes	2.5	0.14	No	
Singapore	11.7%	Yes	Yes	9.4	1.83%	Yes	28/28
Spain	6.2%	Yes	Yes	6.9	1.76	Yes	26/28
Thailand	0.8%	Yes	Yes	3.3	0.46%	No	
UAE	N/A	Yes	No	5.2	N/A	No	
United Kingdom	23.8%	Yes	Yes	6.7	7.9%	Yes	27/28
USA	2.4%	Yes	Yes	7.5	9.62%	Yes	19/28
Venezuela	3.1%	Yes	Yes (drugs)	2.4	N/A	No	

- (1) Population Data taken from Population Reference Bureau, <http://www.brp.org>
(2) GDP Data taken from CIA World Fact Book: <http://www.cia.gov/cia/publications/factbook>
(3) International Narcotics Control Strategy Report 2001 (Bureau for International Narcotics and Law Enforcement Affairs, March 2002)
(4) IBRD 2004 World Development Indicators Table 6.1
(5) Transparency International Corruption Perceptions Index 2003 (where 10 is highly clean and 0 is highly corrupt)
(6) CESifo Working Paper Series, Munich, using average data taken across a range of years and methodologies.
(7) Taken from the UN Periodic Survey of Crime Trends 1997, total recorded crimes.

International Organisations: C = Caribbean FATF; A = Asia/Pacific Group; CE = Council of Europe Select Committee on Money Laundering; I = Offshore Group of Insurance Supervisors; O = Offshore Group of Banking Supervisors; OC = OAS/inter-American Drug Control Commission; S = International Organisation of Security Commissioners

However, when the focus is on 'money laundering activity' it can be seen that we now have a far more disparate list of countries in terms of population, geographical location and income classification. This includes nine countries that are members of the FATF, five of which are fully compliant with the 28 Recommendations requiring specific action. None of these nine countries find themselves the subject of sanctions. It is not particularly surprising that FATF members should be identified as countries in which money laundering is occurring, as it is well known that the proceeds of illegal activity (particularly drug-related activity) will be generated in the major economic areas, particularly

the United States and in Europe. Thus significant flows of illegal funds will take place through these areas. Moreover, as pointed out by the FATF, launderers will rationally prefer to move funds through areas with stable financial systems. However, is it not a little incongruous that the UK, identified as “*the greatest devotee of anti-money laundering provisions within the European Union*” (Levi, 2003:111), should also feature on this list and remain, by demonstration of this devotion to the FATF, untouched by international criticism, secure in its membership of “*the club of ‘virtuous’ countries*” (Masciandaro and Portolano, 2003: 322).

Table 6. Money laundering countries ranked by income group

<i>World Bank Income Group</i>	<i>Number of countries</i>	<i>% of Total</i>
High Income Non OECD	5	4.0
High Income OECD	20	16.1
Upper Middle Income	14	11.3
Lower Middle Income	43	34.7
Low Income	42	33.9
Total	124	100.0

Table 7. Money laundering countries categorised by geographical region

<i>Geographical region</i>	<i>Number of countries</i>	<i>% of Total</i>
America	23	18.5
Asia & Pacific	24	19.4
Europe & Central Asia	43	34.7
Middle East & North Africa	10	8.1
Sub-Saharan Africa	24	19.3
Total	124	100.0

It is instructive to consider evidence of possible differences between the group of 59 identified ‘opaque’ countries and the list of countries monitored for money laundering (having removed the group of 59). Again, these countries can be categorised according to both income and geographical location. In contrast to those in Tables 2 and 3, the majority of these countries are lower middle or low income and are located in Europe and Central Asia.

Given that the CIA and the US State Department have both classified so many countries in terms of money laundering, it is useful to consider a final group of countries: those that have been neither identified as ‘opaque’ nor broadly monitored for possible money laundering. As shown in Tables 8 and 9 below, the majority of the remaining ‘non-laundering’ group of 38 countries are low income located in Sub Saharan Africa. This is potentially instructive, as rather than these non-laundering countries being classified due to the existence of excellent compliance systems that prevent such activity from occurring, they are classified as such because they are deemed to be too underdeveloped to be of use to launderers.

There might be two explanations for countries not being considered attractive homes for the proceeds of illegal activity. First, the financial system might be so underdeveloped as to lack any form of utility as a money laundering location; second, the country might be deemed too unstable or corrupt for criminals to feel confident of recovering ownership of laundered funds, for it has been pointed out that countries determined to be “*corrupted or criminal*” are unlikely to attract illegal funds (Masciandaro and Portolano, 2003: 318).

Table 8. Non-laundering countries ranked by income group

<i>World Bank Income Group</i>	<i>Number of countries</i>	<i>% of total</i>
High Income Non OECD	9	23.7
High Income OECD	0	0.0
Upper Middle Income	0	0.0
Lower Middle Income	11	28.9
Low Income	18	47.4
Total	38	100.0

Table 9. Non-laundering countries categorised by geographical region

<i>Geographical region</i>	<i>Number of countries</i>	<i>% of Total</i>
America	4	10.5
Asia & Pacific	7	18.4
Europe & Central Asia	2	5.3
Middle East & North Africa	3	7.9
Sub-Saharan Africa	22	57.9
Total	38	100.0

Money Laundering, Corruption and Financial Integration

For the purposes of this study, data was taken from the 2004 World Development Indicators report produced by the World Bank. This report provided details of both gross private capital flows and gross foreign direct investment for 2002 for a range of countries.⁹ It might be expected that countries that have liberalised their financial markets have a higher proportion of private capital flows. Globalisation of finance has opened up international capital markets to developing economies. Figures from the IMF indicate that between 1970 and 2000, cross-border capital flows increased from less than 3% of GDP to 17% for advanced economies and from virtually nothing to 5% of GDP for developing countries. As stated by the World Bank, it may be argued that gross

⁹ IBRD (2004) World Development Indicators, Table 6.1, pp. 306 – 309. The indicators are calculated as a ratio to GDP in US dollars.

flows provide a more accurate measure of the extent of financial integration of a country with the rest of the global financial system as in the financial account of the balance of payments, inward investment is a credit, whilst outward investment is a debit. Net flows would, therefore, represent a balance in which many transactions are cancelled out (IBRD, 2004: 309). Information regarding corruption was obtained from Transparency International (TI), which produces an International Corruption Perception Index that relates to perceptions of the extent of corruption and ranges from 10 (highly clean) to 0 (highly corrupt). TI has produced the results of its surveys on an annual basis since 1995 and the latest version covered 133 countries. The average (unweighted) rating for all of the countries included in the 2003 survey (compiled using survey data covering a three year rolling average) was 4.2, ranging from 1.3 for Bangladesh to 9.7 for Finland.

A recent IMF paper provided evidence of a negative relationship between investment inflows and corruption. This paper noted that, "...recent research shows that corruption has a strongly negative effect on FDI inflows" (Prasad et al, 2003: 10).

It is interesting to determine, however, the extent of the relative relationships between money laundering, corruption and capital flows. This has been carried out by determining if there is any manifest difference for the groups of countries included in this chapter. There are two influences to consider. Whilst legitimate funds might well be deterred from entering countries deemed to be corrupt, there is the counterpoint that evidence of corruption might well be an attractor to illegitimate funds provided they can be sure of regaining control of them at the end of the process. It has been noted by the Department of International Development (DFID) that corruption and money laundering "form a cycle of interdependent and illegal activity" (2001: xliii). Unfortunately, there is no discernable difference in the data for corruption and capital inflows between the first two groups of countries. Those that are 'non-laundering' do appear different, although it should be noted that the availability of data to support this assertion is limited.

It can be seen from Table 4, that only one country from the list of opaque countries, Panama, was rated by TI and given a score of 3.4.¹⁰ The overall average for the group of money laundering countries appearing in Table 5 was 4.8, ranging from 9.4 for Singapore to 1.4 for Nigeria. Within this, however, it should be noted that the average for the 8 countries included in Table 5 that are opaque was 4.2, whilst for the FATF members on this list it was 6.3. Is then a lack of corruption a more powerful driver in terms of the activity of money launderers? This is an interesting area for further work.

¹⁰ TI notes that the Bahamas, the Cayman Islands, Liechtenstein, St Kitts and St Vincent had all been surveyed but were not given a rating as there were insufficient sources of data. No surveys had taken place in the Cook Islands, the Marshall Islands, Nauru or Niue.

Countries with liberalised financial systems that are integrated with the world financial system might also be more attractive as a home for laundered funds. Thus it might be hypothesised that there is a relationship between capital inflows and money laundering, the supply side factors. It has been suggested that certain countries might be willing to accept inflows of cash (demand factors) into their economies without asking too many detailed questions as to the origin of the funds. In his study of 159 criminal recovery cases in the Netherlands covering a variety of illegal activities, van Duyn (2003:82) found that the most significant form of concealment was that of export – particularly where the criminal gangs were foreign nationals or had links with other countries. Further, the hard currency was gladly accepted in the receiving countries. For many developing countries, particularly those with over-valued currencies and associated shortages of hard currency, the importation of cash (in sharp contrast to its export) is subject to very little in the way of scrutiny.

Evidence of money laundering and capital flows is inconclusive. The average level of foreign direct investment for money laundering countries from Table 5 was 6.4% (ranging from 0.03% for Nigeria to 29.6% for Hong Kong). The average for the opaque countries on the list was 8.9%, and for FATF countries it was 9.4%. However, a more relevant measure might be argued to be gross private capital flows. In terms of this measure, the overall average for money laundering countries was 27.8% (with a wide distribution from 0.03% for Nigeria to 92.4% for Hong Kong). The average for the 8 opaque countries was 43.7% whilst for the FATF member states it was 32.5%

Looking at the information contained in Table 10, it would appear that the group of secrecy havens (including all countries classified as NCCT) are actually marginally less corrupt and thus it might be expected that they attract greater capital-inflows in comparison with that group of countries identified as money launderers. However, this is a very tentative observation. What is perhaps more relevant is the data for the group of ‘non-laundering’ countries. It was hypothesised that this group would have the least developed and least integrated financial systems and/or would be either too corrupt or in conflict situations. Indeed, for Table 10 it can be seen that this group have the lowest rating from Transparency International (the most corrupt) and have the least evidence of capital inflows. Again this is an area that demands further study.

Table 10. Corruption and capital inflows

<i>Group of countries</i>	<i>Number</i>	<i>Average transparency international rating</i>	<i>Average gross private capital flows as % GDP</i>	<i>Average FDI as % GDP</i>
Secrecy or financial havens	59	4.6	28.7 <i>Excluding Ireland (1)</i> 18.3	6.7 <i>Excluding Ireland</i> 5.0
CIA/US State Department, other money laundering countries	124	4.2	17.4	5.4
FATF member states	29	7.4	40.5	9.6
FATF member states <i>excluding those classified as secrecy or financial havens</i>	24	7.2	26.8	7.0
Non-laundering countries	38	2.4	9.2	4.1

(1) Figures for Gross Private Capital Flows (278.2%) and FDI (47.1%) for Ireland were substantially higher than for any other countries and distorted the average

Concluding remarks

It is arguable whether the countries targeted by the international community are actually those most at risk from money laundering, or indeed, whether compliance with internationally required counter measures actually prevents money laundering from taking place. Clearly, money laundering is an issue for many countries and some, particularly small developing nations, are far more vulnerable to the negative impact that money laundering can have on an individual economy. However, there is no statistical proof that this activity is any greater than for any other country with an active financial market. It is further suggested that the group of countries initially targeted by the international community were identified for reasons other than vulnerability to money laundering.

In its efforts to tighten up on 'weak links', the international community must bear in mind the very substantial costs related to the required upgrading of supervisory and regulatory systems that will be faced by some countries. For some, lack of cooperation may well be involuntary through insufficient resources to cope with the high burden of regulatory enforcement; for others, shortages of hard currency might reduce the inclination to stop suitcases of cash from crossing their borders.

Costs and economic reality will be compounded by an inevitable decline in the number of customers in the event that a host nation is no longer seen to provide an attractive location for legitimate business investment opportunities (Riechel 2001: 10). Indeed, it has been suggested that the current approach of imposing negative sanctions needs to be accompanied by effective measures to replace the investment flows for many capital poor countries possibly through promotion of the entry of well-capitalised legitimate businesses (Rose-Ackerman 1998: 40).

In the event that governments adopt the countermeasures that have been recommended by the international community, it can be expected that their efforts to combat money laundering will affect the allocation of expenditure by diverting public funds into increased law-enforcement and regulatory activity and away from other socially desirable areas. Again this will have a far more visible impact on the public finances of small developing countries where the costs will have a far greater proportional impact on recurrent expenditure.

A problem highlighted in research for the UK points to the imbalance of public and private resources devoted to compliance with anti-money laundering activity. It is also apparent that the government was seen to have shifted the costs onto the private sector while at the same time failing adequately to resource the law-enforcement agencies to whom reports were made (Harvey, 2004: 341). If adequate resourcing by central government is a problem in the UK (Transparency International, 2003:7), what of other countries? Clearly, the policing of the regulations is an extensive and expensive task. Yet many nations are expected to show the same due diligence with a handful of staff and a limited budget.

In conclusion, there needs to be a clear understanding of the purpose of money laundering legislation. If its purpose is merely to demonstrate compliance with the international community, or indeed to evidence devotion to the cause, then the UK is particularly successful in this sphere. If it is to stop money laundering from occurring and thus reduce underlying crime then I would argue that there is no evidence to demonstrate success. The international community is misguided in focusing so much on money-laundering compliance. There is still too little information available as to the risk factors and characteristics of individual countries, and this is clearly an area worthy of further study. At present there is no evidence to suggest that countries that have been targeted are those most at risk from money laundering; nor is there evidence that high standards of compliance prevent money laundering from occurring.

References

- Alfon, I. and P. Andrews, *Cost-Benefit Analysis in Financial Regulation: How to do it and how it adds value*. FSA Occasional Paper Series 3, September, 1999
- Boorman, J. and S. Ingves. *Financial system abuse. financial crime and money laundering – background paper*. Monetary and Exchange Affairs and Policy Development and Review Department, IMF, Washington, 2001
- Camdessus, Michel, *Money Laundering: the Importance of International Countermeasures*. Plenary Meeting of the Financial Action Task Force on Money Laundering, Paris, February 10, 1998
- DFID *International Development Committee 4th Report*. Session 2000–01 House of Commons, Corruption, Vol. I, The Stationery Office Limited, London, 2001
- Economist, *Gimme Shelter*. January 29, 2000
- Financial Stability Forum, *Report of the Working Group on Offshore Financial Centers*. Financial Stability Forum, 2000, available at <http://www.fsforum.org>
- Hampton, M. and M. Levi, *Recent Developments in Money Laundering Policies and Offshore Finance Centres*. University of Portsmouth, Portsmouth, 1999
- Harvey, J., Compliance & Reporting Issues Arising for Financial Institutions from Money Laundering Regulations: A Preliminary Cost Benefit Study. *Journal of Money Laundering Control*, vol. 7, no. 4, 333 – 346, 2004
- IMF, *Finance & Development*, vol. 39 no. 1 (March), 2002
- Levi M., *Following the Criminal and Terrorist Money Trails*. In: P.C. van Duyne, K. von Lampe and J. Newell (eds.), *Criminal Finances and Organising Crime in Europe*. Wolf Legal Publishers, Nijmegen, The Netherlands, 2003
- Masciandaro, D. Crime, *Money Laundering and Regulation: The Microeconomics*. Working Paper, *Journal of Money Laundering Control*, vol. 3, February, 1998
- Masciandaro D. and U. Filotto, Money Laundering Regulation and Bank Compliance Costs: What Do Your Customers Know? Economics and the Italian Experience. *Journal of Money Laundering Control*, vol. 5, no. 2, 2001
- Masciandaro, D. and A. Portolano, It Takes Two to Tango: International Financial Regulation and Offshore Centres. *Journal of Money Laundering Control*. vol. 6, no. 4, 311 – 330, 2002
- OECD, *Towards Global Tax Cooperation: Progress in Identifying and Eliminating Harmful Tax Practices*. Report to the Ministerial Council Meeting, 26th June 2000
- Prasad E., K. Rogoff, D. Wei, and A. Kose, *Effects of Financial Globalisation on Developing Countries: Some Empirical Evidence*. IMF, March 17, 2003
- Riechel, Klaus-Walter, *Financial Sector Regulation and Supervision: The Case of Small Pacific Island Countries*. IMF Policy Discussion Paper PDP/01/6, IMF, Washington, November 2001

- Rose-Ackerman, Susan, Corruption and the Global Economy, In: *Corruption and Integrity Improvement Initiatives in Developing Countries*, 25 - 43, UNDP, New York, 1998
- Schneider, Friedrich and Dominik Enste, *Shadow Economies around the World – size, causes & Consequences*. Working Paper no. 196, CESifo Working Paper Series, Munich, 1999
- Stessens, G., The FATF black list or non-cooperative countries or territories. *Leiden Journal of International Law*, vol. 14, 199 - 208, 2001
- Transparency International UK, *Clean Money. Dirty Money: Corruption and Money Laundering in the UK*. Policy research paper 002, June, 2003
- UN Office for Drug Control & Crime Prevention, *Financial Havens. Banking Secrecy and Money Laundering*. UN Office for Drug Control & Crime Prevention (UNODC), 1998
- Van Duyne, P.C., Money-laundering: Pavlov's Dog and beyond. *Howard Journal of Criminal Justice*, vol. 37, no. 4, 359 - 374, 1998
- Van Duyne, P.C., K. von Lampe, and J. Newell (eds.), *Criminal Finances and Organising Crime in Europe*. Wolf Legal Publishers, Nijmegen, The Netherlands, 2003
- Wechsler, W., Following the Money (Globalisation and Financial Crimes). *Foreign Affairs.*, vol. 8014, July-August, 40 - 47, Council on Foreign Relations Inc., Washington, 2001

Electronic payment systems and money laundering: beyond the internet hype

Ton Schudelaro¹

Introduction

Over the last ten years, the continuing dematerialisation of money and the advent of the Internet, electronic commerce, and mobile communications have led to the introduction of a myriad of new electronic payment systems. These systems have the potential to make payments more efficient and to enable anyone to carry out transactions with anybody from any location at any time. However, they reputedly also have the potential greatly to facilitate the crime of money laundering. In this respect, electronic payment systems have been called the greatest boon to money launderers and have even been presented as one of the four Horsemen of the Apocalypse. Now that the hype surrounding the Internet has subsided, the time is right to make an assessment of the true money-laundering threat posed by electronic payment systems.

To address the issue, we will first give a definition of electronic payment systems, together with some background information. After that, we will take a look at transaction monitoring, which enables financial institutions to profile individual customer behaviour. Next, we will present a hypothetical example to illustrate how electronic payment systems supposedly enable criminals to launder their ill-gotten gains much more easily than before. We will then take a look at the available evidence supporting the claim that electronic payment systems pose a real money-laundering threat. Finally, we will analyse the issue of the supposed anonymity offered by electronic payment systems, and present some conclusions concerning the fight against money laundering in general.

Definition and background

Two kinds of electronic payment systems are usually distinguished, namely, remote access payment instruments and electronic money instruments.² Remote

¹ Ton Schudelaro is former researcher at the Faculty of Law of the University of Tilburg, the Netherlands and the author of *Electronic Payment Systems and Money Laundering. Risks and Countermeasures in the Post-Internet Hype Era* (Schudelaro, 2003).

² See, for instance, BIS (1996: 3), Commission Recommendation 97/489/EC of 30 July 1997 concerning transactions by electronic payment instruments and in particular the relationship

access instruments enable individuals to access funds held in their accounts at financial institutions. These funds often come in the form of traditional credit and debit facilities. Remote access instruments thus include credit and debit cards as well as phone, home, and Internet banking applications. To the extent that mobile phones are used to access funds held in an account, they can also be regarded as remote access instruments. Remotely accessing funds usually requires a personal identification number or code (PIN) or some other similar proof of identity.³

The second kind of electronic payment system consists of electronic money or e-money instruments. E-money instruments can be defined as payment instruments, other than remote access instruments, on which units of value can be stored electronically.⁴ These units of value can be stored either as an aggregate balance from which or to which units can be deducted or added, or as individual strings of computer data. In the latter case, each string represents a single unit of value, which, as far as the individual character is concerned, can be thought of as the digital analogue of a coin or a bank note. As electronic units of value can be stored in various media, electronic money instruments come in different forms. These include stored-value chip cards, also called electronic purses or e-purses, the memories of computers linked together in a network such as the Internet, as well as mobile phones, which may be used as an alternative to electronic purses. When electronic units of value are stored on a computer, e-money is sometimes referred to as digital cash, or by specific product names (BIS, 1996: 3). The terms electronic cash, or e-cash, network money and software money are also sometimes used. Together, remote access instruments and electronic money instruments form what are called cyber-payment instruments.

The development of cyber-payment systems has gone through several stages. The first stage, called the pre-history of cyber-payment systems, is said to have spanned the period from 1976 to 1992 (although credit cards were of course introduced much earlier than that). The period was characterised, among other things, by the development of fundamental technologies – like Diffie and Hellman's (1976) public-key cryptography and Chaum's (1982) blinded signatures – as well as the foundation of DigiCash (the firm to market Chaum's eCash electronic money system based on the use of blind signatures (1989)) and the development of Mondex (a well-publicized e-purse scheme (1991)). Additionally, the pre-history phase also saw the rise of phone and home banking (Böhle, 2001: 8). Additional phases which have been distinguished and

between issuer and holder, OJ L 208, 2.8.1997, p. 52, Articles 2 (b) and 2 (c) and ECB (1998: 7).

³ OJ L 208, 2.8.1997, p. 52, Article 2 (b).

⁴ A legal definition of electronic money is included in Article 1 of EU directive 2000/46/EC (OJ L 275, 27.10.2000, p. 39). The definition states that 'electronic money shall mean monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; (iii) accepted as means of payment by undertakings other than the issuer'.

described in the literature on the development of Internet payment systems are the pioneer phase, the roll back and forward phase, and the next generation, or second wave phase (Böhle, 2001: 7-18).

During the pioneer phase (1993-1995), various schemes were introduced to enable electronic or Internet payments, or to make them safer. Noteworthy developments during this period include the development of the SSL encryption protocol (1994), the foundation of First Virtual Holding, and CyberCash Inc. – two companies enabling credit card payments over the Internet – as well as pilots by both Mondex and DigiCash. The pioneer phase was dominated by start-up companies that were not always related to existing financial institutions. This situation caused some to think that, with respect to electronic payments, a whole range of new and possibly unregulated players could emerge which, in turn, might perhaps raise issues like control over the amount of money in circulation, as well as law enforcement issues such as money laundering. The anonymity supposedly offered by cyber-payment systems was also a factor in claims that such systems would pose a significant money-laundering threat. From the perspective of the banking sector, the pioneer phase can be seen as a period in which existing players were in danger of losing control and of being replaced by newcomers with respect to the provision of payment services.

During the next phase, the roll back and forward phase (1995-1998), the banking sector regained the initiative. This was accomplished by taking various actions, including the introduction of the SET encryption protocol, aimed at securing transactions and at obtaining control over the complete transaction chain in order to try to fend off new start-up companies. Payment schemes developed by the newcomers were taken over or adopted, and existing payment methods were adapted for use on the Internet. Also during this period, Mark Twain Bank in the United States started offering eCash and the first steps towards regulating electronic money institutions were taken on national (for instance, in Germany) as well as international (the EU) levels. In spite of earlier success, some pioneering firms ran into trouble towards the end of the roll back and forward phase. First Virtual was discontinued in 1998. The same year saw DigiCash go bankrupt. However, eCash Technologies, a firm based in Seattle in the United States, took over the eCash product and pilots continued, for instance, at Credit Suisse and Deutsche Bank. But in 2001, eCash Technologies, too, was forced to drop eCash. In 2002, eCash Technologies was bought by the company Infospace.(Infospace, 2002).

Following the roll back and forward phase, developments continued with the introduction of new adapted payment methods said to represent a second generation of electronic payment systems. These systems included payment instruments like Paypal. In 2000, the EU reached agreement on Directive 2000/46/EC for e-money institutions.⁵ Through this directive, implemented

⁵ OJ L 275, 27.10.2000, p. 39.

through Directive 2000/28/EC,⁶ a new type of credit institution, the electronic money institution, was recognised, in addition to the already existing ‘traditional’ credit institutions such as banks, and put under supervision. Anti-money laundering regulations, such as the 1991 EU anti-money laundering directive, which was revised in 2001, were made to apply to this new type of financial institution. In March 2001, another pioneer, CyberCash, went bankrupt.

A survey of developments in Internet and mobile and electronic money payments published in 2004 indicates that, up to now, remote access instruments have generally been more successful than electronic money instruments. (BIS, 2004) According to this survey ‘[p]ayments made using the internet and mobile phones have advanced rapidly and have become quite important in the field of electronic retail payments recently compared to e-money’ (BIS, 2004: 4). However, this does not necessarily mean that all projects meet with success as the survey goes on to note that ‘[w]hereas some products have been successful over the past few years, other initiatives are at an early stage of development. Some products have been discontinued after a short time’ (BIS, 2004: 4). The success of electronic money instruments appears to be more modest (BIS, 2004: 2-4).

Card-based e-money schemes have been launched and are operating relatively successfully in a sizeable number of the countries surveyed. (...) Comparatively successful are e-money products supported by public transport and public telephone companies, and parking meter or vending machine operators. Compared to card-based schemes, developments in network-based or software-based e-money schemes have been much less rapid. (...) Network-based schemes are operational or are under trial in a few countries (...), but remain limited in their usage, scope and application. (...) A vast majority of the participating central banks have indicated that there are no plans to introduce network-based e-money products in their respective countries. From an anti-money laundering point of view it is also of interest that the survey notes that ‘the existing e-money products still do not operate on a cross-border level’ (BIS, 2004: 7).

It must be realised that the development of cyber-payment systems as outlined above is only the latest part in the long history of money. Over the course of many centuries, money has come in many different forms, such as salt in ancient Rome, tea in China, shells in Africa, and tobacco leaves in colonies in North America. Of much greater and lasting importance to the development of money, however, has been the introduction of coins, banknotes, and transferable money, which, in the end, has led to the creation of the modern financial system as it is known today. A constant factor during all these developments has been the desire to make payments more efficient, which has resulted in the ongoing

⁶ OJ L 275, 27.10.2000, p. 37.

trend towards the dematerialisation of money of which cyber-payment systems are only the latest manifestation.

Finally, it must also be realised that over the course of time the financial sector has become subject to an increasing range of supervisory rules and regulations in many countries. These rules and regulations relate to both prudential issues and to the issue of combating money laundering. Examples are given by the European first⁷ and second⁸ Council Directives on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (which, together with a number of other directives, were combined into a single directive, Directive 2000/12/EC,⁹ in 2000) and the above-mentioned 1991 European directive on money laundering. The latter directive, Directive 1991/308/EEC,¹⁰ was updated in 2001.¹¹ Directive 2000/12/EC deals with, among other things, requirements for access to the taking up and pursuit of the business of credit institutions, and provisions concerning the freedom of establishment and the freedom to provide services. The updated Directive 1991/308/EEC contains provisions concerning the issue of customer identification for a number of service providers, including financial service providers, and also requires the reporting of unusual or suspicious transactions, which may be an indication of money laundering activities. As we have already mentioned, in 2000 the EU issued two directives, Directives 2000/46/EC and 2000/28/EC, relating to electronic money. Through these directives a new type of credit institution, the electronic money institution, was made subject to the EU's anti-money laundering directive. Taken together, the above-mentioned initiatives by and large cover the entire field of electronic payment systems, as far as the EU is concerned.

That issues can nevertheless sometimes still arise is illustrated by the fact that the definition of electronic money in Directive 2000/46/EC has led to a discussion as to whether or not prepaid mobile phone credits qualify as electronic money and thus whether or not mobile telephone operators should be subject to prudential supervision and anti-money laundering regulations.¹² Regardless of the question of whether or not prepaid mobile phone credits could be an attractive vehicle for money laundering, cases for and against qualifying prepaid phone credits as electronic money can be made (e.g. Schudelaro 2003). However, it should come as no surprise that mobile telephone operators are not keen on becoming electronic money institutions. In a February 2005 statement, the now defunct Dutch non-bank association of electronic money issuers even said (1.1a2, 2005: §2):

⁷ OJ L 322, 17.12.1977, p. 30.

⁸ OJ L 386, 30.12.1989, p. 1.

⁹ OJ L 126, 26.5.2000, p. 1.

¹⁰ OJ L 166, 28.6.1991, p. 77.

¹¹ OJ L 344, 28.12.2001, p. 76.

¹² For the definition of electronic Money in Directive 2000/46/EC, see note 4.

“[i]n time, we have come to notice that the big players in the market place have not made any serious effort to contemplate the compliance-issues for e-money but focused on avoiding regulation instead. Informally they informed our association that they were confident that, through their lobby efforts, they would be able to avoid e-money regulation. This has indeed proven to be the case, both on the Dutch national level and on the European level.”

In a 2005 guidance note on the application of the e-money directive to mobile operators, the Commission expressed the view that, at least for the time being, it did not want to dampen innovation in the mobile telephone sector by subjecting that sector to excessive regulation. The Commission also expressed the view that mobile phone credits might qualify as e-money in a limited number of cases only, but also that in future, when prepaid credits might be used for more than just micro payments, adequate money-laundering safeguards would need to be maintained (Commission Services, 2005: §§ 6, 12-15 and 22). The course of events described illustrates that regulating financial services, and subjecting organisations to regulations such as those designed to combat money laundering, is not always just a relatively straightforward matter of whether or not, in this case, a payment system falls within the scope of a specific directive, but that it can also involve matters of economics and politics.

Transaction monitoring

Technological developments have not only led to new ways in which people can communicate or carry out transactions, such as the Internet and electronic payment systems, they have also created new ways to record data and obtain useful information from those data. Systems capable of such data monitoring have many applications. They are, for instance, used in the detection of social and medical benefits fraud, of commercial opportunities, including cross-selling, pricing and customer-relations management, as well as for purposes of risk assessment. Assessing the risk of a terrorist attack on commercial airline flights is just one example of the latter application.

The monitoring of data can also be used to prevent and detect money laundering. The data generated by financial transactions for instance, can be checked for the presence of elements that might indicate money laundering. Electronic monitoring systems that check whether a specific transaction exceeds certain reporting limits, for instance, a maximum amount of money, have been used for many years. Of a much more recent date however, are transaction monitoring systems that can build profiles of the financial behaviour of individual customers of a financial institution. These behavioural profiling systems in essence compare all characteristics of a payment, not only to all characteristics of previous payments by the same individual or entity, but also to those of other, similar payers. Transaction monitoring systems can keep records of who made what kind of payment, for what amount, when, where, and to

whom. In this way, a kind of fingerprint of individual customer behaviour can be obtained. This in turn enables the detection of patterns that are unusual, for instance, because of the volume, the amounts, or the persons involved. Although, in the mid 1990s, behavioural transaction monitoring was deemed to be unfeasible because of the large numbers of transactions that are processed by financial institutions each day, nowadays systems exist that can handle tens of millions of transactions daily, and if necessary, multiple systems can be used in parallel.

Various reasons exist for financial institutions to use transaction-monitoring systems. They include both governmental and non-governmental initiatives that stimulate the use of transaction monitoring, as well as the interests of financial institutions themselves. With the current 'War on Terrorism' for instance, financial institutions are asked by governments to check whether they carry out transactions for suspected terrorists. Moreover, financial institutions are under an obligation to report transactions that could be indicative of money laundering. This requirement could arguably also be a reason to use transaction-monitoring systems.

Additional pressure on financial institutions to use transaction monitoring comes from organisations and institutions active in the financial world itself, such as the Bank for International Settlements, and supervisory authorities. The Bank for International Settlements has issued a report in which monitoring is called an essential element of know-your-customer standards, which in turn are said to be closely associated with the fight against money laundering. Supervisory authorities should ensure that adequate know-your-customer principles are adhered to.

Finally, financial institutions also have their own reasons to monitor transactions. One reason is that monitoring systems can help minimise losses by trying to detect fraud. However, monitoring for the detection and prevention of money laundering does not bring financial institutions such clear benefits, except where the protection of reputation or integrity is concerned. Currently, financial institutions across the globe are implementing behavioural transaction monitoring systems.

Monitoring the financial behaviour of persons and entities clearly has privacy implications. Over the past decades, various initiatives have been launched to protect the privacy of individuals. Examples of such initiatives are the Guidelines on the Protection of Privacy and Transborder Flows of Personal Data of the Organisation for Economic Cooperation and Development (OECD), the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data of the Council of Europe, and the 1995 EU Data Protection Directive. Regardless of their legal status, all these initiatives, allow room for the prevention, detection, investigation, and prosecution of criminal activities. But in all likelihood, this room is not even needed to reconcile transaction monitoring with the issue of privacy. Even without the exceptions mentioned, current privacy provisions allow financial institutions to process personal data for purposes such as the observance of legal requirements, which

may include the reporting of unusual or suspicious transactions, the fulfilment of contracts that may involve requirements to protect the interests of customers, and for the upholding of the legitimate interests of the financial institutions themselves, which may include protection of a financial institution's reputation or protection against fraud. Therefore, it seems unlikely that privacy considerations will hamper the use of transaction monitoring systems.

The threat in theory

Many have claimed that electronic money and on-line banking services pose a significant money-laundering threat. 'Financial crime will be a severe problem with digital money' (Bonorris and Coates: iv) 'the potential for conducting financial transactions on-line (...) presents one of the most significant vulnerabilities to money laundering at present' (FATF, 2000a: §104); '[t]he abuse of these systems by launderers is no longer a distant possibility' (FATF, 1999: §87): these are just a few statements of this nature. Some have wondered whether Internet access might be 'the new type of detergent which allows for cleaner laundry' (Bortner, 1996), or have called the increasing utilisation and promotion of on-line banking and electronic payment systems '[t]he greatest boon to money launderers' (Lilley, 2000: 114). Others have gone as far as presenting electronic money, together with tax evasion, as one of the horsemen of the Apocalypse, forgery, currency disruptions, and surveillance being the other three.¹³

How, then, could the supposed money laundering threat created by cyber-payment systems become a reality? The following example describes how one electronic money system, the abovementioned eCash system, was thought to help criminals comfortably launder their ill-gotten gains (Bortner, 1996).¹⁴

Doug Drug Dealer is the CEO of an ongoing narcotics corporation. Doug has rooms filled with hard currency, which represent the profits from his illegal enterprise. This currency needs to enter the legitimate, mainstream economy so that Doug can either purchase needed supplies and employees, purchase real or

¹³ Technology writer and, since September 1996, senior editor of Newsweek magazine Steven Levy as quoted in Hoogenboom (1997).

¹⁴ This example was first presented by R. Mark Bortner in 1996 as part of a final paper requirement at the University of Miami School of Law. In his paper, Bortner analyses the potential of electronic money for money laundering purposes. Although, according to Bortner, electronic money systems generally lack anonymity, he notes one exception, namely, eCash, the payment system originally developed by the company Digicash (see section 5.6.4.2, example 1). This payment scheme is referred to in the cited example, although Bortner uses a somewhat different spelling than used in this study. Since it was first published, Bortner's paper has been quoted or referred to in various publications about electronic payments and money laundering, for instance, Richards (1999: 75-76), Solicitor General Canada (1998: section 2.3) and Hoogenboom (1997: section 5.3). As such, it might be said to have attained some status.

personal property or even draw interest on these ill-gotten gains. Of course, this could be accomplished without a bank account, but efficiency demands legality. Anyhow, Doug employs Linda Launderer to wash this dirty money. Linda hires couriers (“smurfs”) to deposit funds under different names in amounts between \$7,500 and \$8,500 at branches of every bank in certain cities. This operation is repeated twice a week for as long as is required. In the meantime, Linda Launderer has been transferring these same funds from each branch, making withdrawals only once a week, and depositing the money with Internet banks that accept e-cash. To be safe, Linda has these transfers limited to a maximum of \$8,200 each. Once the hard currency has been converted into digital e-cash, the illegally earned money has become virtually untraceable, anonymous. Doug Drug Dealer now has access to legitimate electronic cash (...).

Once the e-cash account has been established, digital funds can be accessed from any computer that is properly connected to the Internet. A truly creative, if not paranoid, launderer could access funds via telnet. Telnet is a basic command that involves the protocol for connecting to another computer on the Internet. Thus, Linda Launderer could transfer illegally earned funds from her laptop on the Pacific Island of Vanuatu, by telnetting to an account leased from any unknowing Internet service provider in the United States and have her leased Internet account actually call the bank to transfer the funds, thus concealing her true identity. This would, of course, leave an even longer trail for law enforcement authorities to have to follow. Anyhow, e-cash, being completely anonymous, allows the account holder total privacy to make Internet transactions. Thus, the bank holding the digital cash, as well as any seller that accepts e-cash, has virtually no means of identifying the purchaser. Therefore, the combination of anonymous e-cash and the availability of telnet may give a launderer enough of a head start to evade law enforcement, for the moment (...).

Above, the sky is a swirling mixture of pale blue and chalky white. Waves of liquid life endlessly wash ashore, greeting the soft warm sand. Palm trees gracefully sway in a quiet dance with the wind. Amidst this tranquil bliss, Linda Launderer sits on the beach with her laptop computer “jacked-in” to the Internet. Unlike the AT&T commercial which portrays an individual faxing messages from a sunny beach to a business associate in a cold northern state, Linda is simply transferring funds into anonymous e-cash accounts so as to conceal the illegally obtained profits of her employer, Doug Drug Dealer. Hence, Linda is laundering money over the Internet while sipping a Margarita.

The threat in practice

The most striking thing about the claims that new electronic methods of payment pose a real money-laundering threat is the lack of evidence supporting these claims. Ever since the Financial Action Task Force (FATF) for instance,

began writing about electronic money (FATF, 1996: §§ 24–29) and on-line banking (FATF, 1997a: §14, §43 Annex C), it has not been able to come up with any clear, real-life case involving these kinds of payment systems. Instead, between 1996 and 2001, the FATF has repeatedly reported a lack of evidence by stating with respect to electronic money, on-line banking, or both that: ‘experts have no evidence to suggest that cyber-payments technologies [mostly electronic purses, AS] are being manipulated by criminal interests’ (FATF, 1996: §29); ‘there have been no reported instances of money laundering through these systems’ (that is, electronic money systems) (FATF, 1997b: Appendix §6); ‘no case of laundering has been detected in this sector’ (FATF, 1998: §7) (that is, that part of the banking sector using new technologies); ‘[a]ll delegations continue to report that there have not been as of yet any investigated money laundering cases involving the new payment technologies’ (FATF, 1999: §27); ‘there were no reported cases of this type of laundering [that is, through on-line banking] taking place at this time’ (FATF, 1999: §31); ‘no money laundering cases have been detected yet which involve [on-line banking]’ (FATF, 2000a: §104, 2000b: §94); ‘the FATF experts have seen few if any examples of on-line banking being used in money laundering’ (FATF, 2000b: §8); ‘the experts were not yet able to provide case examples of money laundering through on-line banking’ (FATF, 2001: §11). Moreover, in the FATF’s 2002 annual report, words like ‘the Internet’, ‘digital’, ‘electronic’, ‘smart card’, or ‘electronic purse’ are no longer even present (FATF, 2002a). In the 2001–2002 report on money-laundering typologies, only one case was presented in which on-line banking might have been used by money launderers, but the link was weak at best. In documents about electronic money prepared by the G10 group of countries and the US Department of the Treasury, similar statements can be found (US Department of Treasury, 1996: section 3; G-10, 1997: 12). In more recent FATF publications, including the 2003–2004 annual report and the 2003–2004 report on money laundering typologies, the situation of 2001–2002 has remained essentially unchanged and no new ‘evidence’ has been presented.

The FATF does not consider the apparent lack of evidence as indicating that no money laundering is taking place through on-line connections. Instead, ‘some experts believe that adequate means of detecting this type of laundering activity have not yet been fully developed’ (FATF, 2001: §11, 1998: §7, 2002b: §8). Others have voiced similar opinions, as reflected in the statement: ‘The best fraud schemes are so good that they are not discovered. So, who can tell me that it is not happening?’¹⁵

One well-publicised case in which money was allegedly laundered through the use of on-line banking services, but in which no hard evidence of this was presented, involved the now defunct European Union Bank, based on the island

¹⁵ KPMG forensic accountant F. Hoek, as quoted in Van Dinther 2000, p. 40. In Dutch: ‘De beste fraudes zijn zo goed dat ze niet ontdekt worden, dus wie zegt mij dat het niet gebeurt’ (translation by the author).

of Antigua. Reportedly, this Internet bank ‘explicitly proposed completely anonymous investments’ (FATF, 1998: §11). Such offerings have been suggested to represent money-laundering services being advertised through the Internet (FATF, 2000b: §4). The story of the European Union Bank took place between 1994 and 1997. In 1994, the East European International Bank was established on the island of Antigua, which is said to harbour more than 50 offshore banks, ‘many consisting of little more than a telephone and a computer behind a brass plate on an office door’ (Rohter, 1997). Within a few months of its establishment, the name of the bank was changed to the European Union Bank. Having set up a site on the World Wide Web, the European Union Bank was called the ‘first offshore bank operating via the Internet’ (FATF, 1998: §72). According to this, now defunct, website:

“[t]he European Union Bank strives to give our European and international clients easy, quick and secure computer access to European Union Bank’s complete range of offshore banking services. Incorporated in Antigua and Barbuda under the International Business Corporations Act (IBC) of 1982, European Union Bank provides multi-currency banking and financial services to clients throughout the world. With utmost privacy, confidentiality and security, European Union Bank clients receive excellent interest rates, offered in a stable, tax-free environment.”¹⁶

Services available from the European Union Bank included numbered accounts, international wire transfers online, tax protection, and ‘[a] number of other specialised bank services to meet individual needs’.¹⁷ Through the European Union Bank, customers could also register within 48 hours and for USD 995, an Antiguan International Business Corporation. Such corporations were advertised as ‘a perfect privacy tool’, because of the allowed use of bearer shares, the absence of a public share register, no disclosure of shareholders, no disclosure of beneficial ownership, and the absence of a requirement to file any corporate reports. The website also pointed out that:

“[u]nder Antiguan law, no person shall disclose any information relating to the business affairs of a customer, that he/she acquired as an officer, employee, director, shareholder, agent, auditor or solicitor of the banking corporation, except pursuant to the order of a court in Antigua. The court can only issue such an order in connection with an alleged criminal offence.”¹⁸

Because of these advertisements, the European Union Bank was accused of being involved in money-laundering activities. In 1996, Lord Mancroft, then chairman of the bank and member of the British House of Lords, denied these

¹⁶ Website of the European Union Bank as quoted in Blum et al. (1998: 59).

¹⁷ Website of the European Union Bank as quoted in Blum et al. (1998: 60).

¹⁸ Website of the European Union Bank as quoted in Blum et al. (1998: 61).

allegations (Blum *et al.*, 1998: 58), but the same Lord Mancroft has also been quoted as saying that financial regulation in Antigua comprises ‘literally two men in a Nissen hut. The country is too small and too badly run’ (Lilley, 2000: 101). In any case, the European Union Bank attracted the attention of money-laundering watchers and, by mid-1995, auditors reported that they were unable to state whether the financial statements presented by the bank fairly presented the financial position of the company. At the end of 1996, the Bank of England advised potential depositors to exercise appropriate due diligence with respect to the European Union Bank, while, in early 1997, the State of Idaho issued an injunction ordering the bank to stop soliciting deposits through the Internet. Also in early 1997, the Ministry of Finance of Antigua told the European Union Bank that it was ‘not in good standing’ and a few months later, it issued a fraud warning (Blum *et al.*, 1998: 58–62). In August of the same year, the two of the bank’s owners absconded with the its deposits, which were said to amount to \$10 million (Bonorris and Coates, 1997: 41), apparently leaving a notice on the locked door of the bank’s office above a dentist’s office and Nio’s Bar and Restaurant, stating that ‘European Union Bank Inc. has been placed in receivership effective this eighth day of August 1997’ (Rohter, 1997).

Some have claimed that the steps taken by the Bank of England and the State of Idaho merely illustrate the inability of authorities to take effective action against the unregulated offering of services through the Internet, stating that the argument that existing rules and regulations apply to new electronic forms of payment ‘seems to miss the point by a long way’, and that ‘[t]he whole point about the Internet is that wherever you are based you can tout for business from anyone anywhere’ (Lilley, 2000: 115). Although certainly the latter claim may be essentially true, a number of arguments can be suggested that put matters into some perspective.

First of all, the question is whether money launderers want to deposit money with financial institutions with an unproven track record and an unknown management. After all, the story of the European Union Bank illustrates how members of the management can abscond with depositors’ funds. If, on the other hand, an Internet-based bank were owned or controlled by a money launderer himself, the question might be asked what the real benefits of having Internet access would be, as far as issuing financial services is concerned, because, in that case, the criminal would be able to deposit funds with and transfer money from his own bank.

A second issue concerns the funds that a money launderer would want to transfer to an institution like the European Union Bank. To deposit money, the money launderer would either have to transport his funds to the bank, for instance, in cash, make a transfer of giro money, or use electronic money. In the first case, the Internet would essentially not enter the picture, and therefore does not seem to pose an additional money-laundering risk. In the second case, the money launderer would already have to have his funds in some account, in which case he would already have succeeded in evading important anti-money laundering measures, such as the reporting requirements. In the third case, the

money launderer would have to buy electronic value first using traditional money, and if he succeeds in this, he has again succeeded in evading anti-money laundering measures, just as in the second case.

Thirdly, it must be realised that the example of the European Union Bank appears to be the only one of its kind to date. Following the case of the European Union Bank, it was reported that ‘entities are using the Internet to offer money laundering services – sometimes styling themselves as legitimate “offshore financial services” or “investment opportunities”, but no new concrete examples have been presented (FATF, 2000b: §4). Moreover, the owners of the European Union Bank escaped with a mere \$10 million. If the aim of combating money laundering is considered to be the prevention of criminals attaining a position of influence in the legal economy, one example involving \$10 million does not appear to be a great threat.

Fourthly, it can be argued that, even though warnings and injunctions may not prevent people from doing business with financial institutions of questionable repute, they can help to put pressure on local regulators to take action. In the case of the European Union Bank, the Antiguan authorities in the end took some action, which may have encouraged the bank owners to abscond (Blum *et al.*, 1998: 6). Although it may not have been their aim, the authorities in this way put an end to the operations of the European Union Bank.

Fifthly, the possible ‘cascading downward’ of regulatory coverage, that is, strict and effective supervision being circumvented through unsupervised, or ill-supervised issuers offering services in well-regulated territories, has been ‘argued to be worse in cyberspace, but hardly a unique problem’ (Mussington *et al.*, 1998: 47): it also exists in the world of bricks and mortar.

Finally, one may wonder if the case of the European Union Bank is actually a case of money laundering or rather a case of Internet-based fraud. After all, making off with depositors’ money appears to be more similar to plain fraud than to providing a seemingly legitimate origin to illegally obtained funds, which is the definition of money laundering.

Analysis: anonymity

From the examples in the previous two sections and from the literature, a number of interrelated issues emerge, each issue having been said to make electronic payment systems attractive vehicles for money laundering. The issues are: the anonymity supposedly offered by these systems; the (in)adequacy of rules and regulations with respect to electronic payment systems; the availability of adequate audit trails; the ease of use of electronic payment systems; the volume of transactions, and the use of the Internet as a platform for money-laundering activities, for instance, through Internet-based front companies or Internet-based gambling operations. A full discussion of all these issues is beyond the scope of this article. Therefore the discussion here will focus on the issue of electronic

payment systems and anonymity. All issues are discussed in detail in A. Schudelaro, *Electronic Payment Systems and Money Laundering. Risks and Countermeasures in the Post-Internet Hype Era* (Schudelaro, 2003).

Many have claimed that electronic payment systems enable anonymous transactions. The literature seems to suggest that anonymity in electronic payment systems is more or less taken for granted. The issue of anonymity is connected to that of electronic payment systems and money laundering in a number of ways, including: the identification of customers; the ability to carry out transactions anonymously; non-face-to-face transactions and know-your-customer principles; encryption, and the use of the Internet as a means of communication and a platform for economic activities. These subjects will now be discussed.

Customer identification and anonymous transactions

In general issuers of electronic payment systems will be regulated and will therefore be subject to reporting and identification requirements. Electronic payment systems will have to function within the regulatory framework to which their issuers are subject. As far as regulated issuers are concerned, the issue of customer identification should therefore not be too problematic, or at least not more problematic than with respect to traditional means of payment. This point of view can be defended best with respect to remote-access instruments. Credit and debit card payments, as well as on-line banking services are, for instance, generally regarded as not being anonymous as these forms of payment enable their holders to access funds held in accounts the opening of which involves standard customer identification procedures. It must also be borne in mind that the use of credit and debit cards, as well as that of on-line banking services, only means that transfer orders are generated and communicated electronically, a process that could also be accomplished through more traditional means, such as paper transfer forms. With remote-access instruments, no value is transferred over open networks, such as the Internet, but only payment messages. The actual payments are cleared and settled using the existing, traditional banking infrastructure. Moreover, as the use of remote-access instruments by definition involves the use of bank accounts, the issuance of such payment systems will be a right reserved to 'traditional' credit institutions like banks, as such institutions are the only ones allowed to receive repayable funds from the public and accept deposits.

With respect to electronic money systems, the situation is different to the extent that such systems can be account-based, though they are not necessarily so. In account-based electronic money systems value is debited from existing accounts to which generally standard identification rules apply. This value is stored on a device after which it can be used to make payments. In the past, such payments have been called anonymous, or as anonymous as cash payments.

With respect to, for instance, card-based electronic money systems, however, it turns out that, in practice, the cards and other hardware used in such systems carry unique identification numbers. Moreover, transactions are often also given unique transaction numbers (BIS, 1996: 25). In this way, it is possible to track individual payments and to establish the value stored on each individual card. It must also be realised that most electronic money systems are single-loop systems, that is, systems in which electronic value can be used to make only one payment, after which the value must be redeemed with the issuer, or another institution must accept the electronic value.

In non-account-based electronic money systems, money is not deducted from any account. In such systems, users can purchase cards already loaded with electronic value, for instance, at news stands or from vending machines. Insofar as such systems are multipurpose, that is, insofar as the electronic value in such systems is accepted by more institutions than just the issuer, the question is to what extent existing identification measures apply. If, for instance, within the territory of the EU, a chip card loaded with electronic value can be used to pay for both car parking and telephone calls, the EU Electronic Money Directive appears to apply. However, in general, cards used to pay parking fees and make telephone calls will usually have quite low value limits and it is questionable whether shopkeepers, let alone vending machines, will ask users to provide any identification. However, the associated money-laundering risk appears to be very limited to almost non-existent, as it is difficult to see the benefits for money launderers of prepaid cards loaded with, for instance, €50 over banknotes of the same denomination. Should criminals be the issuers of electronic money instead of users of electronic money, existing rules such as the EU Electronic Money Directive and parts of Directive 2000/12/EC apply, making it unlikely that a financial institution subject to supervision would fall into the wrong hands. The existing rules allow for requirements to be waived with respect to small issuers, or single-purpose systems, but using such schemes to launder money would be the same as using a front shop, such as a restaurant or bar for the same purposes. The point of view that the issuing of on-line services by regulated financial institutions does not pose a problem is acknowledged by the FATF itself in its statement that '[t]he Internet sites opened by duly authorised banks are not particularly disturbing in themselves' (FATF, 1998: §11).

The only remaining potential problem then lies in the offering of financial services through the Internet by unregulated or ill-regulated entities in areas that do have strict financial regulations. This situation was already discussed above in connection with the example of the Antigua-based European Union Bank. In this respect, it must be borne in mind that, in principle, criminals have always been able to use services offered in ill-regulated areas, either by directly depositing funds in cash with entities located in these areas or by transferring money to bank accounts held with such institutions. These possibilities have existed and still exist, regardless of the introduction of the Internet. The question then is what the additional benefit of having the Internet is to money launderers if they either have to transport cash to ill-regulated territories or channel their

proceeds into the regular financial system before transferring them to ill-supervised financial institutions. If money launderers were to succeed in channelling their funds into regulated financial systems prior to transferring their money to ill-regulated areas, existing anti-money laundering measures would already have failed. Any additional money laundering risk posed by Internet-based payment systems would therefore appear limited, as long as these systems are single-loop systems without the capability of transferring value between two parties without the involvement of a financial institution.

Non-face-to-face transactions and know-your-customer principles

A second way in which the use of new forms of electronic payment could arguably lead to users remaining anonymous is the fact that electronic payment schemes allow transactions to be carried out in a non-face-to-face manner. To carry out transactions customers, including money launderers, no longer need to go to a branch office. As a result of this, an important point of initial suspicion is lost (FATF, 2000b: §9; Bonorris and Coates, 1997: 38), know-your-customer principles are difficult to enforce (FATF, 1997b: Appendix §21; Lilley, 2000: 117), and, regarding Internet banking applications, problems concerning anonymity are reportedly aggravated if procedures allow accounts to be opened without any face-to-face contact, or without a link with already existing accounts (FATF, 2001: §8).

What can be said against these arguments? First of all, the question is to what extent transactions still needed to be carried out face-to-face, even before the advent of the Internet and new means of electronic payment. After all, it has already been mentioned that, in a constant drive to make payments more efficient, the dematerialisation of money and the diminishing need for face-to-face contact have been constant factors. Once an account is opened for instance, transactions can be carried out using traditional paper transfer forms and, using debit cards, cash can be withdrawn from ATMs, all without any interaction between customers and employees of a financial institution. Neither traditional transfer forms nor debit cards are regularly associated with money-laundering risks. According to some, a comparison with more traditional means of payment is incorrect, as ‘the crucial point with on-line banking is that the customer can conduct transactions without any employee interaction at all’ (FATF, 2000b: §9). It is difficult to see, however, how traditional means of payment, such as those just mentioned, would force a criminal intent on hiding his identity, physically to contact a financial institution. Moreover, the FATF has claimed that, with new electronic payment systems, financial institutions can only assume that following its issuance an instrument is only used by the nominal holder (FATF, 2000b: §11); but this situation, too, is not different from that encountered with respect to traditional means of payment. Using front

companies, front men, false identification, etc., it has always been possible for criminals to mislead financial institutions about the beneficial owners of accounts. That this situation is not entirely uncommon is illustrated by the fact that, in 2001, it was reported in the Netherlands that criminals paid youngsters for control of their accounts for fraudulent purposes. The youngsters would give the criminals their bank cards and PIN codes, after which the criminals would channel funds, obtained through fraud with transfer forms, to the youngsters' accounts. The funds would subsequently be withdrawn, leaving the account holders with a debt, and the risk of criminal prosecution (NVB, 2001: 2).

Secondly, the question can be asked whether the introduction of electronic payment systems really leads to the loss of an important point of initial suspicion. Anti-money laundering measures in well-regulated areas have been known for more than a decade now, and if these measures have any effects, it stands to reason to assume that, by now, money launderers will have taken their own countermeasures, for instance, by moving cash depositing activities to less regulated territories. In this way, indicators of suspiciousness, such as a customer being nervous for no apparent reason, have, over the years, probably lost some of their effectiveness. However, the introduction of transaction monitoring software opens new possibilities both for obtaining investigative leads and for enforcing know-your-customer principles.

That monitoring systems, or at least the types of information that can be obtained through the use of such systems, are useful can be illustrated by an example given by the FATF itself. In this example, the FATF described how a bank's suspicions regarding certain transactions were raised by such factors as 'numerous large volume wire transfers, frequent transactions following unusual repetitive patterns (...), and the fact that the direction of the wire transfer often did not appear to correspond to normal or expected business activity' (FATF, 2002b: §30). As recently as 2000, however, the FATF still wondered whether the effectiveness of monitoring systems might not be limited (FATF, 2001: §9). Even if this should turn out to be the case, the automated monitoring of transactions is likely to be more effective than manually checking an ever-growing number of transactions, a number that had reached an average of several millions per day per financial institution even before the new forms of electronic payment were introduced.

The possible counterargument that, in a digital age, cash is no longer important appears to be untenable. Of course, it is true that criminal activities, such as fraud and the looting of accounts by corrupt political leaders, produce proceeds in the form of transferable money that do not need to be placed separately in the financial system. This situation, however, already existed before the introduction of the Internet and electronic payment systems, and has not changed since. Moreover, it appears that cash is still an important means of payment in criminal dealings. After all, cases in which drug dealers are paid with chip cards or in which substantial amounts of electronic cash are found on a criminal's computer have not materialised yet. The FATF itself indicates that cash is still important in relation to certain forms of crime, such as the drugs

trade. Here, it should be remembered that it was especially the ‘War on Drugs’ in the 1980s that initiated the fight against money laundering.

It has been reported, for instance in the German magazine *Der Spiegel* (Knauer, 2000), that nowadays certain types of drugs can be ordered over the Internet and paid for by credit card. This may be true, but it should also be realised that, in this report, the names of the Dutch companies involved as well as those of the employees interviewed were explicitly mentioned so that, had they been desired, counter-measures would not have been too difficult. Moreover, one is tempted to think that, with drugs being sold over the Internet, delivered by mail, and paid for by credit card, thus generating an audit trail, there would have been sufficient leads for law enforcers to start working with.

With respect to a person located in one country wanting to open an account, via the Internet, with a financial institution situated in a second country, it can also be pointed out that in such a case the financial institution could make a deal with organisations in the first country, for instance, the postal services, to have them carry out identification procedures with respect to potential customers in the first country.

Encryption

A third way in which anonymity has been said to arise from the use of new electronic payment systems concerns the use of encryption techniques in such systems. The fear existed that data encryption would lock out law enforcement access to financial information (FATF, 1999: §§ 27 and 33; G-10, 1997: 17) while digitised money, if encrypted, would supposedly be unseen so that trying to trace and control it would be an absurdity (Rahn, 1999: 71). These general remarks do not do justice to the various applications of data encryption technologies in electronic payment systems. Data encryption can be used to ensure data security and to create various levels of anonymity.

With respect to data security, the aim of encryption is to prevent eavesdropping on and alterations being made to messages while in transit. An example of encryption technology for data security purposes is the SSL protocol that nowadays is widely used to secure credit card data to allow purchases on the Internet and prevent credit card fraud. The use of data encryption for security purposes is therefore based on good grounds. And certainly if encryption is used in remote access instruments in which there is a link with an account held with a financial institution, there is little reason to believe that the use of encryption technologies would hamper money-laundering investigations. After all, just as paper transfer orders can be sent to financial institutions in sealed envelopes, which financial institutions have to open in order to carry out the actual transactions, data encryption is used in remote access instruments to ensure that messages can be sent safely between users and issuers without eavesdropping. Issuers still have to decrypt and open the messages, however, in order to know what users want them to do. In their turn, these financial institutions are

generally subject to unusual or suspicious transactions reporting requirements and, at least in well-regulated areas, cooperate with law enforcers. In this respect, when confronted with the US Commerce Department's encryption rules for banks and the suggestion that Columbian drug lords in Cali could use unbreakable encryption to conduct money laundering through Citibank in New York, the then director of the FBI, L. Freeh, said:

“[t]he law enforcement community requires the “plaintext” version of records and documents in order to investigate criminal activity. Banks and financial institutions, bound by established laws and statutory requirements (...), have historically cooperated with law enforcement in providing such records during an ongoing investigation. The FBI encourages the use of robust encryption by these institutions for authentication and to protect the security of the financial transaction. Banks and financial institutions, in concert with approved government regulations and statutory requirements, allow for immediate law enforcement access to the “plaintext” version of any encrypted information requested pursuant to proper legal authority” (Freeh, 1998).

It is also interesting to note that, at a time when some governments have placed restrictions on the export of certain robust encryption systems, the US government has granted licences for the export of strong encryption systems for use in the financial industry (Bonorris and Coates, 1997: 41).

As indicated above, data encryption techniques can also be used to achieve various degrees of anonymity in electronic payment systems. A protocol that creates a limited form of anonymity is the SET protocol. When using this protocol in consumer-to-merchants payments, merchants have access to customers' purchase information but not to their financial data, whereas the situation with respect to the financial institutions settling the payment is just the other way around. The important thing here is that there is a clear audit trail, comparable to that generated during the traditional use of credit and debit cards.

An example of an electronic payment system in which cryptography provides stronger anonymity is the eCash electronic money system. It has been said of this system that its encryption is ‘so powerful that it cannot keep track of how its customers spend their money’(Welling and Rickman, 1998: 322). Payer anonymity is indeed a unique feature of eCash. However, the literature suggests that the anonymity available in the eCash system is taken to be representative of electronic money schemes in general, a point of view that is incorrect. It should also be realised that, in principle, the eCash system was a single-loop system, and that eCash value was issued in specific currencies. In an internationally operating eCash scheme, mechanisms for clearing and settling transactions, redeeming and exchanging different currencies should therefore be available, leading to the question of whether well-regulated financial institutions would want to participate in an international system of which less well-regulated entities might also be part. Although it would have been possible in the eCash system to download value onto computer hard disks and then physically transport these hard disks to any desired location, criminals would still have to redeem value and

exchange currencies. It is also important to note that the eCash system is no longer available and that it never operated internationally. Just as in the case of cash, withdrawing or depositing large amounts of eCash might also lead to the reporting of unusual or suspicious transactions, triggered by the use of monitoring software. In this respect, the eCash system has been said to be compliant with existing reporting requirements (Edgar, 1999: 25). If nevertheless problems arise with respect to electronic money systems and money laundering, it should not prove too difficult to apply the anti-money laundering measures aimed at cash to digital cash systems, especially in view of the analogy between the two means of payment.

Use of the Internet

Finally, it has also been claimed that the use of the Internet as a means of communication and platform for economic activity can assist transactions involving electronic payment systems to remain anonymous. Electronic commerce for instance, supposedly could not flourish without anonymous means of payment. From a more technical point of view, it has also been said that, for instance, the use of Telnet, anonymous re-mailers, and a lack of uniformity in maintaining on-line communication records by service providers (FATF, 2001: §14) may all help criminals, such as money launderers, hide their identities. Internet service providers have no means of identifying persons accessing bank accounts through the Internet (Lilley, 2000: 115). The remarks concerning e-mails and the inability of Internet service providers (ISPs) to identify persons accessing accounts in particular appear somewhat odd and have to be viewed against the background of the issue of data encryption. Encrypting data to protect it from alteration and eavesdropping while in transit has been compared to putting a letter into an envelope in order to prevent unauthorised persons from gaining access to the content of the letter. This parallel can be extended, because just as employees of postal services do not have access to the information contained in closed letters, ISPs do not know who is accessing on-line bank accounts through their systems. It should be sufficient, with respect to remote access instruments, that financial institutions know with whom they are doing business. If need be, checking information concerning Internet traffic, such as log-in data, with ISPs might give investigators some information, but because of the possible use of mobile communications and dynamic Internet-addresses, that is Internet addresses that are not unique to specific devices connected to the Internet, the value of this information may be limited. Any remaining potential problems again appear to lie in the offering of financial services from unregulated areas through the Internet.

As regards the issue of the supposed anonymity offered by electronic payment systems, it certainly looks as if the anticipated problems have failed to materialise, or at least as if money laundering risks are limited. It should also be noted that, even in the absence of electronic payment systems, there are various alternatives

for money launderers to conceal their identity, including the use of front men, front companies, false identification, International Business Corporations, etc. The discussion of the issue of anonymity in relation to electronic money systems therefore seems to have been conducted on the basis of false premises.

Conclusion

Are electronic payment systems really a new type of detergent allowing for cleaner laundry, are they really the greatest boon to money launderers, and do they really herald a money-laundering Apocalypse? Judging from the material presented, the answer at present is no.

With the benefit of hindsight, the conclusion that electronic payment systems do not present the money-laundering threat once thought should perhaps not come as too much of a surprise. First of all, it was not obvious as recently as five years ago that the development of new, often Internet-based forms of electronic payment would take the course they did, a course different from what was expected originally. For various reasons, many Internet-based electronic payment systems have failed to achieve broad customer acceptance as is evidenced by the failure of many start-up companies active in the area of payments. It has turned out that, in the end, large, established financial institutions with a proven track record and sufficient economic muscle are better placed to issue payment systems than smaller, high-tech start-up companies which have sometimes come forward with innovative payment solutions.

Secondly, it appears that the characteristics of electronic payment systems have often been misrepresented in the literature. Electronic payment systems are generally not as anonymous and difficult to track as people have been led to believe. In the vast majority of cases, anonymity in electronic payment systems either does not exist or is limited to merchants having access to order information and financial institutions having access to customers' financial data. Encryption is used to ensure the security of transactions, or provide some level of anonymity, but this technology does not tend to make transactions untraceable.

Thirdly, the financial industry is a sector that, typically, is heavily regulated. Perhaps again with hindsight, it might have been expected that possible legal loopholes created by the issuance and use of new electronic means of payment would, in most cases, be taken care of without too much delay. Certainly in financially well-regulated geographical areas, the suggestion that, in addition to supervised financial institutions, an unregulated sector offering electronic payments could develop seems unlikely.

In addition to considerations concerning the development of electronic payment systems, their general characteristics, and the financial institutions as the issuers of such systems, it must be noted that, since the late 1980s, anti-money laundering regulations have undergone considerable development. Whereas early anti-money laundering initiatives were solely, or primarily, aimed at funds

generated by drugs-related offences, the scope of such initiatives has been extended over the years, both with respect to the types of predicate offences underlying money-laundering activities and the parties addressed. Nowadays, the scope of anti-money laundering regulations often includes a whole range of serious crimes, while institutions and persons that have to comply with these regulations include financial institutions and, at least in the European Union, also lawyers, the sellers of valuable items, etc.

Moreover, the events of 11 September 2001 have played their part in putting money laundering and terrorist financing in the spotlight, and have resulted in various initiatives affecting the financial sector and the issue of money laundering. Together with the already existing fight against money laundering and issues of consumer protection, these terrorist attacks have also stimulated the use of transaction monitoring systems. These systems, which enable financial institutions to keep records of who made what kind of payment, for what amount, when, where, and to whom, are currently being implemented by various financial institutions worldwide. Even if this kind of monitoring turns out to be less than 100 percent effective in detecting money laundering activities, it still seems likely to be more effective than going through the millions of transactions which financial institutions process each day manually.

Furthermore, the apparent lack of evidence supporting any claim that electronic payments currently pose a money-laundering threat should be noted. Some say this lack of evidence only shows that proper detection techniques have not yet been developed or that the best fraud schemes are so good that they are not discovered. Of course, the absence of evidence is not the same as evidence of absence. But the statement that good fraud schemes remain unseen almost seems to suggest that absence of evidence is a kind of proof of existence, and clearly this can never be the case.

The conclusion that electronic payment systems do not present the money laundering threat once thought does not stand on its own, but is supported from various sides. In 1996, the Bank for International Settlements, for instance, concluded with respect to electronic money that, 'in most cases, the security features that suppliers intend to implement (...) might make these products less attractive for use in criminal activities than many existing payment instruments' (BIS, 1996: 25). In 2004, and thus with the benefit of eight years of experience, the Bank for International Settlements still supported this point of view as is clear from the following statement (BIS, 2004: 7).

Many of the security features of e-money schemes, including the limits on the value that can be stored on cards, make them less attractive for the purposes of money laundering and other criminal abuses. Laws combating money laundering are applicable to e-money schemes, as they are to credit institutions, which in many countries are the sole issuers of e-money.

Others have stated that '[o]nly fully anonymous digital cash stands much chance of aiding in financial crimes such as money laundering'.¹⁹ As explained, such systems do not exist and are unlikely to be introduced in the future. Moreover, the question remains which rational criminal would want to invest in expensive efforts to launder money in a new, well-secured electronic money system (Lelieveldt, 1998: 82). According to the FATF, '[t]here is no single design feature of the various e-money systems currently available or envisaged which will make them especially attractive to money launderers' (FATF, 1997b: §64). Although this statement was made in 1997, there is no reason to believe the present situation is any different, especially when keeping the above-mentioned 2004 statement by the Bank for International Settlements in mind. More in general, and also including on-line banking systems, the FATF has stated that measures like putting limits on the amounts of value that can be transferred using cyber-payment systems, linking usage of on-line payment instruments to accounts that have been established in a face-to-face manner, enforcing know-your-customer principles, and developing information technology capabilities to detect suspicious on-line transactions could all help deal with the potential vulnerability of cyber-payments to money laundering (FATF, 2000b: §13). Moreover, certain money-laundering counter-measures, presumably such as those just mentioned, could be easily added to the systems, according to the FATF (FATF, 1997b: §87). In 1997, the FATF wrote that 'it is premature to consider prescriptive solutions to theoretical problems' (FATF, 1997b: §67). In 2005, problems do not seem to have developed much beyond that stage.

It now seems safe to conclude that, at present, electronic payment systems do not pose the money laundering threat once thought, and that, with money laundering and terrorist financing high on the agenda and the availability of transaction monitoring systems, law enforcers are perhaps better positioned than ever in the fight against money laundering.

¹⁹ Mondex chairman Tim Jones as quoted in Froomkin (1996).

References

- BIS, Committee on Payment and Settlement Systems and the Group of Computer Experts of the central banks of the Group of Ten countries, *Security of Electronic Money*. Bank for International Settlements, August 1996
- BIS, Committee on Payment and Settlement Systems, *Survey of developments in electronic money and internet and mobile payments*. Bank for International Settlements, March 2004
- Blum, L., M. Levi, R. Naylor, and P. Williams, Financial Havens, *Bank Secrecy and Money Laundering*. United Nations Office for Drug Control and Crime Prevention, 1998
- Böhle, K., *The Potential of Server-Based Internet Payment Systems. An Attempt to Assess the Future of Internet Payments*. Background Paper no. 3, Electronic Payment Systems Observatory (ePSO), July 2001
- Bonorris, S. and V. Coates, *Digital money: industry and public policy issues*. The Institute for Technology Assessment (ITA), Washington DC, October 1997
- Bortner, R.M., *Cyberlaundering: Anonymous Digital Cash and Money Laundering*. Presented as final paper requirement for Law & the Internet (LAW 745), a seminar at the University of Miami School of Law, 1996
- Commission Services, *Application of the E-Money Directive to Mobile Operators*. European Union Directorate General Internal Market, 2005
- Dinther, M. van, Vrijspel voor witwassers.com. *FEM/DeWeek*, March 18, 38-41, 2000
- ECB, *Report on Electronic Money*. European Central Bank, August 1998
- Edgar, L., *Electronic Payment Systems*. ESPRIT Project 27028, Electronic Commerce Legal Issues Platform, June 10, 1999
- FATF, *FATF-VII Report on Money Laundering Typologies*. Financial Action task Force (FATF), June 1996
- FATF, *Annual Report 1996-1997*. Financial Action task Force (FATF), June 1997(a)
- FATF, *1996-1997 Report on Money Laundering Typologies*. Financial Action task Force (FATF), February 1997(b)
- FATF, *Annual Report 1997-1998*. Financial Action task Force (FATF), June 1998
- FATF, *1998-1999 Report on Money Laundering Typologies*. Financial Action task Force (FATF), February 1999
- FATF, *Annual Report 1999-2000*. Financial Action task Force (FATF), June 2000(a)
- FATF, *1999-2000 Report on Money Laundering Typologies*. Financial Action task Force (FATF), February 2000(b)
- FATF 2001, *Report on Money Laundering Typologies 2000-2001*. Financial Action task Force (FATF), February 2001
- FATF, *Annual Report 2001-2002*. Financial Action task Force (FATF), June 2002(a)

- FATF, *Report on Money Laundering Typologies 2001-2002*. Financial Action task Force (FATF), February 2002(b)
- Freeh, L., in a written response to written questions posed by US Senators following his testimony, June 25, 1997, before the Senate Judiciary Committee on Encryption, Key Recovery, and Privacy Protection in the Information Age, US Department of Justice, Federal Bureau of Investigation, January 29, 1998
- Froomkin, A., Flood control on the information ocean: living with anonymity, digital cash, and distributed databases. *Pittsburg Journal of Law and Commerce*. 395, 1996
- G-10, *Working Party on Electronic Money. Electronic money. consumer protection. law enforcement. supervisory and cross-border issues*. G-10, April 1997
- Hoogenboom, A.B., *Cybercash: potentials for fraud and money laundering*. (unpublished)
- Hoogenboom, A.B., De vier ruiters van de Apocalyps: openbare orde en fraude in cyberspace. In: *Handboek Fraudebeschrijving*. May 1997
- InfoSpace, *Infospace Extends Payments Technologies to Include Electronic Debit and Stored-Value Transaction Services*. Infospace press release, February 19, 2002
- Knauer, S., Drogen, Kick per Klick. *Der Spiegel*, no. 9, 143-144, 2000
- Lilley, P., *Dirty dealing. The untold truth about global money laundering*. London, Kogan Page, 2000
- Lelieveldt, S., Regulering van pre-paid elektronisch geld. In: De Nederlandsche Bank, *Reader elektronisch geld*. 77-85, De Nederlandsche Bank, September 1998
- Mussington, D., P. Wilson, and R. Molander. *Exploring money laundering vulnerabilities through emerging cyberspace technologies: A Caribbean-based exercise*. RAND, 1998
- NVB, Scholieren betrokken bij fraude. *NVBulletin*, no. 4.2, Dutch Bankers' Association, December 2001
- Rahn, R., *The end of money and the struggle for financial privacy*. Discovery Institute Press, Seattle, 1999
- Richards, J., *Transnational criminal organizations. cybercrime. and money laundering. A handbook for law enforcement officers. auditors. and financial investigators*. CRC Press, Boca Raton etc., 1999
- Rohter, L., New bank fraud wrinkle in Antigua: Russians on the internet. *The New York Times*, August 20, 1997
- Schudelaro, A.A.P., To be or not to be electronic money, that's the question. *Information & Communications Technology Law*, vol. 12, no. 1, 49-55, 2003
- Scudelaro, A., *Electronic Payment Systems and Money Laundering. Risks and Countermeasures in the Post-Internet Hype Era*. Wolf Legal Publishers, Nijmegen, 2003
- Solicitor General Canada, *Electronic money laundering. An environmental scan*. Department of Justice Canada, Solicitor General Canada, October 1998
- US Department of the Treasury, *An introduction to electronic money issues. prepared for the United States Department of the Treasury Conference 'Toward Electronic*

Money and Banking: The Role of Government'. September 19-20, 1996, US
Department of the Treasury, 1996
Welling, S. and A. Rickman, Cyberlaundering: The Risks, the Responses.
Florida Law Review, April, 295-327, 1998
1.1a2, *Evaluation of the e-money directive*. February 2005

An assessment of prospective changes in cross-border crime after Estonia's accession to the European Union¹

Anna Markina

*Jüri Saar*²

Introduction

Cross-border crime related to Eastern Europe was already an issue before May 2004. The fall of the Berlin Wall in 1989 created new opportunities and led to a considerable increase in, and diversification of, the phenomenon (Van Duyne, 2001). To the newcomers, the biggest concern of the 'old EU' in this regard appeared to be the security issue. What would happen to cross-border crime after the accession of the ten countries, including Estonia and other former Soviet republics, was a question to which various answers have been given.

Cross-border crime related to Estonia and the other Baltic states has mainly been examined on the basis of the presumption that there would be a movement of offenders from these countries to the European Union and a resulting worsening of the crime situation in the old member states (Junninen and Aromaa, 1999). Such stereotypical assessments are prevalent both in Western European public opinion and among law enforcement professionals. The attitude they embody is not directed solely at Estonia but at the economically less developed newcomers from the East in general. It is an attitude according to which these states are seen as jeopardising the former idyll of Europe by bringing their problems with them. In it, we can perceive the application of older, but more or less similar views to new circumstances, that is, an unwillingness to alter earlier attitudes. This is illustrated by an organised crime report for 2002 prepared by Europol, which concluded, among other things, that Estonian organised crime groups had taken complete control of the import of drugs into Finland (Europol, 2002). As van Duyne (2001) notes, "particularly the association of cross-border crime with organised crime evoked all sorts of nightmares" (p.1). Such an attitude is also manifested in popular images of the Russian Mafya, which have been successfully used to emphasise the extreme danger apparently posed by offenders from the 'new' states (Joutsen, 2001).

¹ This chapter is based on the results of a research project conducted within the framework of public contract 03-175. The research was also supported by Estonian Science Foundation grant no 5108. An earlier version of this chapter was published in *Iuridica International Law Review*, University of Tartu, Vol. 9, pp. 78-88.

² Anna Markina and Jüri Saar are respectively lecturer and Associate Professor at the Institute of Law of the University of Tartu, Estonia.

The research presented in this chapter was conducted in the autumn of 2003, several months before Estonia's accession to the EU. The objective of the study was to analyse expert assessments of the state of cross-border crime and possible developments following Estonia's accession to the European Union. The aim was not to provide a definitive view of the situation and its probable developments, but to offer a comprehensive analysis of expert evaluations on the assumption that this will provide a picture of the prevailing discourse on cross-border crime.

Methodology

There are two main problems associated with the task of assessing cross-border crime. First of all, the phenomenon is vaguely defined. The concept could cover offences that range from shoplifting by Estonian teenagers in Stockholm to sophisticated schemes concerning tobacco smuggling through several countries. Another problem is the lack of agreement with regard to a method for assessing cross-border crime and (even more) with regard to a method for predicting future developments in the area.

The main problem associated with the task was estimation of the impact of the new socio-political situation on the development of crime. No previous EU enlargement had been as big as that of 2004, when ten states joined the Union. The economic and social conditions of the accession countries differed considerably from those of the already-existing members. The enlargement has affected conditions not only in accession countries such as Estonia but also in the European Union as a whole. In other words, all the factors that need to be taken into account to predict future trends in cross-border crime are characterised by a high degree of uncertainty.

From several possible approaches to the research, the Delphi method was selected. It is a method that involves questioning a group of top experts in an area, and is designed to be used when there is a lack of knowledge or a lack of agreement about an issue, or else when a structuring of individual communication is required. The main idea behind the method is that a group of experts yields a better result than the most competent expert belonging to the group (Powell, 2003).

As Lynn et al (1998) point out, the Delphi method is an iterative process designed to establish a consensus among the experts involved (cited in Keeney et al, 2001). The process begins with the administration of a questionnaire or an interview with the aim of collecting initial information about the issue being studied in order to generate ideas to be evaluated later in the process. Feedback from the first questionnaire is usually provided in a form of second questionnaire that summarises the issues raised during the first round; and in the second and subsequent rounds of the process members of the experts' panel are provided with their own responses as well as with the responses of other panellists. The

experts then are asked to reconsider their opinions in the light of the other panellists' responses. The rounds continue until consensus is reached (Keeney et al, 2001). How many rounds are required, depends on whether full consensus is needed, on the resources available to the researcher and so forth. Usually, there are two to four rounds of the process (Rowe and Wright, 1999).

Among the shortcomings of the Delphi technique is the decline in the response rate that takes place from one round to another (Rowe and Wright, 1999), and a lack of evidence on the reliability and validity of the method (Keeney et al, 2001) – though Keeney et al, suggest that it should not be judged according to positivist research criteria. It has also been suggested that the method may do no more than tap collective biases or shared imagery.

The present study included interviews with officials drawn from Estonian law enforcement authorities, such officials all being senior policy analysts and senior operations managers working in areas related to cross-border crime. Thus they comprised the leading officials of the relevant departments of the Police Board, the Security Police Board, the Border Guard Administration, customs, the court system, the Prosecutor's Office, the Ministry of Internal Affairs, the Ministry of Justice, and the Ministry of Finance.

Information on the problem being examined was first gathered separately from each expert. The information thus obtained was summarised, and an overview of the group's perception of the problem was prepared. This process included the highlighting of areas on which the experts agreed and those where dissenting opinions were expressed. The dissenting opinions were transcribed and fed back to the experts so that they could express their opinions about the causes of the dissenting opinions and argue their case. Given the aim of the study, as well as the time and resources available, it was not considered necessary that consensus among the experts should be reached.

In the initial stage, we distributed 64 questionnaires. These were sent out via personal e-mails as we wished to ascertain the ideas and beliefs of the experts individually considered, rather than tapping the official positions of the institutions for which they worked. The experts from the Ministry of Finance either did not reply or said that they had insufficient knowledge of issues of cross-border crime, maintaining that they did not consider such matters as falling within their area of competence. Though in the end some answers were obtained, it was relatively difficult to elicit replies from the officials belonging to the Security Police (KAPO) and the Tax Fraud Investigation Centre of the Tax Board (MUK), and we were unable to obtain any opinions from experts belonging of the Border Guard Administration. 24 questionnaires were returned in total.

The questionnaire distributed at the first stage contained eleven open questions, the aim being to collect information on how cross-border crime was defined by the experts working in the field.

For the second stage, the information collected at stage one was summarised and used to prepare three survey instruments. One questionnaire focussed on changes in cross-border crime following accession to the EU; another dealt with

co-operation with other countries and EU institutions; the third was concerned with the efficiency of various agencies' measures for controlling cross-border crime. In this way, members of the panel received generalised feedback about how the other experts in the field defined the problem of cross-border crime and what developments in cross-border crime they saw taking place in the future. The experts were asked to express their opinions on the issues raised, the questions sent to the panel at this second stage being pre-coded in order to allow us to obtain some quantitative data. Answers were obtained from 19 experts. At the third stage, the information gathered at the second stage was summarised and a consolidated report prepared.

Changes in cross-border crime

First of all, the majority of experts did not consider the date of EU enlargement to be crucial from the point of view of the development of cross-border crime. Estonia's accession to the EU was the culmination of a process of integration that started at the beginning of the 1990s. In the experts' opinion the critical date from the point of view of changes in cross-border crime will be Estonia's expected accession to the Schengen border agreement in 2007.

In order to establish which phenomena fall into the category of cross-border crime, the experts were first asked freely to list forms of cross-border crime. The outcome was a list of types of criminal behaviour and criminal structures, which were divided into eight subgroups: migration of crime; criminal organisations; illegal migration and trafficking in women; drug related crimes; economic crimes and counterfeiting; smuggling; corruption, and other crime categories. The experts were then asked to assess what would happen with regard to each of the eight categories after Estonia acceded to the European Union.

Migration of crime

This category refers to criminal phenomena associated with the movement of people from one country to another. The experts assessed the migration of crime in great detail, and the majority of them predicted an increase in the migration of crime upon Estonia's accession to the European Union. The experts expected that the greatest increases in this category would relate to the hiding of Estonian fugitives in other countries and to crimes committed by 'new immigrants' to Estonia. The immigrants referred to include persons from countries, such as China and other Asian countries, that are far away. Not very surprisingly, we find here the same stereotypical attitudes towards immigrants from poorer countries as those expressed in Western European countries with respect to Eastern European countries.

Table 1. Assessment of changes in migration of crime (N persons=19)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Hiding of fugitives from Estonia in other EU member states	10	5	3		
Number of crimes committed by 'new immigrants' in Estonia	4	11	3		
Number of crimes committed by Estonian residents in other EU member states	3	11	5		
Number of crimes committed by residents of EU member states in Estonia	3	8	8		
Involvement of citizens of other EU countries as victims of crimes committed in Estonia		9	10		
Hiding of fugitives from other EU member states in Estonia	2	5	11		
Involvement of Estonian citizens as victims in crimes committed in other EU member states		5	14		
Number of crimes committed by residents of CIS countries in Estonia		3	13	2	

The expected changes in the migration of crime are first of all related to the increased freedom of movement consequential upon EU enlargement. Since people will take advantage of enlargement to travel to other EU countries more frequently, the risk of becoming a victim of crime will increase as well. Experts predict that the abolition of border controls will induce criminals to travel from Estonia to other EU countries more frequently than law-abiding citizens.

An increase in the number of crimes committed by residents of the CIS in Estonia was considered least likely, due to the role of the Estonian/Russian border as a well-protected external frontier of the European Union upon EU accession.

Criminal organisations

In the responses provided by the experts, cross-border crime was often associated with criminal organisations. The experts for the most part agreed that there would be an expansion in the area of activity of criminal organisations, seeing this as the natural consequence of an increase in the free movement of persons. The problems posed by 'new immigrants' were seen as being the formation of criminal organisations in Estonia by Vietnamese and Chinese etc. gangs, along with the merger of such organisations. According to the experts, the role of Estonia as a transit country would increase because of the activities, targeted at the West, of criminal organisations. An increase in the size of criminal organisations, specialisation in certain types of crime, and a growth in armed conflict among criminal organisation over the control of territory were all considered most unlikely.

Table 2. Assessment of criminal organisations (N=18)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Expansion of areas of activity of criminal organisations	3	13	2		
Formation of criminal organisations by 'new immigrants' in Estonia	5	10	3		
Merging of criminal organisations from different countries	4	10	4		
Role of Estonia as transit country in activities, targeted at the West, of Russian organisations	3	8	7		
Specialisation of criminal units in particular types of crime	1	6	10	1	
Armed conflict over control of territory	3	3	10	1	
Increase in size of criminal organisations	2	4	12		

The replies revealed that in Estonia, the prevailing opinion is that organised crime is, above all, a problem created by 'outsiders', rather than something to which given environmental conditions may be more or less conducive. All the areas of activity of criminal organisations that were expected to grow were related to people coming from outside Estonia.

Illegal migration and trafficking in women

The experts' forecasts included predictions about the illegal inflow of immigrants and labour into the European Union. Estonia was predominantly viewed as a transit country, and in terms of the experts' predictions of increases, illegal

migration from the CIS countries occupied first position. This was followed by illegal migration from other countries via Estonia into other Western countries, while the trafficking of women from Estonia into Western countries was ranked third. The trafficking of women from other countries into Estonia and illegal migration from other countries into Estonia were least likely to be predicted to increase. As to the reasons why Estonia was unlikely to be regarded as a very attractive destination for illegal immigrants in the near future, respondents pointed to the relatively low standard of living and underdeveloped social benefits system compared to the other member states of the European Union.

Table 3. Assessment of illegal migration and trafficking in women (N=19)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Illegal migration from CIS countries via Estonia to other Western countries	4	12	3		
Illegal migration from other countries via Estonia to Western countries	3	11	5		
Trafficking in women from Estonia to other Western countries	3	7	8		
Illegal migration from CIS countries to Estonia	3	7	8	1	
Illegal migration from other countries to Estonia	1	7	11		
Trafficking in women from other countries to Estonia		6	9	2	

The experts obviously considered the dangers related to trafficking in women in Estonia to be less significant than might have been expected on the basis of the international attention paid to this matter in recent years. The institutions that have been most active in studying, and providing information about, trafficking in Estonia are the Nordic Council of Ministries and the International Organisation for Migration. The objective of the recent campaign aimed against trafficking in women in the Northern countries and the Baltic states, was “to map the readiness for recognition of trafficking in persons as a social problem and combating it, as well as notification of strategically important social groups of the reasons for the phenomenon and other accompanying problems” (Nordic Council of Ministries, 2002). The report on the campaign notes, among other things, that the quantity of available information concerning the nature of trafficking in persons in Estonia is rather limited and that understanding of the negative effects of trafficking in persons and prostitution on society is insufficient and in some cases nonexistent. Yet it could be inferred that state officials were not considerably better informed than ordinary citizens. They did not perceive that combating the problem fell within their remit, and there was no national action plan for combating trafficking in persons.

Drug related crimes

The experts clearly distinguished between the consumption, transit and production of drugs. The phenomena most likely to be predicted to expand were the transit of drugs from the CIS countries through Estonia to other Western countries, and the trade in drugs within Estonia. The experts also unanimously predicted the development of international networks of drug traders in Estonia and a growth in drug consumption. The production of drugs by Estonian people in other countries, and the transit of drugs through Estonia to the CIS countries were less likely to be predicted to increase.

Table 4. Assessment of drug related crimes (N=19)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Transit of drugs from CIS countries through Estonia to other Western countries	5	10	4		
Trading in drugs in Estonia	4	10	4		
Development of international networks of drug dealers in Estonia	2	10	5		
Transit of drugs through Estonia from one EU country to another	1	11	5		
Consumption of drugs in Estonia	3	9	6		
Production of drugs in Estonia	4	5	7	2	
Transit of drugs from other Western countries through Estonia to CIS countries	2	5	9		
Production of drugs by Estonian residents in other countries	3	3	12		

Experts' assessments of the production of drugs in Estonia yielded contrasting results. Most thought that production would significantly increase or remain the same. Two experts, however, were convinced that such activities would decline in the future. The lack of consensus may be due to the varying degree to which the experts were informed about the problem and to the fact that the production, supply and consumption of drugs vary with the specific substance concerned.

Economic crimes and counterfeiting

Two types of economic crime were highlighted in the responses of the experts, namely misappropriation of money from EU funds and money laundering. The former was expected to increase significantly. The Director General of the European Anti-Fraud Office (OLAF) predicted that Estonia would experience a

considerable increase in the risk of fraud upon accession to the European Union, as attempts would be made to import goods from Russia via Estonia into the European Union, using forged documents. Meanwhile subsidies made available to Estonian agricultural producers would also be the object of fraudsters (Tänavsuu, 2003a). According to the data made available to the Ministry of Finance, at the end of 2003, no money had been misappropriated from EU funds in Estonia. Despite this, the Agricultural Registers and Information Board had rejected 20 project applications and submitted them for investigation to the Security Police. It was anticipated that after the EU Structural Funds were opened to Estonia later, in 2004, the amount of attempted fraud would increase (Tänavsuu, 2003b).

Table 5. Assessment of economic crimes and counterfeiting (N=19)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Misuse of money from EU funds	11	5	2		
Money laundering	6	9	4		
Circulating of counterfeit money	3	10	4	1	
Tax fraud	6	5	7		
Counterfeiting of passports and other documents	4	7	7	1	
Counterfeiting of money	2	8	6	1	

The assessments according to which money laundering in Estonia is, above all, affected by relations with the republics of the former Soviet Union, are in line with the fact that all the cases of international money laundering that have reached the stage of investigation have been related to Russia or other successor states of the Soviet Union (Saar *et al.*, 2003). Although the local situation with respect to money laundering is, in terms of international comparisons, seen as relatively positive, some areas remain insufficiently regulated. The progress report completed in July 2003 states that, with respect to attempts to combat money laundering, Estonia generally meets the criteria established in the relevant chapter of the EU negotiations. At the same time, attention was paid to the need for supplementary legislation on the supervision of gambling (European Union Secretariat of State Chancellery, 2003). Estonia does not have an official system for ensuring that financial institutions comply with the notification obligation, and the Financial Intelligence Unit lacks the formal authority to request additional information from banks (Tenusaar, 2002).

The experts predicted an increase in the spread and, to a lesser extent, production of counterfeit money. It is believed that as the result of Estonia's accession to the European Union, the forging of passports and other documents may become more frequent, as residents of the CIS will make more intensive use of these counterfeit documents in order to reach Western European countries through Estonia.

Smuggling

One type of criminal offence that is expected to undergo a significant increase is smuggling, especially that arising from the desire to avoid excise duties on tobacco, alcohol and fuel, and from differential rates of excise generally. The area that is least expected to expand is the smuggling of arms. At the moment, trafficking in arms is insignificant in Estonia, something that is also indicated by the information available to the Customs Board. For example, in 2002, customs officials seized two firearms and 21 cut-and-thrust weapons. The experts predicted a slight growth in fuel smuggling. The period 1999–2001 saw a considerable expansion of the trade in illicit fuel, while the volume of fuel seized by customs officials in 2002 decreased again.

According to the Europol report for 2000, commodity smuggling has grown exponentially throughout the EU since the abolition of intra-Community borders in 1993 (EU Organised Crime Report, 2002). The Estonian experts expected an intensification of alcohol and tobacco smuggling after accession to the European Union. According to the Estonian Institute of Economic Research, 37% of smokers in Estonia buy illegal tobacco products and the proportion of illegal tobacco products in domestic consumption amounted to approximately 26–27% in 2002 (Aherma *et al.*, 2002). The excise rates for cigarettes and smoking tobacco will be harmonised with EU requirements by 31 December 2009, those on cigars and cigarillos from the time of accession. The excise rates for cigarettes are being gradually increased in the period 2001 to 2009. The Ministry of Finance has prepared a schedule for harmonising excise duties, while the excise rates presented in the schedule may be subject to change depending on consumer demand in the cigarettes market (Chamber of Commerce, 2003). According to the information available to the Customs Board, the smuggling of tobacco products has increased over the last few years.

Table 6. Assessment of smuggling (N=19)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Illicit trade arising from varying tax rates in EU member states	7	8	2	1	
Smuggling of tobacco	2	12	4	1	
Smuggling of alcohol	1	12	5	1	
Smuggling of fuel	1	11	6	1	
Smuggling of other prohibited goods	1	9	8	1	
Smuggling of stolen goods and objects	2	7	9	1	
Smuggling of arms	1	5	11	1	

The above-mentioned survey conducted by the Estonian Institute of Economic Research indicated that the share of the market of illegal cigarettes in Estonia was stable. Proceeding from that, one may claim that at least some illicit tobacco

remains in Estonia. According to the information of the Finnish researchers Junninen and Aromaa (1999), cigarettes are smuggled from Estonia into Finland. Larger amounts of illicit tobacco are transported from Estonia via Finland to Sweden. The scope of smuggling and the professionalism of these activities have increased in the past few years.

Van Duyne (2003) notes that within the European Union, cigarettes are transported from countries applying lower rates of excise duty to countries where higher taxes are imposed on tobacco products. The excise rates for tobacco will remain relatively low after Estonia's accession to the European Union. Therefore, attention must be paid to the established network of tobacco smugglers, including the possible corruption of officials. All this allows one to predict a growth in the illicit trade in tobacco products as a consequence of Estonia's accession to the European Union.

The market share of illegal alcohol is currently estimated to amount to 25–30%, and the state loses about 200 million kroons (approximately 13 million Euros) in uncollected taxes each year (Josing, 2003). The smuggling of alcohol has, however, been decreasing (*ibid*).

Corruption

Corruption is a very complex phenomenon, one that not only involves legal regulations, but also perceptions, conventions, patterns of behaviour, and levels of trust in state officials. The experts' assessments of corruption in relation to cross-border crime were contradictory. Some expected an increase in corruption, others thought that the situation would remain unchanged or improve. It was interesting to learn that there were no major variations in predictions concerning the level of corruption in the customs, border guard, and police forces.

Table 7. Assessment of corruption (N=18)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Corruption in Estonian customs authorities	1	3	5	6	3
Corruption in Estonian border guard		3	8	6	1
Corruption in Estonian police		2	9	6	1

We would note in passing that that according to various data – *e.g.* police statistics, Transparency International's Corruption Perceptions Index (CPI), public-opinion polls and the GRECO report (Saar jt, 2003) – the level of corruption in Estonia is one of the lowest in the accession countries. According to public-opinion polls, levels of corruption are highest among politicians and police officers. However, the Estonian authorities find that the largest number of

corruption-related problems occur in local government, the Customs Board, and the Border Guard Administration (Open Society Institute, 2002). The European Commission has paid attention to the need to combat corruption in the police and customs service (EU Secretariat of State Chancellery, 2003). The GRECO report also expresses concerns about the vulnerability of customs officers to corruption and organised crime (GRECO, 2001).

Now that Estonia has acceded to the European Union, certain causes of corruption will soon disappear (*e.g.* privatisation has been completed; the local bureaucracy is becoming more transparent and easily controllable; as a result of training and EU requirements, standards of public service may change). At the same time, new opportunities for corruption will emerge. The state bureaucracy will be complemented by the European Union bureaucracy. Because of increases in transport flows, the free movement of persons and increasing EU subsidies, the opportunities for corruption will expand. It is important to note that, as a result of target-oriented ‘enlightenment’ in the area of corruption, people will be expected to be more sensitive to it. This may be reflected in a less favourable assessment of Estonia’s situation later on (*e.g.* CPI scores may decline).

Other crimes

In addition to the crimes discussed above, the experts also highlighted other specific crimes in their answers. Crimes related to the use of information technology were expected to increase most. Here it may be presumed that the predicted increase was related to the general development of technology rather than the enlargement of the European Union.

For a long time, car thefts have been the speciality of several criminal groups active in Estonia. In 2001, the courts for the first time applied the legal tests required to establish the existence of organised criminal activity, to cases involving the transport of stolen cars from Europe into Estonia. Given the absence of border controls between EU countries, it will in future be technically easier to bring stolen cars into Estonia.

Table 8. Forecast of changes in crime related to car thefts, terrorism, and use of information technology (N=19)

	Considerable increase	Some increase	No change	Some decrease	Considerable decrease
Crimes related to the use of information technology	8	8	3		
Car thefts	2	8	8	1	
Terrorism	2	7	9		

According to some experts, the threat of terrorism will increase as a consequence of Estonia’s accession to the European Union; according to others, the level of

danger from this quarter will not change. The relatively slight importance of terrorism as a type of cross-border crime is to be attributed to Estonia's relative distance and isolation from the major areas of terrorist activity.

Conclusions

In general, it can be concluded that, according to the majority of experts, Estonia's accession to the European Union will not be accompanied by abrupt changes in cross-border crime. Accession has been a continuous process taking place over many years, one to which Estonia's official accession was merely the formal culmination. Estonia's expected accession to the Schengen border agreement in 2007 is considered most important, and this will entail major changes. Abolition of controls on internal frontiers facilitates the 'migration' of ordinary crime within the European Union, so we have to be prepared for the migration of crime from Estonia elsewhere and into Estonia from other member states. The opportunities for organised criminal groups to act will expand.

Estonia is seen as an important transit country in cross-border crime involving Russia and the European Union. Just as Western European countries perceive threats associated with the 'strangers' from Eastern Europe, the attitude of the Estonian experts implies a fear of influences from other countries (such as Russia and the Asian countries). The fact that the Estonian/Russian border is an external border of the European Union creates a growing threat of illegal migration and illicit traffic through Estonia, thus imposing great pressures on boarder guards and customs officials. The element most clearly conducive to Estonia's development into a transit state for cross-border crime would be growing corruption of the employees of the local law enforcement authorities.

When considering cross-border crime, the experts primarily proceeded from the assumption that most attention would be focused on organised criminal groups. It was predicted that the 'new immigrants' might form criminal groups and that criminal organisations from several countries might merge. According to the foreign experts, cross-border crime primarily involves semi-professional groups whose activity is not centrally co-ordinated and whose activities are based on market developments.

Misappropriation of money from EU-related funds will be the most acute type of economic criminal offence, according to both local and foreign experts. Economic offences are often based on complicated financial schemes the detection and prosecution of which requires increasingly complex investigation. Specialists at the Ministry of Finance will play an increasingly important role in counteracting such crimes, which, it is thought, are not being dealt with adequately enough at present.

In handling cross-border crime, more emphasis should be placed on an illegal activities paradigm, as this would allow for a more adequate assessment of types of crimes, and for more efficient prediction and control in particular. In the case

of economic offences, attention should be focused on crime prevention strategies aimed at the reduction of opportunities. Attempts to limit criminal activities must be as broad as possible (not, for example, relying solely, or mainly, on police measures). To that end, it is necessary to increase the transparency of business activities and decrease the opportunities for committing economic offences. The relevant authorities must be constantly ready to identify and combat the activities of terrorist associations or networks in Estonia.

The main recommendation for the control and prevention of cross-border crime is that techniques of crime analysis should be developed, with a focus on the methods and mechanisms by which crimes are committed. Continuous analysis of crimes committed in the past will allow experience to be drawn upon more effectively and will improve the accuracy of predictions of the likelihood of offences being committed in the future.

References

- Aherma, E. jt., *Tubakaaktsiisi harmoneerimisega kaasnevad muutused Eesti majanduses* (transl.:Changes in the Estonian economy accompanying harmonisation of excise duties on tobacco). Research paper – public procurement (004569-VT), Tallinn, 2002, available at: <http://www.eib.ee/files/tubakas.pdf>
- Chamber of Commerce, *Mis muutub peale iihinemist maksude valdkonnas?* (transl.: What will happen with taxes after accession?). Chamber of Commerce, 2003, available at http://www.koda.ee/e_uudised.html?reziim2=&reziim=uudis_naita&uudis_id=437&gallup_id=20.11.2003
- Duyne, P.C. van, Cross-Border Crime: A Relative Concept and Broad Phenomenon. In: P.C. van Duyne, V. Ruggiero, M. Scheinhorst, W. Valkenberg (eds.), *Cross-Border Crime in a Changing Europe*. 1–14, Nova Science Publishers, Inc., Huntington, New York, 2001
- Duyne, P.C. van, Organizing Cigarette Smuggling and Policy Making, Ending up in Smoke. *Crime. Law and Social Change*, vol. 39, 285–317, 2003
- European Union Secretariat of State Chancellery, *Monitoring Report for the Commission Review – Estonia*. European Union Secretariat of State Chancellery, June 2003(a), available at <http://www.eib.ee/files/EE-ch04-commented.pdf>
- European Union Secretariat of State Chancellery, *Monitoring Report for the Commission Review – Estonia*. European Union Secretariat of State Chancellery, June 2003(b), available at <http://www.eib.ee/files/EE-ch25-commented.pdf>
- Europol, *EU Organised Crime Report*. Europol, 2000, available at <http://www.europol.eu.int/index.asp?page=EUOrganisedCrimeSitRep-2000>
- Europol, *EU Organised Crime Report*. Europol, 2002, available at <http://www.europol.eu.int/index.asp?page=EUOrganisedCrimeSitRep-2002>
- GRECO, 2001, available at <http://www.greco.coe.int/>
- Josing, M., *Alcohol Consumption and Illegal Alcohol Market in Estonia*. Estonian Institute of Economic Research, December 2003 (unpublished)
- Joutsen, M., Cross-border crime patterns between Eastern Europe and the European Union. In: P.C. van Duyne, V. Ruggiero, M. Scheinhorst, W. Valkenburg (eds.), *Cross-Border Crime in a Changing Europe*. 15–32, Nova Science Publishers, Inc., Huntington, New York, 2001
- Junninen, M. and K. Aromaa, *Crime across the Border: Finnish Professional Criminals and Estonian Crime Opportunities*. National Research Institute of Legal Policy, Research Communications 45, Helsinki, 1999
- Keeneya, S., F. Hassona, H.P. McKennab, A critical review of the Delphi technique as a research methodology for nursin. *International Journal of Nursing Studies*, vol. 38, 195–200, 2001

- Lynn, M.R., E.L. Layman, S.P. Englehardt, Nursing administration research priorities: a National Delphi study. *Journal of Nursing Administration*, vol. 28, No 5, 7-11, 1998
- Nelken, D., The Globalization of Crime and Criminal Justice: Prospects and Problems. In: S. Einstein and M. Amir (eds.), *Organized Crime: Uncertainties and Dilemmas*. 439–461, Office of International Criminal Justice, Chicago, 1999
- Nordic Council of Ministers, *Nordic-Baltic Campaign against Trafficking in Women in Estonia*. Nordic Council of Ministers, 2002, available at <http://www.nordic-balticcampaign.org/estonian/index.html>
- Open Society Institute, *Korruptsioon ja korruptsioonivastane poliitika Euroopa Liiduga ühinemise protsessis* (transl.: Corruption and anti-corruption policy in the process of accession to the European Union), Open Society Institute, 2002, available at <http://www.jti.ee/et/tie/korruptsioon/osi-korr-final.pdf>
- Powell, C., The Delphi technique: myths and realities. *Journal for Advanced Nursing*, vol. 41, no. 4, 376–382, 2003
- Rowe, G., G. Wright, The Delphi technique as a forecasting tool: issues and analysis, *International Journal of Forecasting*, vol. 15, 353–375, 1999
- Saar, J., A. Markina, A. Ahven, A. Annist, J. Ginter, *Kuritegevus Eestis 1991-2001* (Transl.: Crime in Estonia 1991–2001), 2nd Edition, Kirjastus Juura, Tallinn, 2003
- Tänavsuu, T., *Finantspettuste uurija Euroopa Komisjonis: Eestis läheb huvitavaks. Intervjuu OLAFi juhiga Franz-Hermann Brüneriga* (Transl.: Investigator of financial fraud in European Commission: It is going to be interesting in Estonia. Interview with Director General of OLAF Franz-Hermann Brüner). Eesti Päevaleht, 6.10.2003, 2003(a)
- Tänavsuu, T., *Leedu Sapardi projekte üritavad petturid tüsata* (Transl.: Swindlers try to fool in Lithuanian Sapard projects). Eesti Päevaleht 14.10.2003, 2003(b)
- Tenusaar, A., *Tegevuskava rahapesu tõkestamise meetmete tõhustamiseks Eestis. Kavand seisuga aprill 2002* (Transl.: Action plan for increasing efficiency of money laundering prevention measures in Estonia. April 2002 draft). Available at the Internal Security Policy Department of the Ministry of Internal Affairs, 2002

The crusaders: Swedish companies in Russia and the Baltic states handling uncertainty and criminal threats

Nils Bagelius¹

Introduction

As a result of the liberation and the transformation process in the former USSR, Western companies gained access to new markets in the Baltic States, Russia and Ukraine, as well as gaining access to a supply of resources from the East. The commercial as well as the non-commercial environment indicates that there are large differences in the codes of conduct, traditions and values between the East and the West as well as difficulties in generating information for Western firms. Lack of information creates uncertainty and can be a direct obstacle in the way of investment (Lowther, 1997). However, many companies in Sweden have invested in the East and have expressed their intention of committing themselves to the area on a long-term basis.

Internationalisation is one of the most risky activities for a company (Ansoff, 1984; Young *et al.*, 1989; Omsén, 1982). Despite extensive efforts, a general theory of internationalisation has not so far been developed. Most investigations of internationalisation (Miklos, 1998; Salmi, 1996) are decision oriented. However, internationalisation is a process (Johanson and Mattsson, 1990) rather than a single event. Therefore a longitudinal study could contribute to further development of a theory of internationalisation.

The high-speed economy of the West (Ekstedt *et al.*, 1999; Nyberg, 2002; Kristensson Uggla, 2002) has encountered an equally high-speed economy in the East. After the liberation, politicians² as well as firms in the East acted quickly in order to demonstrate that real changes had taken place in the lives of citizens and to facilitate the adaptation of local enterprises to Western commercial standards. In general, changes in traditions and values – the informal rules of the game – could not keep pace with politicians' and authorities' desire for rapid changes in the formal rules of the game, such as the law, and this created uncertainty. It would therefore be interesting to discover whether in the former planned economies Western companies implemented a strategy *in action* (Johanson &

¹ Nils Bagelius is Management Consultant at the Stockholm International Banking Institute, Sweden.

² Interviews with Madis Üürrike, Minister of Finance Estonia, Rudolf Jalakas, Manager in Handelsbanken and Malcolm Dixelius, researcher, author and reporter for TV4.

Mattsson, 1992; Håkansson & Snehota, 1995) or *before* action (Porter, 1985; Ansoff, 1984).

The power of the State was reduced after the Brezhnev era and later during the Gorbachev era. A dense network of coalitions and alliances, including criminal ones, was created for the distribution of goods and services. This caused distorted and illegal competition. A number of researchers (Leitzel, 1998; Lowther, 1997) argue that criminality has a negative influence on foreign direct investments. Brock (1998) found that criminality in Russia had curbed the size of direct investments. Dixelius³ argues that almost all companies operating in Russia are directly or indirectly influenced by organised crime. Aromaa and Lehti (1996) argue that foreign companies that invest in St. Petersburg sooner or later find themselves having to come to terms with criminal groups or organised crime. A number of other researchers have described the impact of crime in the East on society and on enterprises.⁴

Coercion is generally represented in the business literature as a tool used by the authorities. Coercion and especially criminal threats and violence in inter- or intra-organisational relations are rarely described in the literature on macroeconomics (Blomqvist & Lundahl, 2002) or microeconomics (Hamel and Prahalad, 1995; Humes, 1993; Kotler, 2003). However Sjöstrand (1997) and Castells (1998) to a limited extent, and Gummesson (2002) to a larger extent, have carried out studies of coercion in commercial life.

Estimates of risk and uncertainty have so far been dealt with as particularisation⁵ in the literature. However firms are confronted with multidimensional country- as well as commercial risks (Oxelheim and Wihlborg, 1987; Miller, 1993; Khoury & Zhou, 1999), which can be interdependent. Risk and uncertainty estimates are dynamic processes; for, when certain risks are reduced other risks can arise. The lack of uniform definitions of e.g. country risks (Oxelheim & Wihlborg, 1987; Miller, 1993) makes it difficult to implement a systematic analysis of risk and uncertainty. In the East the formal rules of the game and the available resources for law enforcement cannot guarantee that contracts will be fairly adhered to (Hendley et al., 1997). There is a need to investigate how foreign companies have in practice managed the multidimensional country risks and commercial risks in an Eastern environment that is very different compared to what the Western companies experience at home.

³ Interview with Malcolm Dixelius 1999.

⁴ Relevant works include: Dunn, 1997; Lowther, 1997; Rawlinson, 1997; Serio, 1997; Kryshstanovskaya, 1996; Handelman, 1997; Shelley, 1995, 1997; Dixelius and Konstantinov, 1999; Volkov, 1999; Sutela, 1994; Galeotti, 1999; Dahan, 2000; Grossman, 1994; Leitzel, 1998; Bäckman, 1998; Gilinsky, 1999; Repetskaya, 1999; Vilks and Bergmanis, 1999; Voronin, 1997; Boskholov, 1995.

⁵ Particularisation researchers focus on particular perspectives or on selected risks and uncertainties. A general theory, including country risks and commercial risks, has not been developed so far.

Against this background the general research objective and four questions were formulated. The general objective is to generate knowledge about, and to increase understanding of foreign direct investment⁶ in the former Soviet Union, where planned economies are undergoing a process of marketisation. The investigation reviews Swedish companies and their direct investments in the East. The four research questions were formulated as follows:

- By what means did the companies establish themselves and manage uncertainty during the period of transition from a command economy to a market economy in the East?
- What differences between the West and the East have a strategic impact on companies' decisions about uncertainty and risk in relation to their commitments in the East?
- In what way can the companies reduce the degree of uncertainty surrounding their direct investment commitments in the transitional economies in the East?
- Were companies' commitments in the East the product of decisions of a long-term nature or were they the product of ad hoc decisions once liberalisation had opened the Eastern economies to foreign investment? If the latter, could the companies' actions be explained as symbolic strategies?

The environment in the East

The industrial, commercial and legal traditions of the East differ from those of the West. Marketing and sales functions in the East are poorly developed. The often non-transparent infrastructure of industry in the East, and the lack of retailers and shops limit access to strategic products as well as general supplies. Too often, goods fail to arrive on time, to arrive at the correct destination, to arrive in the right quantity and to have the correct specifications (Brock, 1998; Lankes and Venables, 1996). This creates a high degree of uncertainty for firms used to operating in a much more predictable environment.

Despite this uncertainty, the potential market and low production costs in the East have been attractive enough for companies in the West to take a chance. However, productivity is generally low as is awareness of the importance of quality. This offsets the advantages of low production costs in the East. Weak payers; the loss of public sources of finance for local businesses; the speculative activities of banks: these have created a need for advance payments.

⁶ With direct investments means investments in wholly owned companies, majority and minority owned companies and alliances with capital infusion in which the owned share is at least 10%.

Mechanisms for the enforcement of commercial agreements are deficient and the security of written agreements can be questioned (Hendley *et al.*, 1997; 1998; Arino *et al.*, 1997).

The need for rapid changes of formal rules such as laws and decrees, which could support the new market economy, and the slow pace of change to informal rules such as traditions, values and codes of conduct have created a disjunction between the formal and informal rules of the game (Rawlinson, 1997; Neimanis, 1997; Rose, 1998; Piirainen, 1997).

The bureaucracy is frequently responsible for unpredictability, arbitrariness and slowness. Contacts with the tax authorities and customs as well as procedures to set up business in Russia are resource-demanding and time-consuming obstacles. Officials in the bureaucracy have not been able to keep pace with all the formal changes, and this creates insecurity. Additionally, a lack of skills, low bureaucratic salaries, defective legislation, cumbersome administrative procedures and

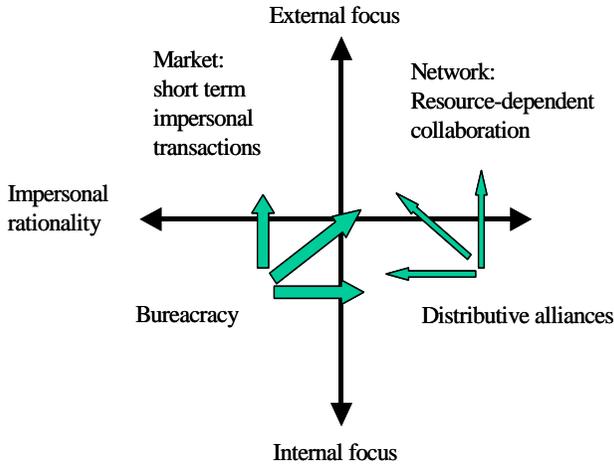
traditions of non-transparency create fertile soil for corruption (Rawlinson, 1997; Ledevena, 2000; Bäckman, 1998; Radaev, 2000).

An extensive informal economy and widespread barter trade were inherited from a command economy in which personal relationships were important as vehicles for getting hold of resources that the State could not offer. This relationship economy created a negotiating economy (Sutela, 1998).

After liberalisation, a focus on the market economy developed, and this contributed to the flourishing of commercial life. The environment in the East offered hidden vested interests, an archipelago of informal relationships and unfamiliar codes of conduct, which had been institutionalised during the seventy-year period of the command economy. These facilitated the acquisition of scarce products for consumption and the fulfilment of production plans issued by the authorities (Salmi, 1996).

Networks involving citizens, employees in companies, the authorities and government – so-called *distributive alliances* – were generated during the period of the command economy as means of acquiring scarce products and privileges. A number of new distributive alliances within the bureaucracy were created in order to further the members' interests in the new market economy. Also, the distributive alliances, which had existed at the time of the command economy, attempted to broaden their collaborative networks and acquired a new interest in the market (figure 1).

Figure 1. Transition from command economy to market economy - and the development of distributive alliances



The Russian researchers Jakobson and Makasheva (1996) use the concept of coalition to refer to persons in smaller exclusive groups who use their relationships and friendships to explore ways of obtaining products and privileges or to protect themselves. The terms ‘alliance’ and ‘coalition’ are used interchangeably in the literature and the two categories blend into each other. Definitions of alliances or coalitions then depend on the personal preferences of the author.

As this investigation deals with positioning, uncertainty and risk reduction from an interdependence perspective, the term ‘alliance’ will be used instead of ‘coalition’.

The formation of a distributive alliance can be oriented to the short as well as to the long term; it can be strategic or operative, and the alliance can be formed between individuals and groups who lack political ambitions. A distributive alliance can consist of vertical as well as horizontal relationships. Individuals from business, banks, the authorities and the political sphere can form a distributive alliance. One form of distributive alliance is the criminal one.

Coalitions and alliances consist of individuals or groups interacting with a deliberate purpose. They are issue-oriented with an external focus and built on a concerted membership (Stevenson *et al.*, 1985) in inter-organisational and intra-organisational contexts. Coalitions or alliances are to a varying extent broadly and loosely defined in sociology and social-psychology (Collins and Raven, 1969), organisation theory, (Jones, 1995; Gupta, 2003), economic transaction cost theory (Coase, 1991) game theory and rational choice theory (Leiserson, 1966; Riker, 1962), criminology (De Borchgrave *et al.*, 1997), marketing (Gummesson, 2002) and strategy (Lorange *et al.*, 1993; Håkansson and Sharma,

1996). Often a coalition is defined as an alliance of politically oriented individuals or organisations (Leiserson, 1966) for some specific purpose, an alliance as a close association of individuals or organisations with a common goal.

Some authors insist on distinguishing coalitions – which are seen as temporary, (Lacity, 1993), rapidly responding, instrumental groupings of actors – from alliances, which are conceptualised as deeper, more substantial and more permanent. Albrecht and Brewer (1990) argue that alliances involve commitments that are longer standing, not on a single issue, deeper and built upon more trusting political relationships. However coalitions can also be long lasting, while alliances can also be short-term oriented. Coalitions can, like alliances, build on informal rules of the game such as trust. Coalitions are not limited to a single issue and can manage multipurpose issues.

Alliances have increased in popularity in recent years and are mentioned in the microeconomic strategy-oriented literature. The term ‘coalition’ is parsimoniously represented in the strategic business literature; however it can be found in Porter (1985) and Porter and Fuller (1986). Theories of coalitions are concentrated primarily in the literature dealing with legislatures, parliaments, cabinets and studies of social movements (Gupta, 2003). Alliances can be strategic or operative and are institutionalised measures to reduce risks and uncertainties. Alliances are established to generate value-creating activities in order to develop, strengthen and defend positions. Alliances can be categorised and be placed on a continuum – with transactions on the free market at one end, and total integration or hierarchy at the other (Lorange *et al.*, 1992). From a nano perspective alliances can endure for lengthy periods and can be family or kinship oriented. A family oriented hierarchical alliance is the clan and a network market oriented alliance is the circle (Sjöstrand, 1993).⁷ Alliances can also be informal. In the criminological literature Block (1983) divides criminal alliances into longer lasting enterprise syndicates and short-term power syndicates. In business, alliances such as collusions are fraudulent and illegal (Jones, 1995). Informal alliances are often invisible.

During the period of the rapid adaptation of the formal rules of a market economy, the authorities were unable to keep pace with new expectations, and political turbulence in the wake of liberation created decision-making uncertainty, and weakened the power of the State (Karaganov *et al.*, 1998). This development gave considerable encouragement to criminal activity, which became more visible (Serio, 1997; Shelley, 1997; Boskholov, 1995; Repetskaya, 1999). The gap between the rich and the poor grew wider as the privatisation process proceeded. A number of oligarchs succeeded in gaining control of large parts of the economy (Hoffman, 2003). Large amounts of capital were invested or hidden abroad (Beare, 2000) and a cash-less society developed in the East

⁷ The Russian researchers Jacobsen and Makasheva use the concept ‘vertical clan’ for the hierarchy and ‘horizontal clan’ for the network configuration when they propose their concept of distributive coalitions. These, they mention, are small exclusive groups with “clan” qualities.

(Karaganov *et al.*, 1998). The State could only collect a fraction of the taxes it needed (Shlapentokh, 1994) and a large number of employees had to wait long periods for their salaries.

Citizens and actors within the commercial sector responded to the weakened role of the state by inventing a number of creative procedures to avoid its interference and control in order to hide their money transactions (Birdsall, 2000). Russia was affected by hyperinflation⁸ from 1992 to 1996, Estonia for a period of 2 years and Latvia and Lithuania for 3 years. A large number of banks were established in the four countries to manage the flow of money that was being created by the germinating market economy. However the local banking system could not offer firms services of the same standard as that found in the West. A parliamentary and financial crisis in 1998 had serious consequences for the financial sector and a large number of banks were liquidated (Pleines, 2000).

A lack of social capital (Hedlund and Sundström, 1996) – a consequence of the prohibition on the establishment of voluntary organisations during the communist regime – has had a negative effect on the level of trust in society. Mistrust and a lack of confidence in the official communist ideology and politics have left in their wake a general sense of insecurity. Due to the long period of isolation and the inward-looking attitudes fostered by communism, foreign actors have come to be looked upon with scepticism and mistrust.

After the crisis, greater commercial stability was experienced in the East. Representatives of foreign companies perceived a slight reduction in corruption as well as other criminal activities in the ten-year period after 1992.

Theory

The research applies a holistic⁹ and eclectic¹⁰ perspective. Four main theoretical frameworks, which partly overlap and partly complement each other, are used.¹¹ They are:

- industrially oriented network theory (Johanson and Mattsson, 1990; Möller & Wilson, 1995);

⁸ Inflation more than 100 percent annually (European Bank for reconstruction and Development, 2002).

⁹ In a holistic view the researcher pays attention to the parts and the whole, constantly shifting attention from the detail to the whole and from the whole to the detail. According to classical mechanical physics the whole can only be understood through its parts. The holistic view maintains that details can only be understood through the whole. This is a systemic view where every detail is gradually understood within the context of a whole system.

¹⁰ An eclectic perspective is one that draws insights from many theories.

¹¹ The company's commitments are analysed from four intermixed theoretical perspectives, which implies that an eclectic approach has been employed in the study.

- competence-driven resource-based theory (Collis and Montgomery, 1995; Chakvarathy and Lorange, 1991)
- organisationally oriented resource-dependent theory (Pfeffer and Salancik, 1978) and
- relationship marketing theory (Grönroos, 1992; Normann, 1991) further developed in a many-to-many marketing perspective (Gummesson, 2004).

Theoretical frameworks within criminology (Abadinsky, 2000; Naylor, 1997; Albin *et al.*, 1995; Johansen, 1996), are used for support e.g. for the development of a network orientation to criminal activities. Perspectives on strategy (Porter, 1990; Stacey, 1993; Hamel and Prahalad, 1995) and uncertainty (Miller, 1993; Sjöstrand, 1997), which have also been used in the analyses, support the analysis of strategy in action, the need for flexibility, and the management of internal as well as external uncertainty in an integrated manner.

The main theoretical contributions come from the dynamic, socially and industrially oriented ‘business-to-business’ network theory. This theory explains the totality of relationships among firms engaged in production, distribution and the use of services in what might best be described as an industrial system (Easton, 1992). The basic assumption in the network theory is that the individual firm is dependent on resources controlled by other firms. The firm gains access to these external resources through its network position (Johanson and Mattsson, 1992). This theory applies to the process of internationalisation and the current reduction of uncertainty in exchange relationships between actors. The network theory has also been applied in the research’s description of the transformation of the societies in the East as well as the description of the distributive alliances and criminal groups.

The organisationally oriented resource-dependent theory focuses on dependency and interdependencies as well as interorganisational power relationships, strategy and reduction of uncertainty. The competence driven resource-based theory elucidates the need to establish structural innovations and develop competence in order to generate unique products or concepts to maintain a competitive position. Main concepts used by the theory are firm capabilities, advantages and mobility of resources. The marketing oriented relationship marketing theory is a more comprehensive theory than the industrially oriented, ‘business-to-business’ network theory. The relationship marketing theory focuses on relationships, networks and interactions (Gummesson, 2002) and is equally applicable to services as to industry. The core of the relationship marketing theory is interaction in exchange processes, creation of values and confidence. This theory describes the interaction, quality, retention and defection that are important in order for an organisation to cultivate a customer base. The theory focuses on a number of commercial relationships, including relationships on the ‘mega level’ above the market and at the ‘nano level’ within the organisation. In this study some of these relationships

are considered of great importance for an understanding of the company's commitments in the East.

The four main theoretical frameworks take the organisation as the unit of analysis. They express the organisations' dependence 'upstream' on suppliers, and 'downstream' on the market. All four main theoretical frameworks express the need for the structural imperfection inherent in the organisation and the desire to control the imperfections of others. The four main theoretical frameworks deal with exchange processes. The relationship marketing, the network theory and the resource dependent theory focus on adaptation as well as the influence on the environment exerted by management and include competition as well as collaboration. However, the resource-based theory concentrates more on influence and is more oriented towards strategy before action than the other theories. The resource-based theory is closer to the industrially oriented paradigm and focuses on competition and competitive positions to a greater extent than the network theory, the relationship marketing theory and the resource dependent theory.

Methodology

The empirical core of the investigation consists of 13 in-depth case studies. Analyses of the cases cover a time span running from the company's basic decision to invest in the East at the beginning of the 1990s, up until 2000. During this period six companies partially or wholly liquidated their commitments in the East. Given the need for comprehensive analysis of complex and dynamic issues, case studies were favoured over statistical sampling and formal questionnaire surveys. The study of the cases included interviews with about 100 key informants in addition to observations and action research during 30 site visits. A large number of documents and 1,100 published sources were analysed.

I had an excellent opportunity to take advantage, for research purposes, of my involvement in missions to the East on behalf of a number of Swedish companies. In this way, through interaction with my Eastern counterparts, I was able to acquire an awareness of the backgrounds, assumptions and outlooks of business people from the East.

The companies

The investigation deals with establishment and development processes in the East of thirteen companies belonging to different industries. The companies are: ABB (a global engineering company), AGA (a producer of gas and gas appliances – one of the five largest gas companies in the world), ASG (concerned with transportation – by air, sea, rail and road), Baltica Finance (engaged in the trade,

storage and shipment of oil), Dagens Industri (producers of commercial newspapers, such as *Delovoj Peterburg* in Russia and *Äripäev* in Estonia), Ericsson (producers of telecoms), Hallberg-Sekrom (mechanical engineers), Nordic Tra & Bygg (manufacturers of wood processing equipment and suppliers of prefabricated houses produced in St. Petersburg), Primus (producers of gas appliances – including the Primus stove – for industry and for leisure pursuits), Pripps-Hartwall-BBH (brewery company of which Baltika Brewery in St. Petersburg is a large tax payer in Russia), Saturnus (a trade and venture company operating in Russia in the integrated forestry and wood processing industry, and in the mechanical engineering industry), Swedish Tobacco (producers of snuff, cigars and lighters) and Vin & Sprit (producers of alcoholic beverages such as Absolut Vodka and other brands).

Research questions answered

In the first section above we listed four research questions.

1. The first question concerned the means by which the companies established themselves in the East and managed uncertainty as they began their activities there. The companies' conduct can be described as follows.

The companies used a mix of ownership strategies¹² and establishment strategies in making their initial commitments to the East. All of the companies agreed to an organic increase of their commitments in the East in order to avoid the conflicts that might otherwise have broken out had their commitments generated instant increases in capacity and dominant positions in the East. The larger companies acquired local companies in the East to a greater extent than did the smaller companies but acquisitions did not instantly add capacity. The more internationalised the companies, the more distinct was the desire to acquire local companies. The less internationally experienced companies started with green-field¹³ operations.

These findings correspond to the network theory and the findings by Forsgren (1989). The network theory and Forsgren explain this phenomenon in terms of a desire on the part of the internationally experienced companies to acquire positions in order to reduce their competitive interdependencies. For less internationalised companies the desire to go green-field could be explained by

¹² Ownership strategies refer to the degree of the firms' control of foreign units and can be divided in two ideal forms, total ownership, (internalisation) and varying degrees of involvement of market actors (market). A joint venture ownership strategy is a hybrid and implies a jointly owned company.

¹³ Green-field establishment strategies advance step-by-step, and offer firms the privilege of gradually learning about the conditions of the new market and avoiding the risk of committing larger resources in unfamiliar markets. Green-field entry strategies are usually much slower than acquisition entry strategies.

their desire to eliminate disturbances downstream and upstream in their domestic networks when new relationships are established abroad.

However, some of the more internationally experienced companies had to choose green field too, because of formal obstacles in the environment, lack of financial resources and lack of appropriate acquisition objects. The larger companies also established green-field operations to generate relationships and collect information in the opaque business environment before they made larger acquisitions.

Acquisitions that are initiated and driven by subsidiaries with local knowledge and market relations are more evolutionary, incremental and organic compared with acquisitions driven by business firms' headquarters. Such acquisitions are more likely to have a revolutionary character due to their tendency to bring about almost instant adaptation on the part of the acquired firm to the codes of conduct of the acquirer, and to the fact that decisions are made at a distance.

During the development process, the companies increased their share of ownership both in their joint ventures with local entrepreneurs, and in their majority owned commitments in the East. Therefore companies preferred hierarchy¹⁴ to market. One of the reasons was that companies estimated the commercial uncertainty as large. However, if companies had estimated a country's uncertainty as large they normally should have shared the risk and used the market as the default mode to managed their uncertainty.

Hierarchy also helped the companies meet the need for efficient coordination between their business units in the West and the East. The companies wanted to control the transfer of competence from the West to the East and to implement their own value-based norms. Hierarchy secured the transfer of resources from the West to the East. The companies diversified upstream to Western suppliers in order to avoid an uncertain and irregular supply of products of inferior quality from agents in the East. The lack of local companies in the East with the competence and ability to exploit the Western companies' competitive advantages as efficiently as the Western companies was also a factor in decisions to internalise the Eastern companies' operations. In Russia, strong protection of the interests of local minority shareholders was a final factor in the decision of companies to internalise their commitments in the East.

2. The second question concerned potentially important differences between the West and the East that have a strategic impact on companies' decisions about uncertainty and risk in relation to their commitments in the East.

Differences in commercial, industrial and judicial traditions; differences in citizens' behaviour; foreign actors' limited access to information; the influence of rapidly spreading and increasingly visible criminal phenomena: all these had an impact on companies' behaviour. These differences correspond to variations in

¹⁴ Hierarchy means internalisation and market means that the company can take advantage of collaboration with others.

structural and natural imperfections, which are discussed in the traditional as well as the more modern dynamic internationalisation models, such as the dynamic Uppsala School of Internationalisation and the network theory. However, the influence of crime is seldom treated in the business, and the business research literature.

The foreign companies developed and maintained their positions in the East through the introduction of new, differentiated products, the development of local resources and local relationships, and the introduction of new inventions. Important inventions were activities (which the foreign companies executed with greater effectiveness than local competitors) such as quality assurance, the application of modern production processes and empowerment of employees. Other important inventions concerned activities within marketing and distribution. Pripps-Hartwall-BBH, for example, developed a local distribution system whereby beer and soft drinks could be conveyed from their breweries to shops so that customers did not have to fetch the products at the gates of the breweries, as had been the normal practice during the period of the command economy.

3. The third question concerned the ways in which the companies reduce the uncertainty surrounding their direct investment commitments in the transitional economies of the East.

A summary of the more frequent activities used to manage dependencies and uncertainty are presented in figure 2. The main activities the companies used to manage interdependencies and uncertainty were as follows. The companies:

- exploited the natural driving forces of local demand in the East and/or exploited favourable factors of production in related commitments in the East;
- established strong links with parts of systems in which they could launch differentiated products and exploit current innovations downstream in the market in order to generate viable interdependencies and organic growth;
- established loose couplings with segments of the environment that had an unfavourable influence or could generate conflicts of interest or other imbalances. They avoided any explicit connections with local crime;
- invested in interorganisational relationships to reduce uncertainties arising from commercial, industrial, judicial, information and behavioural asymmetries between the West and the East;
- invested in intra-organisational relationships in order to generate sufficient confidence to enable them to establish a foundation for transformation of competence and the integration of activities between East and West;
- invested in the transfer and transformation of competence in the East; introduced norms and values in the East in accordance with their own

- prevailing norms, values and codes of conduct in order to strengthen and develop the internal resources available to support and increase the performance of the external resources associated with their commitments in the East;
- transferred resources in order to revitalise and develop local performance within production, processes, marketing and systems with the aim of supporting development and defending their structural imperfections in the East;
 - reduced intra-organisational hierarchies, empowered employees, and distributed information from the “top down” as well as from the “bottom up” in the East;
 - complied with local formal rules and procedures, established supporting tactical alliances for access to local professional knowledge and intelligence resources;
 - created links for the acquisition of resources from suppliers in the West in order to avoid over dependence on the supply of products of inferior quality from suppliers in the East;
 - reoriented commitments in the East or withdrew when environmental influences generally, or commercial relations specifically, no longer made possible a satisfactory level of performance.

4. The fourth question related to the extent to which the companies' commitments in the East were the product of decisions of a long-term nature rather than the product of ad hoc decisions.

Four companies, AGA, Dagens Industri, Swedish Tobacco and Pripps-Hartwall-BBH, explicitly expressed a great deal of courage before they made their initial commitments in the East. This could be an indication that these four companies applied a symbolic strategy. However the four companies based their commitments on estimates and information collected in cooperation with foreign as well as local intelligence resources in advance of their commitments in the East. The four companies also had initial intentions and visions and therefore did not use symbolic strategies but had the courage to act at the moment of truth.

For all the companies, their direct investments in the East were of a long-term nature. The companies were ‘doers’ and applied conventional strategies-in-action, which resulted in considerable learning and exchanges of experience between themselves and local actors in the East. Eight of the companies could be characterised as pioneers and five of the companies could be characterised as followers. The pioneers had a strong desire to influence and change the networks that they were able to establish in the East. The followers adapted their commitments to the existing prerequisites in the East.

Development of relationships

The companies created an influence with differentiated products, innovations and advantage packages. The companies established strong links with certain segments of the Eastern market to increase stability and control of performance and reduce uncertainty. The companies invested in portfolios of commercial as well as non-commercial relationships to achieve a controllable environment. The companies strengthened their relationships with local actors having power and influence in the East, in order to prove their presence. They established supporting tactical alliances with actors who could support them with information and expertise in relation to economic and legal matters in order to avoid disturbances and to cope with the formal rules and standards of business activity in the East.

The companies diversified upstream to suppliers in the West, and internalised their commitments in the East to an increasing extent. In order to minimise potential initial conflicts the companies undertook an organic expansion of their commitments in the East. In general, companies selling to local markets in the East developed local brands and introduced new products after they had trained local staff. Companies producing in the East developed the local competence that they had invested in the production of equipment; and if they exported, they selected a number of competitive products, whose range was later increased.

Development of supporting resources

In order to develop local supporting resources in the East the companies transferred resources and expertise there. The transfer of complimentary supporting products and local innovations helped to reinforce their competitive position and generated dependency on the companies' products in Eastern markets. The companies transformed competence by having recourse to value-based leadership at board meetings, in management and among employees in the East.

Representatives of the companies had a deep understanding of, and a firm commitment to the process of the competence transformation. The companies revitalised processes, production and systems in the East in order to reduce the gap in performance between the West and the East. The companies' value-based norms stabilised the performance of business units in the East.

The development of human capital in the East was of vital importance. Social relations and trust created a foundation for the transformation processes and achievement of a level of local performance close to Western standards. Employees from the West who participated in the transformation process were dedicated, inspired, committed and keenly alive to the local individual's desires

and competence. “*It is important to put them on track and then they roll on by themselves*” (Bengtsson, Manager of International Relations, AGA).

Companies from the West sent representatives to the East to act as standard bearers of their own commercial culture. They broke down hierarchies and communicated information in a top-down as well as a bottom-up fashion. They empowered employees and encouraged them to act professionally in accordance with the standards and culture of companies from the West. The representatives trained and educated people in the East using hands-on educational techniques, and offered a great deal of feedback in order to transmit confidence and increase levels of organisational competence – which in turn was a foundation for the establishment of fruitful external relations of a commercial as well as non-commercial kind.

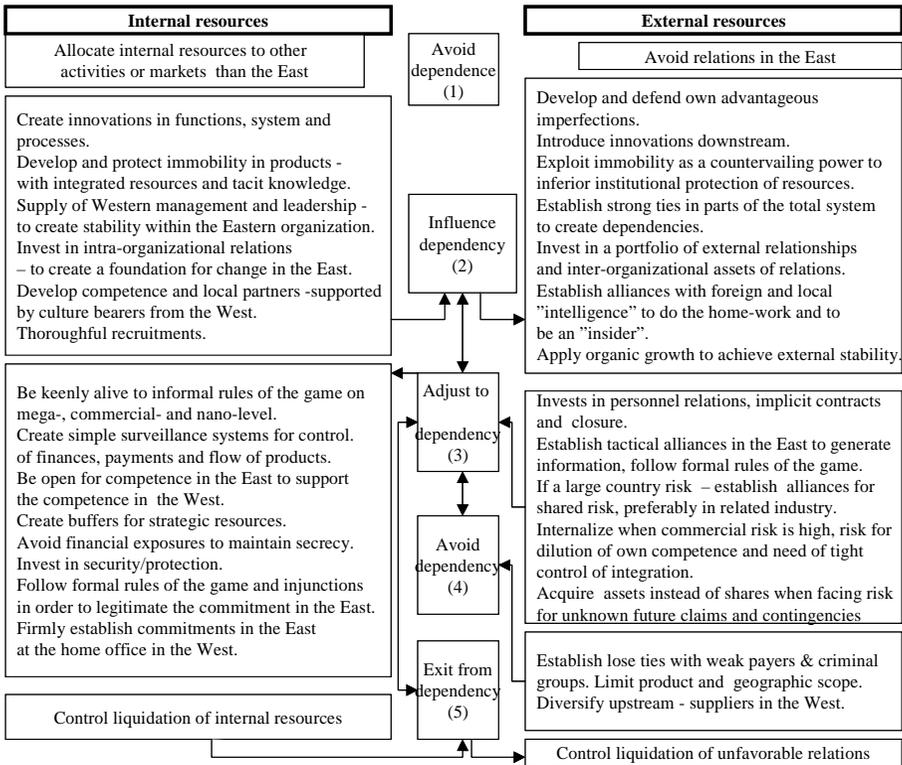
The representatives supported management and participated in meetings of the boards of directors of the companies’ subsidiaries in the East. Most of the companies created a family atmosphere at board meetings, within management and among employees in their Eastern subsidiaries: “Employees from BBH formed a tight joint circle, almost a clan. The Russians could recognise the phenomenon, felt acquainted and we won their hearts” (Charles Eriksson, Manager of Finance and Administration on BBH).

The goal in the long run for the companies was to appoint local managers. However the lack of appropriate competence and the need for tight coordination in the initial stages led ABB, AGA, Ericsson and ASG to recruit leaders from the West for most of their subsidiaries in the East.

Swedish Tobacco, Dagens Industri, Pripps-Hartwall-BBH, Primus, and Hallberg-Sekrom recruited local managers for their Eastern subsidiaries. However, most of the companies recruited controllers from the West. Western, and the complicated Russian systems of financial control were executed in parallel with each other in order to control performance from the Western side and to meet Russian bookkeeping demands.

In order to adapt the supporting resources to the prevailing prerequisites in the East, the companies implemented simple surveillance and management systems to control the flows of products and remuneration. The companies adapted their performance in the East to the formal rules in force there. They paid taxes, fees and other impositions, and avoided financial exposure to criminal groups, investing in security and creating buffers for strategic supplies from the West.

Figure 2. Summary of frequent activities to manage dependencies



All the companies, with the exception of Baltica Finance, made relatively limited financial commitments to the East despite the fact that some companies, such as AGA, Swedish Tobacco, and Pripps-Hartwall-BBH, invested in local production in the East. The relatively small commitments could be looked upon as options with a reserved right to play and with a potential future leverage, if successful. The companies were seriously aware of the multidimensional uncertainty and risks involved in the transition economy. They used a variety of entry modes and made frequent adjustments to their commitments to secure a viable position in the East. They concentrated their behaviour on a selected number of critical factors, which they could control, and parry (figure 3). Besides they made purposeful investments in relationships and confidence.

Figure 3. Potential strategies employed by the companies

THE BUSINESS ENVIRONMENT	THE COMPANIES	
	Small amount of flexibility, considerable interdependence	Considerable flexibility, little interdependence
Low level of predictability	Speculation	Parry
High level of predictability	Planning	Control

Many companies from the West had quicker pay-offs on their commitments in the East as compared to the pay-offs on their commitments in the West. One reason could be that they were able to obtain a first mover advantage and did not have to capture market shares from institutionalised competitors, as is often the case in the West. Another explanation could be that they were able to offer rapid access to products which were in large demand in the East and which local competitors could not offer.

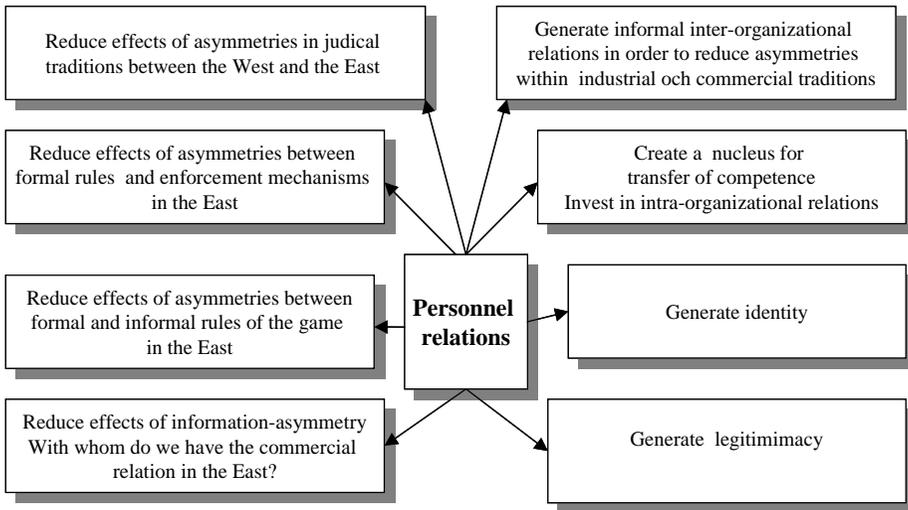
Three main contributions to business research

The importance of personal relationships

The case studies revealed that personal relationships are of utmost importance in intra-organisational as well as inter-organisational relations in the East. The functional significance of personal contacts is much greater in the East (Salmi, 1996). While in the West personal contacts are often a result of business, in Russia they are the prerequisites. In intra-organisational relations, personal relations were prerequisites for the creation of a foundation on which companies could change processes and begin the transformation of competence in the East (figure 4). The companies' mission was to develop Eastern employees in such a way as to enable them to be insiders, thus enabling them to understand how to take care of, and to develop the advantages of the West and to coordinate resources between the West and the East.

From the inter-organisational point of view, face-to-face relationships allow rapid feedback and the establishment of mutual confidence, which can reduce the uncertainty deriving from the differences between the industrial, commercial and judicial traditions of West and East, as well as from differences in codes of conduct and access to information in inter-organisational exchange processes.

Figure 4. The importance of personnel relations in the East



The informal archipelago of institutionalised networks in the East generated competitive advantages for persons with connections and information in the East. The companies from the West made efforts to get behind the curtain of hidden informal relationships. To do research in advance of any larger commitment was important for the companies from the West. They had to investigate dependence and interdependencies between local commercial counterparts, authorities and politicians in their due diligence studies in order to become insiders.

In the West the companies know how to do business. In the East the companies had to know with whom to conduct business. In the East, informal structures were often more important than formal networks.

The importance of judicial relations

Legislation, institutions and informal practices could not keep pace with the new business conditions. Confidence, trust and privileged information about the companies’ counterparts in the East had greater instant value than written agreements, while self-enforcing mechanisms had priority in disputes.

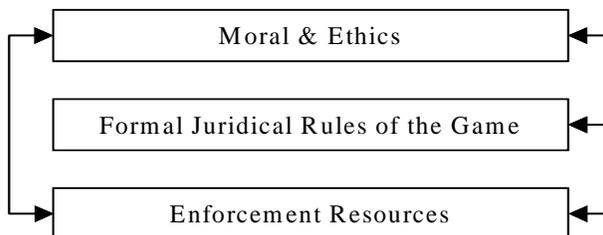
The study has paid attention to the differences in legal behaviour and traditions between the West and the East. In the West the formal rules give commercial actors a degree of confidence in their business dealings. In the East the situation is different. For example, Russians’ interpretations of commercial agreements often led to particularisation (Burger *et al.*, 2002). That is, when a dispute occurred, the Russians often focused on and wanted to re-negotiate a

certain issue instead of considering the agreement in its entirety.¹⁵ If a foreign company anticipated winning a dispute in court it could not be sure of being compensated because its commercial counterparts in the East could relatively easily redistribute their assets if they realised that they were going to lose the dispute.

If disputes could be settled formally, commercial actors had to rely on courts or arbitration courts in the East or in the West. The study reveals that the companies from the West had little confidence in the formal rules or enforcement mechanisms of the East. Disputes could instead be settled by self-enforcing mechanisms such as are applicable in relational contracts in the West. Some of the investigated companies failed to settle the disputes and lost their investments in the East or they had to reconsider their commitments.

The study reveals that commercial rather than country risks – such as political and policy uncertainty, macro-economic and social uncertainty and uncertainty due to the influence of nature – were the companies' main concerns. As a consequence of the risk and the legal turbulence in the East, the companies preferred to internalise their commitments in order to retain control of their resources. The study elucidates the importance of fit between the informal and formal rules of the game. The rules of the game together with competition and cooperation govern the behaviour of actors both in the market and within organisations. The management of judicial relations and informal rules of the game therefore become important. Formal rules, such as laws and decrees can be changed instantaneously and on an ad hoc basis. Informal rules such as taboos, values, traditions, and codes of conduct are developed over long time spans, are transferred from one generation to the next, are path dependent and are institutionalised in society, which means they take longer to change (North & Naishul, 1992; Sjöstrand, 1993). In the East three gaps developed in the rules of the game due to the rapid changes during the transition from a command economy to a market economy (figure 5).

Figure 5. Gaps between formal and informal rules of the game and resources for enforcement



¹⁵ Interviews with Kaj Hobér and Bengt Sjövall, lawyers employed by Mannheimer Swartling, a law office that deals with large numbers of cases on behalf of Swedish companies in the East.

A misfit developed between the formal rules, which could be changed quickly and in an ad hoc fashion, and the informal path-dependent rules subject to slow change. The misfit led to the development of insecurity.

Rapid change of an ad hoc nature in the formal rules, sometimes with retroactive effects, caused confusion and made it difficult for the authorities as well as commercial actors to adapt to the situation, which in turn generated insecurity.

A gap developed between the formal rules and the resources for enforcement. The courts, police and other enforcement resources were dependent on domestic actors and interest groups for retention of their positions and jobs. This interdependence generated vested interests and corruption (Dixelius and Konstantinov, 1999; Shelley, 1995).

The study has shown that a State with reduced power does not have unilateral control of the formal rules of the game. Coastal and Baltika Finance were able to establish new rules of the game in Estonia when local distributive alliances, which included representatives from industry and Parliament, tried to gain control of Baltika Finance and Coastal's transshipment terminal in Tallinn. ABB in Latvia was asked to assist the Latvian State when new rules of the commercial game were to be established.

Mart Grosholm, a manager with responsibility for Swedish Tobacco's operations in the East described how the company made adjustments to the formal rules of the game and avoided a lengthy and expensive liquidation when it sold its commitment in Nevo, Russia, to an ostensible buyer without giving notice through the pages of the business press: "*If you live among wolves, then you yourself will turn into a wolf*".

The influence of crime

The power of the Soviet State declined during the Brezhnev era (1964-1982) and more rapidly so during the Gorbachev era (1985-1991). During the investigation it was noticed that this encouraged the formation of coalitions in the distribution of goods and services, but that it also encouraged criminal practices and organised crime (Jacobson and Makasheva, 1996; Serio, 1997; Voronin, 1997). This gave rise to a distorted form of competition, unrestrained by norms of loyalty, and this had an influence on many of the companies' commitments in the East.

Members of coalitions used mechanisms other than the official rules and enforcement mechanisms of the state in order to resolve commercial conflicts. Informal groups with limited public control and shielded from observation were able to have an impact on the establishment of formal rules, and an influence on commercial life. The performance of these groups also influenced citizens' codes of conduct in the East. The presence of these hidden legal or illegal groups had an influence on most of the companies' commitments in the East. Because of the deterioration of proper law enforcement and security the companies had to

strengthen security and increase surveillance. Some companies hired international professional intelligence investigators to acquire information concerning hidden networks.

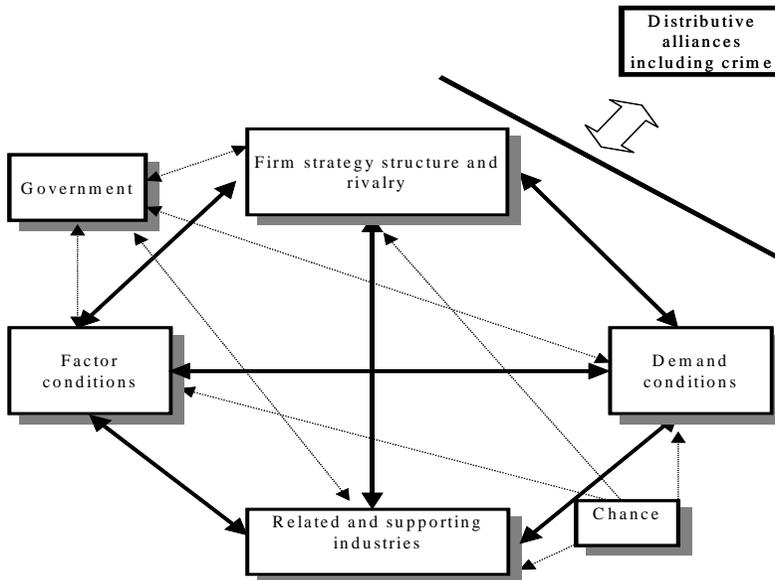
The well-known national diamond (Porter, 1990) describes the four determinants that create a supportive environment for firms in one industry but not for those in other industries. The four determinants are a) factor conditions, b) demand conditions, c) related and supporting industries and d) firm strategy, structure and rivalry. In a revision (Sölvell, Zander and Porter, 1991), influences deriving from government and chance were considered. The diamond should again be revised (figure 6) to include the influence of distributive alliances and crime on commercial actors.

As the study reveals, legal and illegal distributive alliances can have an interactive impact on commercial actors, demand and factor conditions, related and supporting industries, and the government. Crime has been brought to light in large commercial organisations. It also appears in symbiotic relations with the authorities and government in the East as well as in the West. A number of newspapers mention that corruption has been revealed within the organisations of such well-known global actors as the European Union (EU) and the Olympic Committee. Also, well-known companies in countries that are known to be free of corruption, such as Sweden, have recently been exposed as acting in collusion and in conflict with the law.

In order to combat corruption and to enforce anticorruption strategies, there is a need to strengthen local and international resources and competence. Corruption, which is a frequently occurring phenomenon in many countries in the East as well as in a number of nations in the western hemisphere (Transparency International, 1999) could, if it grew in significance and became more widespread in the future, be looked upon as an institutionalised commercial factor.

Distributive alliances and criminality had a specific influence on seven out of the thirteen companies that were investigated: ASG and AGA in Moscow, Baltica Finance in Estonia, Orimi Wood in St. Petersburg, Saturnus in Archangels, Swedish Tobacco in Latvia and Russia and Vin & Sprit in Russia.

Figure 6. The Determinants of Competitive Advantage

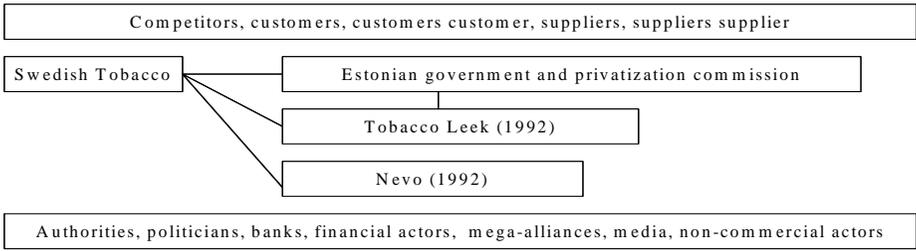


The case of Swedish Tobacco

The development of Swedish Tobacco is one example of the dynamics of the internationalisation of foreign companies in the East and of their interaction with distributive alliances. The company had direct relations with a number of important counterparts in the East. Relationships with the general environment and other commercial actors such as competitors, suppliers, the authorities, the mass media and others were analysed in the case study when they had an impact. In the figures below, these relationships are represented as a frame, within which the focal company, Swedish Tobacco, acted.

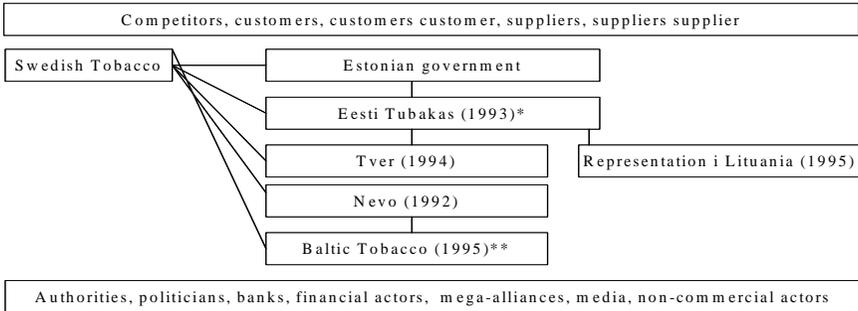
Swedish Tobacco, with production facilities in Sweden and in the Netherlands, produces and markets pipe tobacco, snuff, cigars and lighters for the international market. Until 1999, it produced cigarettes mainly for the Nordic market. In 1992, the company initiated collaboration with the Estonian state-owned tobacco company, Tobacco Leek, which produced and marketed cigarettes in Estonia. In the same year, Swedish Tobacco also initiated collaboration with a large Russian company based in St Petersburg, Nevo, which had a broad range of tobacco products (figure 7). Then, in 1993, Swedish Tobacco and the Estonian government established the joint venture, Eesti Tubakas, for the production and sale of cigarettes in Estonia and for the future export of cigarettes to Russia. In 1994, Eesti Tubakas and Swedish Tobacco acquired a joint stake in a tobacco company in Tver, Russia, which would produce cigarettes for the Russian market.

Figure 7. The focal network 1993 for Swedish Tobacco



The network in the East grew rapidly (figure 8). Swedish Tobacco established the joint venture, Baltic Tobacco, with the Russian company, Nevo, in St. Petersburg in 1995.

Figure 8. The focal network 1995 for Swedish Tobacco



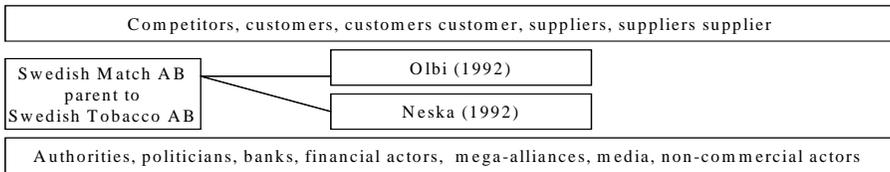
* Swedish Tobaccos share 67 % ** Swedish Tobaccos share 50 %

Baltic Tobacco would develop, produce and market certain new tobacco products, which would be sold in the St. Petersburg region, and Swedish Tobacco would supply the knowledge to develop these products. Baltic Tobacco would also sell goods produced by Swedish Tobacco. In Lithuania Swedish Tobacco established an outlet for tobacco products produced by Eesti Tubakas.

In Latvia criminal groups offered Swedish Tobacco an opportunity in 1996 to establish facilities for the production of cigarettes for the Russian market. However after a number of meetings Swedish Tobacco politely refused. In 1996, a merger between Swedish Tobacco and Swedish Match took place. Following the cessation of cigarette production by Tubakas Leek in 1997, winding up of the joint venture in Tver and a break with Nevo, both in 1996, Swedish Match/Swedish Tobacco established sales offices in Estonia and changed the name of its sales office in Lithuania. Swedish Tobacco had since 1997 planned to introduce the cigarette, 'Blend' in Russia and worked out a resource-demanding marketing plan. This led to the installation of sales representatives in Moscow in 1998.

In Russia, the local companies Olbi and Neska marketed Swedish Match cigarette lighters. Swedish Match had established this collaboration already in 1992. Swedish Match/Swedish Tobacco sold their cigarette division to an Austrian company in 1999. The sales representatives in the Baltic States and in Russia were withdrawn. As a result of pressure from criminal distributive alliances, Swedish Match decided against introducing a new brand of cigarette lighters, which would have competed with existing brands marketed by Olbi and Neska. However Swedish Match continued its collaboration with Olbi and Neska for the purposes of marketing of the actual cigarette lighters (figure 9).

Figure 9. The focal network 1999 for Swedish Tobacco



Swedish Match/Swedish Tobacco made parallel commitments in the Baltic countries as well as in Russia. The company’s stepwise retreat from the East occurred as a consequence of parliamentary, commercial, criminal and internal disturbances. Important occurrences for Swedish Match/ Swedish Tobacco’s commitments in the East:

- Refusal of an offer from criminal distributive alliances to establish production in Latvia;
- Retreat from the joint venture, Eesti Tubakas, in Estonia due to parliamentary vested interests and an unfavourable tariff policy
- Retreat from Tver in Russia due to limited accessibility of information and potential influence of criminal distributive alliances;
- Retreat from Baltic Tobacco in Russia due to the influence of legal and semi-legal distributive alliances in Nevo;
- Retreat from the marketing of cigarettes in Moscow due to a strategic reorientation within the group Swedish Match/Swedish Tobacco when the parent company sold its cigarette division in Sweden to Austrian Tobacco;
- Pressure of criminal distributive alliances on Swedish Match to focus on two brand names of cigarette lighters and to avoid introducing other brands of cigarette lighter in Russia.

The case of ASG

Swedish Match/Swedish Tobacco is an example of expansion and contraction of a foreign company’s commitments in the East. ASG on the other hand is an

example of continuous expansion of a foreign company's commitments. However, ASG had to make retreats in the East or secure their commitments to avoid pressure from illegal distributive alliances. Important occurrences for ASG's commitments in the East:

- Liquidation of shares in a Moscow joint venture due to the influence of criminal distributive alliances. ASG lost all its investments in Moscow. ASG had made the deal with three representatives who, though they claimed to be the owners of the joint venture, were, in fact, only representatives of the owners. Disputes broke out between ASG and the representatives and ASG tried to contact the owners. Unable to make contact with them, ASG had to settle the dispute in a Russian court. ASG lost and its representatives were accused of being criminals;
- Establishment of a company in Ukraine together with two local experts who managed the local relationships and local business in order to allow the company to avoid direct pressure from criminal distributive alliances;
- Establishment of an own terminal in Latvia in an area where most of the customers were located to avoid pressure from criminal distributive alliances.
- Establishment of a terminal in Hamina in Finland for luxury products in order to avoid customs procedures in Russia, certain transport assignments and pressure from criminal distributive alliances;
- After an initial time period ASG curtailed the transport of goods having a certain value for criminal distributive alliances, such as spirits and cigarettes.

Changes in the thirteen companies' networks

Changes having great influence on actors can occur as a consequence of inter-organisational disturbances in market and mega relationships, or as a consequence of intra-organisational disturbances in the relationships of an organisation or group. A combination of disturbances had an influence on the companies' focal networks (figure 10).

The companies managed the pressure exerted by criminal groups in different ways (figure 11). Dagens Industri sought to influence public opinion with its many newspaper articles about the pressures of legal and illegal distributive alliances on commercial actors in the East. Dagens Industri's local papers in the East were charged and their representatives summoned to appear before the courts 57 times, however the papers won all the legal cases.

Table 10. Changes in the thirteen companies' networks

	Changes in focal* net-works in the East during the process	Due to intra- or inter-organisational relations			
		Intra-organisational (within the company or group)	Inter-organisational (between external actors)		
			Commercial	Parliamentary	From criminal distributive alliances in:
AGA	X	X	X	X	
ASG	X	X	X	X	Russia
Baltica Finance	X		X	X	Estonia
Dagens Industri	X		X	X	Latvia
Saturnus Russia	X		X		Russia
Swedish Tobacco	X	X	X	X	Russia and Latvia
Hallberg-Sekrom					
Nordic T & B ¹⁶	X		X		Russia
Primus Russia	X	X	X	X	
ABB Baltikum	X	X	X	X	
Ericsson	X		X	X	
Pripps-Hartwall-BBH	X		X	X	
Vin & Sprit	X		X		Russia

*) The focal network is the network that the company can enact.

Pripps-Hartwall-BBH created a countervailing power against criminal distributive alliances when it appointed representatives from the Russian tax authorities to the board of its brewery, Baltica. Swedish Tobacco created a similar countervailing power when representatives of the Estonian government were appointed to the board of Eesti Tobacco. Together with its collaborating partner Coastal, Baltica Finance was able to create a countervailing power against local criminal distributive alliances which included business persons as well as state officials. Coastal had a large and important network of relationships in the international oil market and among international authorities such as IBRD, the World Bank and the IFC, and it could influence the deliveries of oil from Estonia to the West.

¹⁶ Nordic T & B is Nordic Tra & Bygg.

Table 11a. The management of criminal interference

Company	Negotiations			
	On own merit	Support from local experts	Support from intelligence	Support from institutions
AGA	X	X	X	X
ASG	X		X	X
Baltica Finance	X	X		X
Dagens Industri	X	X		
Saturnus	X	X		
Swedish Tobacco	X	X	X	X
Hallberg-Sekrom				
Nordic T & B	X	X		
Primus Russia	X	X		
ABB Baltikum			X	
Ericsson			X	
Pripps-Hartwall -BBH	X		X	
Vin & Sprit	X	X		X

Table 11b. The management of criminal interference

Company	Security forces or police	Re-grouped	Ceased operation sold out or liquidated	Moulded public opinion	Established counter-veiling power
AGA	X				
ASG	X	X	X		
Baltica Finance		X			X
Dagens Industri	X			X	
Saturnus		X	X		
Swedish Tobacco		X	X		X
Hallberg-Sekrom					
Nordic T & B		X	X		
Primus Russia		X	X		
ABB Baltikum	X				
Ericsson	X				
Pripps-Hartwall -BBH	X				X
Vin & Sprit		X	X		

Most of the companies used self-enforcing mechanisms to resolve conflicts with distributive alliances. ASG however failed to solve its problems in Moscow after intense negotiations and then had recourse to lawyers. The Russian lawyers had close relationships with local invisible structures. ASG lost and was forced to leave the jointly owned terminal in Moscow. AGA, Baltica Finance, Dagens Industri, Saturnus, Swedish Tobacco, Nordic Tra & Bygg, Primus and Vin & Sprit on the other hand made extensive use of local experts in parallel with self-enforcing mechanisms and became successful in their management of all kinds of relationships with legal and illegal distributive alliances. Local experts could call on their experience and local contacts. They knew the implicit rules of the game, collected information, delivered messages and influenced commercial as well as non-commercial counterparts. After some period the foreign companies'

representatives learned from them in a process of trial and error and were able to develop their negotiation skills and sensitivity. The larger companies used foreign and local intelligence in order to get behind the hidden local relationships and to mobilise pressures. A limited number of the companies turned to institutions or to the police force.

Six out of thirteen companies wholly or partly liquidated their commitments in the East. ASG liquidated its joint venture in Moscow 1997. Vin & Sprit was forced to change its agent in Russia in 1994. Petroprimus sold its business to its Russian partners in 2000. Saturnus moved from Russia and established businesses in Estonia in 1992. Swedish Tobacco ceased operation in Estonia in 1997 and in Russia in 1999, and Nordic Tra & Bygg ceased collaboration with Orimi Wood in St. Petersburg in 1998. AGA wanted to sell their production units in Kaliningrad and Russia. However it could not find local buyers and the production units were mothballed.

Five out of thirteen companies, wholly or partly liquidated their commitments in the East due to interference from criminal groups. These companies were ASG, Vin & Sprit, Saturnus, Nordic Tra & Bygg and Swedish Match/Swedish Tobacco. Primus closed its unit in Moscow and smaller distribution centres in Russia due to interference from distributive alliances whose backgrounds, motives and relationships are unclear, though suspicious. Dagens Industri in Latvia, AGA and Pripps-Hartwall-BBH in Russia were threatened. Ericsson, AGA, ASG, ABB, Dagens Industri and Pripps-Hartwall-BBH increased and strengthened their security and also hired professional security guards.

Three of the companies suffered interference from Eastern criminals in Sweden and one company suffered the loss of an employee who was murdered in Sweden by gunmen. Other Swedish investigations (OMA, 2000; Ådal & Anisimov, 2000) as well as a number of international investigations indicate that organised crime had an influence on foreign companies' commitments in the East.

Conclusions: the moral

The focus in this study has been on how Swedish companies capture commercial positions and how, from a dependence perspective, they manage uncertainty and risk. The research shows that in general companies are loosely coupled with their environment and want to act so that they can foresee and control events. Predictability, however, requires strong links and commitment to certain parties in society and the business community, which leads to dependencies and reduced flexibility. The companies deliberately selected relationships and commitments, managing interdependencies and power asymmetries mainly through adaptation or control. They implemented a strategy-in-action; they were doers.

In the early stages, the Swedish companies applied a mixture of establishment and ownership modes. The need for control of resources, in accordance with the network oriented theory; the need for protection of resources, in accordance with the resource based theory; the need for reduction in the level of dependence on Eastern suppliers for strategic resources of uncertain availability, in accordance with the resource dependent theory: all this increased the rate of internalisation of the companies' commitments in the East during the development process.

The companies strengthened and developed their internal resources to support marketing investments and relationships. Although they had initial advantages as a result of their products, their competence, their financial positions and their relationships in the West, they continuously launched innovations to strengthen dependencies and improve and defend their positions in the East. The companies' commercial advantages were difficult for Eastern competitors to imitate. They were also a protection against opportunistic commercial behaviour and enabled institutionalisation in the East with its weak formal rules and corrupt systems of enforcement. The cases revealed simultaneous penetration and integration activities in the East as a consequence of the demand for large resource transfers and the Swedish companies' demanding resource transformation in the East. The findings are a contribution to theories of internationalisation, and complement the more common decision-oriented studies.

Three main conclusions from the investigation concern crucial relationships whose significance is underestimated in the literature on strategy, marketing and internationalisation: 1. the importance of personal relationships; 2. the demand for self-enforcing legal control over commercial disputes; and 3. the influence of crime. When making commitments in the East, Western actors should be very keen to investigate with whom they establish relationships in order to become insiders. Confidence, trust and privileged information about counterparts in the East had greater instant value than written agreements. The same applies to self-enforcing mechanisms in disputes.

Further observations include the Swedish companies' employment of "irrational-oriented rational mechanisms", an expression for the social exchange of trust, shared values and ideals in commercial, mega, and nano relationships and interactions. Through personal relationships, confidence and trust the Swedish companies created platforms for intra-organisational changes in relation to their investments. Meanwhile, their counterparts in the East could act as insiders. Personal relationships reduced the effects of industrial, commercial, and legal asymmetry between the West and the East, as well as of differences in codes of conduct and access to information in inter-organisational exchange processes.

The contemporary high-speed economy – with its rapid technological development, its rapid access to information, its heightened internationalisation, its integration of national economies and global financial systems – together with increased international competition, create gaps between formal and informal rules of the game as well as in the enforcement of agreements within and

between nations. Networks are organisational forms which are familiar to criminals who are not concerned with the absence of regulations but instead utilise this special experience as a competitive advantage in relation to the authorities and commercial actors. This development occurs because supporting administrative sectors in the societies cannot keep pace with the high-speed development of the commercial sector.

In the light of growing corruption in Russia and in the West it may be necessary to reconsider the rules of the game if legality is to prevail. It may be necessary to change definitions of organised crime because corruption is one of the most important contemporary factors as far as organised crime is concerned. Corruption, the threat of violence and criminal monopolisation are recurring features of the definitions of organised crime offered in the Anglo-American literature and they are also found to a certain extent in the definition of organised crime offered by the expert group on organised crime in Europe.¹⁷ With increased levels of corruption, it may be necessary to reconsider the prerequisites for legal business, and it may in future be necessary to have recourse to alternative mechanisms for the regulation of interactions between commercial partners. Such developments have been revealed in the East and recently revealed also in the West in larger corporations such as: Royal Ahold in the Netherlands; Xerox, Enron and Worldcom in the US; Parmalat in Italy; ELF Aquitaine in France; Skandia in Sweden, and the Yukos Oil Company in Russia.

This investigation has for the first time integrated theories drawn from business with theories drawn from criminology. The cases that have been studied strongly indicate that criminal actors and illicit distributive alliances had an impact on many of the Swedish companies' commitments in the East.

¹⁷ For a discussion of the definition of organised crime that emerged from the Expert Group on Organised Crime of the Council of Europe in 1997, see Van Duyne (2003).

References

- Abadinsky, H., *Organized Crime*. Sixth edition, Belmont, Wadsworth, 2000
- Albini, J.L., R.E. Rogers, V. Shabalin, V. Kutushev, V. Moiseev and J. Anderson, Russian organized crime: its history, structure and function. *Journal of Contemporary Criminal Justice*, vol. 11, no. 4, 213-243, 1995
- Albrecht, L. and R.M. Brewer, *Bridges of power: women's multicultural alliances*. New Philadelphia, Society Publishers, 1990
- Ansoff, Igor H., *Implanting Strategic Management*. London, Prentice Hall, 1984
- Arino, A., M. Abramov, I. Skorobogatykh, I. Rykounina, and J. Vila, Partner selection and trust building in West European-Russian joint ventures. *International Studies of Management & Organization*, vol. 27, Issue 1 (Spring), 19-37, 1997
- Aromaa, K., M. Lehti, *Foreign Companies and Crime in Eastern Europe. The Security Environment in St. Petersburg and Estonia in 1995*. Helsinki, National Research Institute of Legal Policy, Publication no. 135, 1-74, 1996
- Beare, M.E., *Russian (East European) organized crime around the globe*. Australian Institute of Criminology, Australian Customs Service and Australian Federal Police, Transnational Crime Conference, Canberra, March 9-10, 2000
- Birdsall, K., Everyday crime at the workplace: covert earning schemes in Russia's new commercial sector. In: A. Ledevena and M. Kurkchian (eds.), *Economic crime in Russia*. Boston, Kluwer Law International, 2000
- Block, A., *East Side, West Side: organizing crime in New York. 1930-1950*. New Brunswick, Transaction Books, 1983
- Blomqvist, H.C. and M. Lundahl, *The distorted economy*, New York, McMillan, 2002
- Boskholov, Sergei, Organized Crime and Corruption in Russia. *Demokratizatsiya*, vol. 3, no. 3 (summer), 270-274, 1995, [Paper from Transnational Crime and Corruption Centre TraCCC], available at <http://www.american.edu./traccc/work/boskholovarticles.html> (visited October 5, 2002)
- Brock, G.J., Foreign Direct Investment in Russia's regions 1993-95, Why so little and where has it gone. *Economics of Transition*, vol. 6, no. 2, 349-360, 1998
- Burger, E.S., and I. Paliashvili, Russian-Ukrainian Legal Group, P. A., *Some practical guidance for avoiding disputes arising from commercial and investment activity in Russia and Ukraine*. Russian-Ukrainian Legal Group, P. A., 2002, available at <http://www.american.edu/traccc/pdfs/burger/Guidance.htm> (visited October 5, 2002)
- Bäckman, J., *The inflation of crime in Russia. the social danger of the emerging markets*. Helsinki, National Research Institute of Legal Policy, 1998
- Castells, Manuel, *The Information Age. Economy. Society and Culture*, vol. 3, Cambridge MA, Blackwell Publishers, 1998
- Chakravarthy, B. and P. Lorange, *Managing the Strategy Process: A Framework For a Multibusiness Firm*. Englewood Cliffs NJ, Prentice-Hall, 1991

- Coase, R. H., The nature of the firm, in O.E. Williamson, and S.G. Winter (eds.), *The nature of the firm. origins. evolution. and development.* Oxford, Oxford University Press, 1991
- Collins, B. and B. Raven, Group structure, attraction, coalition, communication and power. In: G. Lindzey, E. Aronson (eds.), *The Handbook of Social Psychology.* Reading MA, Addison-Wesley, 1969
- Collis, D.J. and C.A. Montgomery, Competing on resources: How do you create and sustain a profitable strategy? *Harvard Business Review*, vol. 73, no. 4. pp. 118-128, October 5, 2002
- Dahan, Frédérique, Money-Laundering control and the Rule of Law in Post-Communist Russia. In: A.V. Ledevena and M. Kurkchiyan (eds.), *Economic Crime in Russia.* Boston, Kluwer Law International, 2000
- De Borchgrave, A., W.H. Webster, R.H. Kupperman, E.R. Peterson, G.P. Burke, Cilluffo, J. Frank, and R.J. Johnston, *Russian organized crime. global organized crime project.* Washington, CSIS Task Force Report, Centre for Strategic and International Studies, 1997
- Dixelius, M. and A. Konstantinov, *Maffians Ryssland.* Stockholm, Kommentus, 1999
- Dunn, G., Major mafia gangs in Russia. In: Phil Williams (ed.), *Russian organized crime. the new threat?* 63-87, London, Frank Cass, 1997
- Easton, G., Industrial Networks: a Review. In: B. Axelsson, and G. Easton (eds.), *Industrial networks – A new of view of reality.* London, Routledge, 1992
- Ekstedt, E., R. Lundin, A. Söderholm and H. Wirdenius, *Neo-Industrial organizing: renewal by action and knowledge formation in project intensive economy.* London, Routledge, 1999
- European Bank for Reconstruction and Development, Table A.3.3, Inflation in Central and Eastern Europe and the CIS. *Transition Report.* European Bank for Reconstruction and Development, 2002
- Forsgren, M., Foreign acquisitions, internationalisation or network interdependency? In: T.S. Cavusgil, L. Hallén and J. Johanson (eds.), *Advances in International Marketing. Volume 3,* 141-159, 1989
- Galeotti, M., *The Russian Mafiya.* Organized Russian & Eurasian Crime Research Unit, Keele University, 1999
- Gilinskiy, Y., Organized crime in Russia. Domestic and international problems. In: E.C. Viano (ed.), *Global organized crime and international security.* Aldershot, Ashgate, 1999
- Grossman, Gregory, What was - is, will be- the Command Economy? *MOCT-MOST. no. 4,* 5-22, 1994
- Grönroos, Christian, *Service Management. Ledning. Strategi och Marknadsföring i Servicekonkurrens.* Göteborg, ISL, 1992
- Gummesson, E., *Many-to-Many Marketing.* Malmö. Liber, 2004
- Gummesson, E., *Relationsmarknadsföring från 4 P till 30 R.* Malmö, Liber, 2002
- Gupta, D., *Coalitions in theory and practice, a critical review of existing research. Seminar on Modern European Politics Government Department.* Cornell University, New York, April 30, 2003

- Hamel, G., C.K. Prahalad, *Att konkurrera för framtiden*. Göteborg, ISL Förlag, 1995
- Handelman, Stephen, *Comrade Criminal: Russia's New Mafiya*. New Haven, Yale University Press, 1997
- Hedlund, S., and N. Sundström, Does Palermo represent the future of Moscow? *Journal of Public Policy*. vol. 16, no. 2, 113-155, 1996
- Hendley, Kathryn, B.W. Ickes, P. Murrell and R. Ryterman, *Observations on the Use of Law by Russian Enterprises*, Working Paper no. 201. IRIS, University of Maryland, April, 1997
- Hendley, Kathryn, P. Murrell and R. Ryterman, *Law. Relationships. and Private Enforcement: Transactional Strategies of Russian Enterprises*. Working Paper no. 201. IRIS, University of Maryland, 1998
- Hoffman, D., The oligarchs. Wealth and power in the New Russia, *Public Affairs*, 2003
- Humes, S., *Managing the Multinationals*. New York, Prentice Hall, 1993
- Håkansson, H. and D.D. Sharma, Strategic alliances in a network perspective. In: D. Iacobucci (ed.), *Networks in Marketing*. London, Sage, 1996
- Håkansson, H and I. Snehota, *Developing Relationships in Business Networks*. London, Routledge, 1995
- Jakobson, L.I. and N.A. Makasheva, *Distributive Coalitions in Post – Socialist Russia. Ideology and Economic Reforms. A Round Table Discussion of Scholars*. Russian State University Moscow, Lenin Hills, Russia, September 2, 1996
- Johansen, P.O, *Nettverk i Gråsonen. et perspektiv på organiseret kriminalitet*. Oslo, Ad Botam Gyldendal, 1996
- Johanson, J. and L-G. Mattson, Internationalization in industrial systems. A network approach. In: D. Ford (ed.), *Understanding business markets: interaction. relationships and networks*. London, Academic Press, 1990
- Johanson, J. and L-G. Mattson, Network Positions and Strategic Action – an analytical framework. In: B. Axelsson and G. Easton (eds.), *Industrial Networks – A New View of Reality*. 205-217, London, Routledge, 1992
- Jones, G.R., *Organizational theory; text and cases*. New York, Addison-Wesley Publishing Company, 1995
- Karaganov, S., I. Malashenko, A. Fedorov, A. Safonov and V. Vorozhtsov, *Russia: eliminating crime*. Cambridge MA, Harvard University, September 1998
- Khoury, Sarkis Joseph and C. Zhou, *Country risk: existing models and new horizons*. Riverside, University of California, Version February 1, 1999
- Kotler, Philip, *Marketing Management*. Prentice Hall, 2003.
- Kristensson Uggla, Bengt, *Slaget om Verkligheten. Filosofi – Omvärldsanalys – Tolkning*. Stockholm, Brutus Östlings Bokförlag, 2002
- Kryshtanovskaya, Olga, *Financial Oligarchy in Russia*. Reprinted in Russica Information Inc. RusData DiaLine-BizEkon News, January 10, 1996, available at <http://www.lexis.com> (visited February 18, 1999)
- Lacity, M.C. and R. Hirschheim, *Information systems outsourcing; myths. metaphors and realities*. New York, Wiley, 1993

- Lankes, H-P and A.J. Venables, Foreign direct investment in economic transition, the changing pattern of investments. *Economics of Transition*, vol. 4, no. 2, 331-347, 1996
- Ledevena, Alena V., Economic Crime in the new Russian Economy. In: A.V. Ledevena, Alena and M. Kurkchiyan (eds.), *Economic Crime in Russia*. Boston, Kluwer Law International, 2000
- Leiserson, M., *Coalitions in Politics*. New Haven CT, Yale University Press, 1966
- Leitzel, Jim, *Corruption and Organized Crime in the Russian Transition*. New Economic School Moscow, Russia, March, 1998
- Lorange, P., B. Chakravarthy, J. Roos and A. van de Ven, (eds.), *Implementing strategic process: change. learning and cooperation*. Oxford, Basil Blackwell, 1992
- Lorange, P. and J. Roos, *Strategic alliances. formation implementation and evaluation*. Cambridge, Blackwell, 1993
- Lowther, N.J., *Organized Crime and Extortion in Russia: Implications for Foreign Companies*. In: *Transnational Organized Crime*. London, Frank Cass, vol. 3, no. 1 (spring), 23-38, 1997
- Miklos, S., Experiences with foreign direct investment in Eastern Europe. *Eastern European Economics*. vol. 36, no. 3 (May-June), 28-48, 1998
- Miller, Kent D. A., Industry and Country Effects on Managers' Perceptions of Environmental Uncertainties. *Journal of International Business Studies*, vol. 24, no. 4, 693-714, 1993
- Möller, Kristian and D.T. Wilson, Interaction and Network Approach to Business Marketing, A Review and Evaluation. In: K. Möller and D.T. Wilson (eds.), *Business Marketing: An Interaction and Network Perspective*. 587-613, Boston, Kluwer Academic Publishers, 1995
- Naylor, Thomas R., Mafias, Myths, and Markets: On the Theory and Practice of Enterprise Crime. In: *Transnational Organized Crime, Volume 3*. London, Frank Cass, 1997
- Neimanis, G.J., Business Ethics in the former Soviet Union: A report. *Journal of Business Ethics*, vol. 16, no. 3, 357-362, 1997
- Normann, Richard, *Skapande Företagsledning*. Stockholm, Bonniers, 1991
- North, Douglass C. and Vitali Naishul, Institutions, Ideology, and Economic Performance, Institutional Development in the USSR. *Cato Journal*, vol. 11, no. 3 (winter), 477-497, 1992
- Nyberg, Mikael, *Kapitalet.se*. Stockholm, Ordfront, 2002
- OMA 2000, *Undersökning av svenska företags ryska och baltiska etableringar*. Stockholm, Stockholms Handelskammare, Slutrapport, Oktober, 2000
- Omsén, Arne H., *Strategisk Marknadsutveckling*. Malmö, Liber, 1982
- Oxelheim, L. and C. Wihlborg. *Macroeconomic Uncertainty. International Risks and Opportunities for the Corporation*. New York, Wiley, 1987
- Pfeffer, J. and G.R. Salancik, *The External Control of Organizations*. New York, Harper & Row Publishers, 1978
- Piirainen, T., *Towards a New Social Order in Russia. Transforming Structures and Everyday Life*. Aldershot, Dartmouth, 1997

- Pleines, H., Large-scale corruption and rent-seeking in the Russian banking sector. In: A.V. Ledevena, and M. Kurkchiyan (eds.), *Economic crime in Russia*. Boston, Kluwer Law International, 2000
- Porter, M.E., *Competitive Advantage*. New York, McMillan Publishers, 1985
- Porter, M.E., The competitive advantage of nations. *Harvard Business Review*, vol. 68, no. 2, 73-94, 1990
- Porter, M.E. and M.B. Fuller, Coalitions and Global Strategy. In: Porter, M. E. (ed.), *Competition in Global Industries*. Boston, MA, Harvard Business School Press, 1986
- Radaev, V., Organized violence in Russian business in the late 1990s. In: A.V. Ledevena, and M. Kurkchiyan (eds.), *Economic crime in Russia*. Boston, Kluwer Law International, 2000
- Rawlinson, P., Russian organized crime. A brief history. In: P. Williams (ed.), *Russian organized crime; the new Threat?* London, Frank Cass, 1997
- Repetskaya, A.L., Regionalization and expansion; the growth of organized crime in East Siberia. In: E.C. Viano (ed.), *Global organized crime and international security*. Aldershot, Ashgate Publishing Company, 1999
- Riker, W., *The theory of political coalitions*. New Haven, Yale University Press, 1962
- Rose, R., *Getting Things Done in an Anti-Modern Society. Social Capital Networks in Russia*. Glasgow, University of Strathclyde, 1998
- Salmi, A., Russian networks in transition; implications for managers. *Industrial Marketing Management*, vol. 25, no. 1, 37-46, 1990
- Serio, J., Threats to the Foreign Business Community in Moscow. In: P. Williams (ed.), *Russian organized crime. the new threat?* London, Frank Cass, 1997
- Shelley, L.I., Privatisation and Crime: The Post-Soviet Experience. *Journal of Contemporary Criminal Justice*, vol. 11, no. 4. 244-256, 1995
- Shelley, L.I., Post-Soviet Organized Crime: A New Form of Authoritarianism. In: P. Williams (ed.), *Russian Organized Crime. The New Threat?* London, Frank Cass, 1997
- Shlapentokh, Vladimir, *The West as a Major Problem for Russia and its Future*. May 25, 1994, available at <http://washington.uwc.edu/courses/geo110/russia.htm> (visited September 11, 1998)
- Sjöstrand, S-E., The Socioeconomic institutions of organizing: origin, emergence, and reproduction. *The Journal of Socio-Economics*, vol. 22, no. 4, 323-352. 1993
- Sjöstrand, S-E., *The two faces of management: the Janus factor*. London, International Thompson Business Press, 1997
- Stacey, R., *Strategic Thinking and the Management of Chance. International Perspectives on Organizational Dynamics*. London, Kogan Page, 1993
- Stevenson, William B., J.L. Pearce and L.W. Porter, The Concept of "Coalition" in Organization Theory and Research. *Academy of Management Review*, vol. 10 no. 2, 256-268, 1985

- Sutela, P., Insider Privatisation in Russia: Speculations on Systemic Change. Bank of Finland, *Europe-Asia Studies*, vol. 46, no. 3, 417-435, 1994
- Sutela, P., *Russia's strange market economy is impeding reform*. Helsinki, Unitas, 1998
- Sölvell, Ö., I. Zander and M.E. Porter, *Advantage Sweden*. Stockholm, Norstedts, 1991
- Transparency International, *Corruption Perceptions Index*. Göttingen University and Transparency International 1999, online database available at <http://www.gwdg.de/~uwvw/1999Data.html> (visited October 5, 2002)
- Van Duynes, P. C., Medieval thinking and organized crime economy. In: E. Viano, J. Magallanes and L. Bridel (eds.), *International organized crime: myth, power and profit*. Cincinnati, Anderson Publishing, 2003
- Vilks, A. and D. Bergmanis, Global Organized Crime in Latvia and the Baltic's. In: E.C. Viano (ed.), *Global Organized Crime and International Security*. Aldershot, Ashgate Publishing Company, 1999
- Volkov, Vadim, Violent Entrepreneurship in Post-Communist Russia, *Europe-Asia Studies*, vol. 51, no. 5 (July), 741-754, 1999
- Voronin, Y. A., The emerging criminal state. Economic and political aspects of organized crime in Russia. In: P. Williams (ed.), *Russian organized crime; the new threat?* London, Frank Cass, 1997
- Young, S., Hamill, J., C. Wheeler and J.R. Davies, *International Market Entry and Development*. Hemel Hempstead, Harvester Wheatsheaf, 1989
- Ådahl, Martin and O. Anisimov, *Att lyckas i Ryssland. exempel från svenska framgångsföretag*. Stockholm, Ekerlids, 2000

Adventure capitalism and economic crime in the countries of transition: The case of the Czech Republic

*Miroslav Scheinost
Vladimir Baloun
Drahuse Kaderabkova¹*

Introduction

It is not easy give a short description of the development of such a complicated phenomenon as economic crime in a changing society and an economy in transition. That is why this chapter will limit itself to the presentation of some of the characteristic features – which will be described rather than analysed – of an economy in transition, and to the presentation of some selected items of information that have been generated by a research project on economic crime. This project was carried out by the Institute of Criminology and Social Prevention in Prague between 2000–2003 and was based on the statistical analysis of government databases; on the analysis of other available sources and studies; on the analysis of the development of relevant legislation, case studies, and court files, and finally, on interviews with judges, public prosecutors and police officers. Some of its interim results have already been published (see Scheinost *et al.* 2002/3/4). This chapter seeks to update the picture by reporting on the current incidence of economic crime (stressing, in particular, its likely true extent, over and beyond the crimes that are known to the authorities). In addition, it describes the characteristics of Czech financial markets as a means of illustrating the development and characteristic features of economic crime in general. Finally, it reports some findings from an analysis of the files of offenders focussing particularly on interesting differences between the results of such analysis and the results obtained from the interviews with the professionals.

Changes in the economic and legal landscape

In the Czech Republic, the economic crime of the 1990s was not only a burden for the Czech economy, but was, in a certain sense, also a reflection of the specific political and policy perspectives adopted by the authorities in relation to

¹ Miroslav Scheinost is Director of the Institute of Criminology and Social Prevention, Prague, Czech Republic. Vladimir Baloun and Drahuse Kaderabkova are senior researchers at the same institute.

the economy and to society. The authorities were keen to ensure that the social and especially economic transformation at the beginning of the decade took place as quickly as possible. They were therefore impatient and underestimated the need, when designing policies, to take into account all the relevant social and economic circumstances surrounding the transition.

Since the socialist assumption of power in 1948, the structure of ownership had been simplified due to the process of nationalisation, which for more than four decades thereafter formed the basis of the theory and practice of the planned economy. It was necessary not only to return this structure to its pre-nationalised form by a reverse transformation, but also to upgrade it so that, together with newly created economic interests, it would correspond to the principles of free-market economics.

In a very short time, ownership of the lion's share of what had formerly been state property, changed hands. This encompassed property owned by various types of co-operatives and a substantial amount of property administered by municipalities (chiefly communal undertakings). These property transfers were implemented either by various forms of *privatisation* – such as transformation of utilities into new types of business company and the public sale of specific companies – by the offer to citizens of the co-ownership of selected entities (*coupon privatisation*), or by *restitution*, where the state returned nationalised property to its original owners.

Transformation of the ownership structure inevitably impacted on other related phenomena, such as the dissolution of existing state corporations and organisations, the rapid and in some cases frantic formation of new private companies and other legal economic entities. Last but not least it stimulated the equally massive and rapid creation of a significant group of self-employed individuals.

Changes of this nature naturally led to high levels of labour and professional mobility. Parallel with this movement of labour forces there was also a change of personnel in existing state administrative institutions, including law enforcement authorities. It was also necessary to staff new institutions of the state administration. As in the economic sphere, new people were recruited who often had little or no practical experience with the specialist tasks they were required to perform. The emerging new business community (including many banks) required time to learn how to use the tools available in the developing liberal market. This, and the state's lack of specialist staff, which could have protected its economic interests, opened the way for widespread economic abuse of a criminal kind.

The liberalisation of economic life clearly had to be accompanied by changes in the legal environment, covering both economic and commercial law and the revision of penal law to protect changing economic interests. In the case of economic crime, penal law enforcement was forced to undergo a major change, with a shift of priorities from the protection of 'property in socialist ownership' to protection of the rights and legitimate interests of private economic entities.

It is well known that penal and other legislation bear all the marks of the conditions in which they were transformed at the beginning of the 1990s. Regulations were prepared hastily, new instruments lacked the test of legislative experience and last but not least specialist know-how was in short supply. In addition there was a lack of practical experience in enforcing these measures. Obviously, there were also different political approaches concerning the process of economic reform. These differences had to do with the principle of reform itself, its speed, and the strategy and specific measures for achieving it. In general, the prevailing opinion was that for the success of the process of transformation speed was more important than the systematic drafting of legal regulations. Though the historical distance separating us from the reform period is small, its highlights and contours allow us to assess the legislative reforms concerning the economic sphere, including the changes in the penal law that were designed to protect economic interests often in an *ex post*, rather than an *ex ante* fashion.

In the above-mentioned research we asked professionals employed by law enforcement authorities to express their opinions of both penal and non-penal items of legislation related to the commercial sphere. The majority of judges and public prosecutors we interviewed regarded the existing commercial legislation as imperfect. 58% of the judges and 66% of the public prosecutors expressed the view that it suffered from many shortcomings. 72% of the judges and 67% of the public prosecutors thought the correlation between the quality of such legislation and the occurrence of economic crime noteworthy. The respondents even thought that in some case, the poor quality of commercial legislation provided an encouragement to economic crime (Scheinost, *et al.*, ICSP 2004).

With regard to penal legislation, the Criminal Code was expanded by incorporating new economic and property crimes in response to transgressions that were previously unknown in the Czech Republic (or, rather, were unknown in the conditions of state ownership and planned economics) and which could not be prosecuted under existing legislation.

Between November 1989 and the end of 2003, the Criminal Code was amended forty-four times and underwent many substantial changes, the majority of which concerned the prosecution of economic crime. The new and partial amendments, however, solved only urgent problems. As a result of the frequent and diverse partial modifications and additions, the Criminal Code became 'congested' and could hardly be enforced consistently.

For domestic and foreign economic entities, the complicated and sometimes confusing legal situation is extremely burdensome, while also creating an actual incentive to commit economic crimes. As an example we may refer to the case of light fuel oils (which gave rise to tax frauds that took advantage of imperfect tax legislation and incoherent regulation of the designation of oil products).

It is true that over the past few years there has been a positive change both in the quality of legislation and in the activities of the regulatory bodies and law enforcement authorities. This change entails that certain dubious business activities from the 'founding period' cannot be repeated anymore. Cases from

this period concerned large privatisation investment funds – such as V. Kozeny’s Harvard Investment Funds, the Trend fund, or CS Funds – which took advantage of coupon privatisation to amass huge quantities of investors’ property and, through a range of different financial operations, to transfer this property out of the funds. Deliberate and serious economic criminal activity is gradually being brought to light and the culprits have been prosecuted, even if, particularly in major cases involving significant damage, the criminal proceedings have been extremely protracted.

Current incidence of economic crime

The essence of the threat and expansion of economic crime, as well as the difficulty of obtaining evidence of it, lies in the similarity of legal and criminal economic conduct in terms of the commercial instruments used in both cases. Schemes of criminal economic activity are, in terms of their instruments and courses of action, practically identical to schemes of legal economic activity. Of course, legal behaviour abides by the law, but due to this ‘commercial similarity’ it is sometimes very difficult to prove that the law has been broken. Both with regard to the drafting of laws, and with regard to their application, the boundary between licit and illicit activity in the economic sphere is often difficult to draw. Therefore, in speaking of recorded economic crime, we have to take account of the possibility that a significant portion of it is hidden as a result.

Therefore, we may only guess at the true extent of economic crime, over and above the crimes that are known to the authorities. In our research, the opinions of professionals employed by law enforcement authorities were sought by means of a questionnaire. The professionals were asked what portion of the economic crimes committed each year they thought remained undetected.

Table 1. Extent of undetected economic crime per year (% of respondents who estimate this proportion to be . . .)

Profession	up to 20%	up to 40%	up to 60%	up to 80%	over 80%	no answer	Σ
Judges (n=105)	1	5	13	18	5	58	100
Public prosecutors (n=82)	0	6	17	24	9	44	100
Police officers (n=32)	0	3	25	31	6	35	100

It is evident that a majority of respondents from all three professions considers the proportion of economic crime that goes undetected to be very high. Only 3 to 6% of respondents consider the proportion to be below 40%, while 23% of judges, 33% of public prosecutors and 37% of police officers believe it to be over 60%.

Of course, these are only estimations based on subjective feelings and personal experience, not exact and reliable data concerning real situation. Nevertheless, a majority of those questioned were specialists in dealing with perpetrators of economic crime. Therefore, judging from their responses, we might presume that the proportion of economic crimes that remains undetected each year is about 50%. We must be similarly wary of the figures for recorded economic crime bearing in mind that its real extent is likely to be greater. Figure 1 shows trends in economic crime in relation to total recorded crimes.

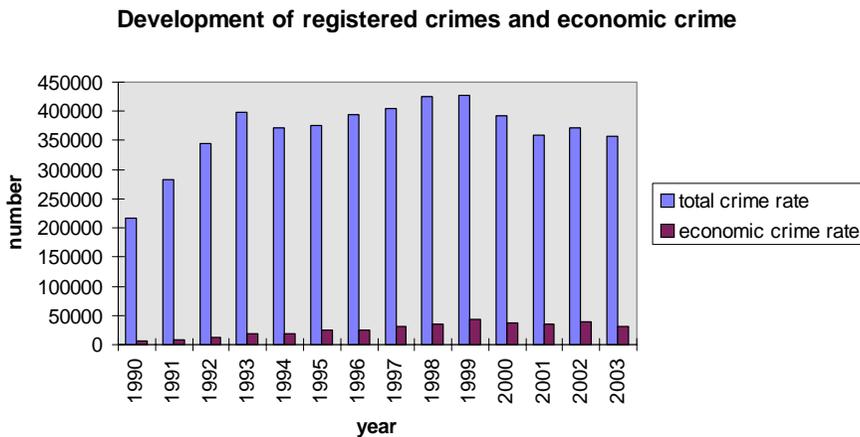
Table 2. Economic crime as a proportion of total recorded crime

1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
4	5	5	7	6	7	8	10	10	10	10

Source: Crime statistics in the CR. Police of the Czech Republic.

During the 1990s economic crime increased consistently as a proportion of total reported crime until in 1999 it represented one tenth. In 2002 recorded incidences of economic crime stood at 10.8%, the highest proportion yet registered. The following table illustrates the eleven-year development of this proportion.

Figure 1. Trends in the total of reported crimes and in economic crime



The *financial damage inflicted* is a function of the substance of the crimes rather than their number. In 2002, total financial damage caused by all kinds of crime amounted to the sizeable sum of CZK 43.3 billion (i.e. about €1.5 billion), of which economic crime was responsible for about CZK 29 billion (€1 billion), i.e. 67%, disproportionate to its relative frequency.

The financial market

Many of the problems, endemic in recent times, can be illustrated by what can be observed in financial markets. Since November 1989, financial markets in the Czech Republic (or Czechoslovakia) have developed extremely inconsistently. This can be explained by the fact that in Socialist Czechoslovakia (as in other countries of the former Soviet bloc) financial institutions were either liquidated completely or distorted for purposes of the 'planned' economy. One example is the capital market, while the role of banks was similarly distorted, with banking houses coming to be used more or less exclusively as clearing centres for national (later state) companies.

After 1989, therefore, on the one hand the distortion of this segment of the market economy had to be remedied, and on the other hand, rules essential for economic conduct had to be reconstructed, both in an organisational and legal sense. The conduct of entities on the financial market is, however, not only guided by formal but also by ethical norms. These are of equal importance and involve compliance with modes of behaviour which may not be formally sanctioned but which are essential for the operation of the financial sector and the economy in general. The absence of such unwritten norms or a failure to observe them, were and remain one of the key problems of the emerging business environment in the Czech Republic as elsewhere in the transition countries. To give one example of the many possible: whereas in the developed economies the payment of liabilities and compliance with contracts in general is taken for granted, and while an entity that acts otherwise finds itself almost spontaneously removed from the market without the intervention of law enforcement authorities, in the Czech Republic this social-economic mechanism does not work. Since the beginning of the transformation period, the problem of non-payment of liabilities has been so great that it has almost become the norm. This is the case both between business entities and between business entities and the state, and even between the state and state companies. This also led and still leads to a form of 'self defence' on the part of sellers, who require payment in cash – a practice that still persists in the Czech Republic, despite it being not only unusual in the established and developed economies but also highly regulated by anti-laundering provisions (it is viewed a priori as a way of legalising the proceeds of crime). When the Bill on the Limitation of Cash Payments was debated in the Chamber of Deputies, some opposition MPs argued that the strict limitation of payments in cash might mean the liquidation of businesses. Given what we have said, this argument was not entirely unreasonable. A specific feature of financial crime is that it affects areas where people work: money (including securities) represents a commodity that can be easily misappropriated without it being difficult to use it again anywhere on the market; most often it involves someone else's money (money invested or entrusted to the perpetrator by other persons) when, with a relatively small amount of capital of one's own, it is possible to control disproportionately larger

amounts of other people's capital (either in the form of deposits or capital holdings etc.).

This fact also explains the differences between perpetrators and victims of this form of economic crime: perpetrators are usually people who have decision-making powers in relation to the relevant financial matters (either as direct owners or as members of management), while the victims come from all social groups and backgrounds and suffer quite catastrophic economic damage as a result of this form of crime. It has been found, however, that to commit financial crime in the Czech Republic does not require any particularly expert knowledge and that the 'modus operandi' does not – unlike what is usually presumed to be the case with white-collar crime – need to be particularly sophisticated. The most well known perpetrators of financial crime thus far have by no means come only from the ranks of university graduates with an education in economics. They have also been apprentices, high school graduates and university graduates in disciplines other than economics. Likewise, the Czech experience shows that the victims of such criminal schemes, including relatively transparent financial crimes, are not only people with low levels of education, but also such highly educated people as economists and lawyers. The findings from the file analysis and from interviews with experts show that in some types of financial fraud these groups actually predominate, either due to their ability to deposit large sums of money or because they were intentionally targeted in advance by advertising campaigns.

Both of the aforementioned characteristics (namely, the prevalence of cash-based transactions and the possibility of gaining control of other people's money) led to the phenomenon that, in the Czech Republic, is referred to as *tunnelling* (asset stripping). This is a transaction whose purpose is to siphon off funds from a prosperous, legally functioning company with the aim of self-enrichment.

As is evident, a person or persons who exert control over the relevant company, whether this is proprietary or managerial, may only perpetrate tunnelling. (Scheinost c.s. 2002: 3).

The banking system

After 1989, and following approval of the measures that laid the foundations for social and economic reconstruction, the banking system was the first that required reform. It should be pointed out that the incidents that were later referred to as 'tunnelling' originated in the banking sector. It is estimated that cleaning up the banking sector cost the State CZK 170 billion (this might not be the final figure. As a comparison, state budget income for 2004 is expected to be around CZK 754 billion). From the start we should make it clear that these losses are not caused exclusively by criminal activity; the problem is deeper than that.

At the beginning of the transformation period, the five main state-owned banks were joined on the financial market by the first entirely private banks. By law these were subject to the licensing regulations of the Czechoslovak State Bank, although this had neither sufficient source documents from the banks nor sufficient experts to perform due diligence. The lack of experts was a problem experienced by banks generally: some criminal cases which later found their way into the media relied heavily on the understandable lack of knowledge of bank officials, although we can also assume that some small banks were deliberately established for fraudulent purposes.

At the same time, many new entrepreneurs were desperate to obtain funds, which, with few exceptions, were very scarce. The demand for bank loans was such that banks needed to increase their disposable capital and did so almost exclusively by attracting depositors through the offer of high rates of interest. In the first place this led to higher interest rates on loans granted. In the second place it meant that, due to their low capital coverage, the banks almost inevitably found themselves in difficulties with regard to harmonising the timing of payments of interest on deposits and the receipt of accrued interest on loans, or the need to reconcile the immediate repayment of deposits with expiration of the repayment terms of loans.² Banks had to develop their business activity, which in their case rests chiefly on the provision of loans; on the other hand they could not allow their major clients (still state enterprises) to go bankrupt without at the same time writing off their debts.

The pressing demand for loans led directly to a criminality: among other things it was generally known (although understandably unproven) that bank officials (so-called loan officers) requested ‘tithes’ for the allocation of loans (that is, 10% of the amount loaned); that business plans were not checked sufficiently thoroughly; that highly questionable guarantees (the precious stones case) or guarantees that were criminal in nature (the Barak Alon case) were accepted for loans.³ This led, in a short space of time, to a banking crash. The first bank had its licence withdrawn in 1993, and this was followed by a chain of crashes. The result was legislative reform (including several amendments to the Act on Banks and the setting up of a deposit insurance fund) on the one hand, and a shake up of the whole banking market (with particular reference to mergers and take-overs of bankrupt banks by other banks) on the other hand. Ultimately the whole banking sector was privatised with varying degrees of success (the IPB – Nomura case is an example)⁴ and the effects of this are still being felt today.

² At that time it was common to provide the vast majority of loans for a 4-year period (without distinction), which in itself is absurd and lacks economic logic.

³ Precious stones were accepted by several banks as loan guarantees, but the value of such stones was over-estimated by the authorised experts. The B. Alon case consisted in the acceptance of a worthless financial instrument by an important Czech bank as guarantee for manifold higher credit.

⁴ The problem with this transaction was that NOMURA did not join IPB as a strategic partner but evidently did so for illegitimate reasons.

At the same time, however, special forms of financial crime, which came to be referred to as *tunnelling*, emerged. This was the allocation of loans by a bank's owner(s) or its management either to companies in which they had a personal interest, or to companies acting in collusion with them. This was relatively common, particularly in the case of small banks.

Savings and Loans Associations

A tightening up of the rules governing the formation of banks, and fresh banking legislation in general, led to stricter rules for the provision of loans etc. At that time, banks were relatively uninterested in so-called retail banking. This may have been the reason for the parliamentary initiative to authorise the setting up of savings and loans associations (SLAs), which had a tradition dating back to the time of the Austro-Habsburg monarchy. The Act on SLAs was passed in 1995. It was, however, extremely imperfect, perhaps because its provisions were based purely on the experience of the monarchy and the first Czechoslovak Republic, and it made possible many activities that were potentially subject to abuse.

The development of SLAs essentially mirrored the development of the banking system – undergoing rapid initial expansion followed by the first problems and then a crisis of the entire system. We should add that unlike banks (whose problems were not exclusively due to criminal activities) some of the associations directly offered the opportunity for tunnelling. Their initial 'start-up' had the character of pyramid companies. The purpose of SLAs was to gather the liquid funds of its members and provide them with cheap and accessible credits and loans (to serve more or less as non-profit institutions for their members), but nobody saw anything strange in the fact that certain SLAs tried to recruit members (it is very important to remember that they were members and not just depositors) with promises of interest rates of 20 to 25% on their deposits (or more accurately their membership shares). Neither the new SLA Supervisory Office, nor the CNB (Czech National Bank, whose powers, it must be said, did not directly cover SLAs) nor the Ministry of Finance objected to the fact that many associations ran very aggressive campaigns (involving celebrities from the world of politics and show business). Nor did they object to the fact that associations pursued activities (involving exchange rate transactions, securities market transactions etc) which, although not prohibited by law, were nevertheless on the edge of legality. The result was the truly massive criminal tunnelling of many of the SLAs, which the Czech State both *de facto* and *de jure* acknowledged to have taken place when it offered compensation to the members of such associations.

Securities market (capital market)

Privatisation in the Czech Republic took place in two stages:⁵ the so-called *small* privatisation (which consisted of the direct sale of small business outlets or shops, or of long-term leases of premises suitable for small business outlets), and the so-called *large* privatisation (the privatisation of large, state enterprises, whether industrial or business companies). The latter took a number of forms – from sales to specific interested parties, to auctions (such transactions often being affected by the problems of the banking system due to the absolute lack of licit capital), although large privatisation was mainly accomplished by means of so-called *coupon* privatisation.

The coupon privatisation was based on the correct premise that the relevant companies had originally been national and subsequently state enterprises, which over the course of 40 years had been in so-called public ownership. This pseudo-ownership was to be replaced by real ownership and it was expected that, through the coupon scheme, citizens of the Czechoslovak Federal or Czech Republic (this phase occurred during the break-up of the joint Czecho-Slovak state) would ‘buy’ shares in selected companies, which would thereby be privatised (this was basically meant to be a fast-track route to share-ownership). It was obvious that this was rather a ‘de-nationalisation’ and only the first step towards real privatisation. In this first stage no one anticipated the massive input of privatisation investment funds in the process (this was meant to take place in the second stage, when the minor shareholders were meant to come together in the actual exercise of ownership rights). From the very beginning the public found it difficult to grasp this concept, until the appearance of the financier Viktor Kozeny and his so-called ‘guaranteed ten-fold valorisation’.⁶ His Harvardské privatizační investiční fondy (Harvard Privatisation Investment Funds) became market leaders and as a result were copied by other privatisation funds. Investment funds themselves were in some cases established by banks. As a result, an extremely non-transparent environment developed including, in many cases, so-called cross ownership. Cross-ownership means that banks (or their management) own themselves via their investment companies.⁷ Alternatively banks owned companies and at the same time provided these companies with credits.

⁵ This excludes restitution, which is also a method of privatisation consisting in the return of state property to its original private owners.

⁶ Mr. Kozeny promised coupon investors that he would obtain ten times more money than the original administrative fee they had to pay for the possibility of taking part in the coupon privatisation. The fee was CZK 1,000. In other words, they were promised the sum of CZK 10,000, if they invested their ‘coupons’ in the Harvard funds. The promise itself was formulated ambiguously, but it motivated many people to take part in the coupon privatisation process.

⁷ This was the case of IPB, which was in this way privatised by its management.

This stage resulted not only in extremely murky activities on the capital market but also in the relatively high-profile international failure of the new Prague Stock Exchange, which had ambitions to become the most important stock exchange in Central and Eastern Europe. Real investors still generally avoid the Prague Stock Exchange – the Czech equity market depends on a limited number of securities, or companies, and the stock exchange is only used for speculation and is most definitely is not a source of capital for companies. These choose rather to obtain funds through bank loans, and such preference has to a certain degree become a typical characteristic of the Czech Republic.

A further possibility for illegal activities at the expense of small shareholders arose shortly before passage of the amendment to the Act on Investment Funds and Investment Companies, which understandably imposed stricter conditions on their operations. Unfortunately, before the amendment came into force, many investment companies managed to transform themselves into holding companies, not covered by the amendment. The result was a mass of legal disputes, for example: the protracted dispute between shareholders in Harvardský průmyslový holding (HPH) and the holding's own management; the dispute between the annual general meeting held by one section of shareholders against the annual general meeting held by a second section; a prohibition issued by the Ministry of Finance on the payment of stock interest; a protest by another section of shareholders; an international arrest warrant for Viktor Kozeny and some others of the holding's statutory representatives. When this dispute will end it is impossible to say.

There was also the notorious case of the CCS funds, where more than CZK 1 billion were removed from the Czech Republic at the expense of fund holders, and the case of the funds owned by the former tennis player Šrejber, who was even put on trial and convicted, although the conviction was overturned on appeal. Such were the consequences of this stage and the most famous cases, which attracted much media interest at the time. In addition there were also many smaller investment companies, which followed the same *modus operandi*.

Cases such as these, although often still unresolved legally, now belong to the past in terms of their *modus operandi*. Since then, we have witnessed the appearance of criminal activities (which will certainly continue into the future) more familiar in the old established market economies and which can be regarded as 'classic' crimes, such as insider trading. For the reasons mentioned above, the Czech capital market plays essentially only a minor role (acting as a place for people to deposit their savings in order to earn interest on them, not as a place where firms can raise capital). Therefore we do not anticipate, in the Czech Republic in the near future, crimes of the type that involve manipulations of share values (cf. the well-known example of Enron, the Californian energy company). Financial crime in the Czech Republic was so idiosyncratic and essentially unrepeatable that it did not occur on such a scale in other post-Socialist countries. As a matter of fact the perpetrators of many of these crimes were not even charged, let alone brought to trial, and in

comparison with the extent of the damage inflicted, the number of persons that has actually been convicted is negligible.

Criminals, their targets and behaviour

In 2002, the numbers of persons convicted of economic crimes included only 45 re-offenders, or 3.1%, whereas the proportion of re-offenders among persons convicted of property crimes was 18.8%, and 16% for the total offender population. In 2002, the largest group of persons convicted of economic crimes (501) came from the 30-39 age group, which is 53 more than the previous year. Unconditional sentences were imposed on 110 people, and conditional sentences on 1,007 people. Other sentences included three prohibitions on persons convicted of economic crimes from operating in specific areas of activity. 186 people received fines; 48 people were ordered to perform community service; 67 received another sentence, and a further 67 had their sentences waived.

Table 3. Numbers of prosecuted, charged and convicted persons in 2002

	persons prosecuted	persons charged	persons convicted
Economic crime	3542	2805	1452
Property crime	46691	40579	29991
Total crime	93378	77210	65098

Source: Crime statistics yearbook 2003. Ministry of Justice of the Czech Republic.

We may add to this statistical overview some of the results of our own research. In this research project a sample of 115 cases of economic crime that were brought to justice (at the level of regional and district courts) in 2000 and 2001, was analysed. With regard to the victims, analysis of the sample showed that in 29 cases a financial institution had suffered damage; in 23 cases the victims were self-employed persons; in 39 cases economic entities (companies, joint-stock companies etc.) outside the financial sphere were prejudiced financially; in 29 cases the state had suffered damage (through the non-payment of tax and other levies etc.), and in 5 cases the victims were other institutions from the non-financial sector.

These figures indicate that economic crime is spread relatively equally over all four main economic sectors – self-employed persons, institutions in the financial sector, companies outside the financial sector and the State. The data do not allow us to determine whether, in terms of the extent of damage inflicted, any one of these sectors suffered significantly more or less than the others.

In seven cases institutions were damaged by attacks from inside. In two cases the offenders were employees; in four cases members of the institutions' management, and in one case a co-owner. Thus, attacks on institutions by 'insiders' were not very frequent, but happened nonetheless and were mostly

carried out by people in senior positions. In three cases, an attack on the same institution caused damage exceeding CZK 5 million.

Table 4. Damage caused in relation to the damaged entity

Damaged entity	under CZK 100,000	over CZK 100,000	up to CZK 1 million	up to CZK 5 million	over CZK 5 million
Bank	0	0	0	3	9
Insurance company	0	2	1	6	0
Savings and loans association	0	0	0	0	1
Savings bank	0	0	0	2	1
Other fin. institution	0	0	0	2	2
Company, firm	2	2	4	22	9
State	3	3	0	14	7
Other entity	0	0	1	2	1
Natural person	1	2	1	12	7
Total	6	9	7	63	37

The table demonstrates that damage most frequently ranged from CZK 1 to 5 million. It is clear that damage caused by economic crime is significant and extends to many millions. In 82% of the cases investigated, damage exceeded CZK 1 million. Although these high levels of damage are chiefly characteristic of banks, savings companies and other financial institutions (which did not suffer lower levels of damage in the cases examined), they dominate among all types of damaged entity.

In the cases analysed, 155 offenders were charged and 148 convicted, of which 90% were men and 92% citizens of the Czech Republic (apart from 6 citizens from Slovakia, the numbers of foreigners are minimal). Twenty-four of the above cases (i.e. 20%) involved more than one offender, although no charges were brought against an organised group or criminal association. Only a small number of cases (i.e. 35, or less than one third) concerned a one-off criminal offence (the other cases concerned continuing criminal activity). Only in a very small number of cases (12%) was the crime committed spontaneously; the vast majority (80, or 70%) of crimes were committed intentionally and were planned in advance (the remainder were committed under the pressure of a specific situation, i.e. the perpetrator had debts – 10% – or the available information did not allow for the crime’s classification).

Law enforcement practice thus demonstrates that the perpetrators of economic crimes are generally prosecuted as individuals. The cases analysed did not include prosecutions involving organised crime, although the findings display a large degree of deliberate and planned criminal activity on the part of a number of cooperating perpetrators. The UN or the EU definition of organised

crime would certainly have been applicable. The number of foreigners involved would also indicate that economic crime is almost exclusively the domain of Czech criminals.

These findings tend to contradict the opinions of the law enforcement professionals, as revealed in our questionnaires. Such professionals should, however, be regarded as competent as all police officers who responded to the questionnaire stated, with one exception, that they specialised in economic crime, while 93% of the public prosecutors we questioned, and 45% of the judges, were also specialists in this area.

Respondents were asked to estimate the proportion of economic crimes that involve organised groups (lower level of organisation), and also to describe their own experience with cases of economic crime that could be characterised as involving criminal conspiracy (that is, as involving higher forms of criminal organisation as defined by the Section 89 (17) of the Czech Criminal Code). Tables 5 and 6 show their responses.

Table 5. Estimated proportions of economic crimes that involve organised groups (% of respondents)

Profession	Up to 20%	Up to 40%	Up to 60%	Up to 80%	Over 80%	No answer	Total
Judges (n=105)	9%	10%	13%	1%	0	67%	100%
Public prosecutors (n=82)	13%	13%	7%	4%	0	53%	100%
Police officers (n=32)	9%	22%	12%	19%	0	38%	100%

Table 6. Personal experience with cases of economic crime that could be characterised as criminal conspiracy (% of respondents)

Profession	Yes, more than once	Yes, once	No	Don't know	Total
Judges (n=105)	13%	9%	77%	1%	100%
Public prosecutors (n=82)	23%	17%	59%	1%	100%
Police officers (n=32)	61%	10%	23%	6%	100%

The views of organised economic crime of law-enforcement professionals differ substantially from what in practice emerges from the documented proceedings of criminal trials. Representatives of all three professions believe that organised groups (as defined by the Criminal Code, which describes the organised group as a lower level of organisation) play a quite significant role; while a large number of them even state that they have dealt with cases which could be described as instances of criminal conspiracy.

This difference must of course again be evaluated critically. It is true very few cases in general have been prosecuted under the Section 89 (17) of the Czech Criminal Code. The number of cases prosecuted under this section has gradually increased over the last three years and there now exist some instances of

economic crime that have been prosecuted as criminal conspiracies. As this provision was introduced into the Czech Criminal Code in 1995, it took some time to learn how to apply it. It was (and still is) not easy to prove all the constituent elements stipulated by the legal definition of criminal conspiracy. It seems that for law enforcement authorities is less complicated to prosecute and sentence perpetrators as individuals than to try to prove the organised character of their activity.

We may conclude that the legal instruments allowing the prosecution of cases under the organised crime clause are available, but that their application lags behind, especially with regard to economic crime. One of the reasons could be the conviction or experience of law enforcement authorities that to prove the existence of organisation in economic crime cases is so complicated that the prosecution and punishment of offenders as individuals is sufficient. A second reason could lie in the character of economic crime itself. Perpetrators usually misuse existing formal structures and often do not need to create special criminal structures with a division of tasks, roles and so forth.

On the other hand, we must also take into account the possibility that respondents have overstated the involvement of organised structures in economic crime. They may incorrectly generalise their specific personal experience or feelings (opinions, even those of experts, are still a fragile kind of data). Nevertheless, our analysis of court proceedings showed that in the majority of cases, offenders were prosecuted as individuals, even in cases in which several offenders acting in concert were involved. Therefore, it is probably not possible to make a reliable estimate of the involvement of organised groups in economic crime, though it seems that organised criminal activity in the economic field might not be as rare as is suggested by the statistics concerning the prosecution and sentencing of perpetrators of economic crime.

Information obtained from respondents also suggests that involvement on the part of non-Czech nationals is more frequent than suggested by analysis of the criminal records available. Respondents were asked whether over the last five years they had dealt with a case of economic crime in which a foreign national had been involved; and they were also asked for their opinion on the proportion of economic crime that extended beyond the borders of the Czech Republic. Tables 7 and 8 provide the findings.

Table 7. Cases involving foreign nationals during last five years (% of respondents)

Profession	Yes, more than once	Yes, once	No	No answer	Total
Judges (n=105)	38%	15%	46%	1%	100%
Public prosecutors (n=82)	61%	15%	22%	2%	100%
Police officers (n=32)	63%	9%	25%	3%	100%

Respondents are clearly of the opinion that economic crime is not exclusively the domain of domestic criminals, as might appear to be the case from the documents we analysed. More than half of those questioned from all professions have handled at least one case in the last five years in which a foreign national has been involved. This is remarkable in light of the figures for sentenced offenders that emerge from the case analysis. A partial explanation might lie in the possibility that foreigners that have anything to do with such cases are often not sentenced – perhaps because they are frequently not identified or captured by the police, manage to leave Czech territory and so forth.

Table 8. Estimated proportions of criminal activity where offenders' activities cross the borders of the Czech Republic (% of respondents)

Profession	Up to 20%	Up to 40%	Up to 60%	Up to 80%	Over 80%	No answer	Total
Judges (n=105)	11%	9%	4%	0	0	76%	100%
Public prosecutors (n=82)	9%	16%	4%	2%	0	69%	100%
Police officers (n=32)	9%	34%	16%	3%	0	38%	100%

Table 7 shows that the proportion of respondents, particularly judges and public prosecutors, who failed to answer the question on which its figures are based, was very high. Based on the opinions of the rest, we may presume that a certain portion of economic crime is committed on an international or cross-border scale. This is not a dramatic revelation: it merely illustrates that in the Czech Republic too economic crime has begun to be organised across international borders.

Conclusions

There is no need to emphasise again the dangers that economic crime represents: its modus operandi is hard to distinguish from ordinary economic activities, a feature that makes it very difficult to identify and successfully to prosecute. More than other types of crime, economic crime also typically blurs the boundaries between conduct that is legal but unethical, conduct that exploits opportunities at the boundaries of what is legal, and conduct that is unambiguously illegal.

One of the most important developments since 1989 has been the removal of the distinction between different types of ownership, something that did away with the need for any special legal protection for social ownership. On the other hand, too few regulations and penalties have been introduced to prevent abuse of the transfer of social property into private hands and to regulate effectively the fundamental transformation from a planned to a market economy.

The sudden freedom to do business without proper determination of the boundaries of economic competition; the real and sometimes hasty support for certain 'enterprising' individuals at the beginning of the 1990s: all these factors created the conditions for unlawful financial machinations and various new forms of economic crime (so-called tunnelling, property and tax fraud).

It is also important to bear in mind that the penal law does not have the means to eliminate or substantially reduce the impact of the factors that give rise to economic crime in the first place. In this respect it has only a residual role. This means that penal repression is only applied under extreme circumstances, where other instruments, chiefly of an economic nature, are inadequate.

Fully functioning market economies have adequate self-regulating mechanisms, but these are absent in the Czech Republic. This results in the need to 'manage' the economy by legislation and where possible to define exactly forms of criminal activity in this field. In reality, however, this approach can be counterproductive if it produces too much complexity, something that is confirmed by constant criticisms of the apparent inadequacy of Czech legislation. Indeed, one may suggest that the more detailed the attempts to define different types of economic crime, the easier it becomes to find ways to get round the letter of the law.

Definitive answers to this problem have to be found outside the sphere of legal instruments. Of crucial importance is the quality of the environment in which commercial competition take place. This should include the relevant regulation of the legal relations associated with business and economic activity in general, and should include rules that make it possible to respond to breaches of the law as quickly as possible. Factors such as adequate control mechanisms and the quality of the state apparatus also have a crucial role to play. The existence of effective non-punitive sanctions for breaches of legal and ethical norms and an emphasis on their enforcement would thus play a key role in preventing economic crime.

An analysis of the available material allowed certain more general observations concerning economic crime, showing, in particular, that there are a number of phenomena that either assist the perpetrators of economic crime, or accentuate the negative impacts of this form of crime.

The widespread incidence of economic crime that goes unreported is evidently accompanied by some degree of criminal organisation and by international involvement, although it is also true that economic crime is generally quite primitive in nature and relies on rather simple patterns of behaviour for its execution. Our study has also revealed that economic offences involving organised crime are rarely prosecuted or proven, and that damages of many millions are as likely to be inflicted by simple fraud as they are by more organised approaches. In addition, economic crime damages not only the entities that are directly targeted by criminals, but it also indirectly affects a wide range of other entities (employees whose insurance has not been paid, investors who lose deposits or shares, clients of banks that have suffered damage etc.).

Recent years have seen an increase in the numbers of people prosecuted for most forms of economic crime, suggesting greater effectiveness both in the prosecution of such crimes and in the work of law-enforcement authorities. It is, however, true that the number of criminals convicted of economic crime as a proportion of people prosecuted is still much lower than for property crime, or compared to the numbers of people prosecuted and convicted in general. For example, even though comparison within a single year is potentially misleading and can only be illustrative, we may note that in 2002 the conviction rate for persons prosecuted for economic crime amounted to 40%; for property crime the figure was 64% and for the total number of persons prosecuted 70%. This only confirms the complexity and the difficulties that attend criminal proceedings in cases of economic crime.

As far as the perpetrators of economic crime are concerned, our research has confirmed that they are intelligent, and that they tend to have above-average levels of education; but our research also shows that economic crime, at least as far as the Czech Republic is concerned, is by no means restricted to such people. A significant proportion of offenders obtained their knowledge not through formal qualifications but through their own business experience. It is also evident that even people with low educational levels are able to cause great damage. Alarming is the fact that approximately one-fifth of criminals re-offend, which suggests that even persons who have been convicted can regain access to the field of commerce relatively easily. It would seem that until recently in the Czech Republic the relative success of this type of crime had been facilitated less by high qualifications and creative ability on the part of criminals than by credibility and inexperience on the part of its victims. The general 'simplicity' of the criminals is attested to by the fact that in the majority of cases they have used the proceeds of their criminal activities to finance their own personal expenditure – rather investing the proceeds with a view to expanding their current activities, or creating new legal economic activities.

In the future it will be interesting to monitor the extent to which economic crime is affected by the new forms of criminal behaviour that are anticipated following accession to the European Union.

References

- Baloun, V., *Kriminalistika*, vol. 4, 2002
- Berka, J. and L. Nedorost, *Insurance fraud*. Právní rádce, 26.6.2002
- Berka, J. and V. Větrovec, *Credit fraud*. Právní rádce, 26.6.2002
- Council of Europe, *Recommendation No. R(81) 12 on economic crime*. Council of Europe, Strasbourg, 1981
- Dvořák V. et al., Economic crime. In: *Operational investigation of the criminal police*. Police Academy of the CR, Prague, 1995
- Eysenck, H. J. and G.H. Gudjonsson, *The causes and cures of criminality*. New York, 1989
- Kadeřábková, D., *Economic crime and its manifestations*. ICSP, Prague, 1999
- Kadeřábková, D., The occurrence of economic criminal activities and the description of differences of external factors before and after 1990. In: *Probable development of selected forms of crime*. ICSP, Prague, 2001
- Kadeřábková, D., *Quantitative. structural and regional occurrence of economic crime*. Internal material of ICSP, Prague, 2001
- Koukal, P., Bank and criminal proceedings. *Právní praxe*, vol. 2, 1996
- Nečada, V., A Review of the development of the criminal legislation on economic crime in the CR after 1989. Part 1-3. *Trestní právo*, vol. 1, no. 3, 2003
- Němec, M., *Organised crime*, Prague, 1995
- Příb, J., *Do we have an entrepreneurial milieu of a high quality in the CR? Summary of the basic results from the survey*. Economic Chamber of the CR, Prague, 2002, available at www.komora.cz
- Raban, P., Toward the last huge amendment of the Commercial Law. *Právník* vol. 6, 2001
- Scheinost, M. and V. Baloun, Economy and Crime in the Society in Transition - the Czech Republic Case. In: P.C. van Duyne, K. von Lampe, N. Passas (eds.). *Upperworld and Underworld in Cross-Border Crime*. Wolf Legal Publishers, Nijmegen, 2002
- Scheinost, M. and V. Baloun, Financial crime in the Czech Republic: its features and international extension. In: P.C. van Duyne, K. von Lampe, J.L. Newell (eds.), *Criminal finances and Organising crime in Europe*. Wolf Legal Publishers, Nijmegen, 2003
- Scheinost, M., Financial crime in the Czech Republic. Some preliminary findings based on case analysis. In: P.C. van Duyne, M. Jager, K. von Lampe, J.L. Newell (eds.), *Threats and Phantoms of Organised Crime, Corruption and Terrorism*. Wolf Legal Publishers, Nijmegen, 2004
- Scheinost, M. et al., *Research on Economic Crime*. ICSP, Prague, 2004
- Various authors, *Criminality in the frame of the Czech capital market*. Institute of the Czech Ministry of Justice for education of judges and state prosecutors, Prague, 1997

Criminal sub-contracting in the Netherlands: The Dutch ‘koppelbaas’ as crime-entrepreneur

Petrus C. van Duyne

Mark J. Houtzager¹

New concerns about an old phenomenon

The recent expansion of the European Union has given rise to a very sensitive controversy: the free movement of labour. Many ‘old’ member states have expressed their concerns that influxes of cheap labour from Poland, Hungary and other new member states will increase pressures on the employment situation. This concern may be justified, but it ignores the existence of a traditional underground, ‘black’ labour market in the European Union (Esope Project, 2004).

The black labour market is a common phenomenon in all industrialised countries in which labour relations are extensively regulated. Such regulation usually takes place for social security and labour safety reasons. As social insurance contributions are paid by employers as well as employees, both have an economic incentive to evade these expenses. This evasion is a broadly ingrained phenomenon, ranging from households hiring a ‘black’ cleaning lady to construction firms using fraudulent subcontractors to reduce their costs and maintain competitive advantage, excusing such behaviour by means of the familiar references to ‘cut-throat competition’. Mateman and Renooy (2001) provide a sketch of the black (undeclared) labour situation in seven EU-member states. Though estimates of the financial impact of the problem are inevitably subject to much uncertainty, the fact that such estimates typically fall within the range of 3 to 15% of Europe’s GDP suggests that the impact of the problem is large. Given increased mobility Europe-wide after 1989 (Höhnekopp, 1997), it is unlikely that this impact will decline.

The diversity of labour-related tax evasion indicates that the black labour market is a many-faceted economic and social phenomenon. This does not imply that it is a disorderly or disorganised market. As a matter of fact, whether it concerns the undeclared cleaning lady fostering her network,² or illegal aliens being hired by a subcontractor, organising reliable labour has the appearance of an orderly process. Some manifestations may even be qualified as ‘organised

¹ Petrus C. van Duyne and Mark J. Houtzager are respectively Professor of Empirical Penal Science and doctoral student at the University of Tilburg, the Netherlands.

² It is interesting to observe the narrow price ranges in this domestic market, and the ‘invisible’ way in which yearly increases in hourly pay are adopted regionally within a few weeks.

crime', if we abstract from the controversy around this ill-defined concept (Van Duyne *et al.*, 2002; Van Duyne, 1996).

Despite this ubiquitous phenomenon affecting so many people and enterprises, little is known about its structure and organisation. There are sectors, like the construction industry, agriculture and catering, where the phenomenon has traditionally been concentrated, but they are too diverse to allow cross-sector generalisations. Moreover, apart from the involvement of the construction industry, which rates high in every country, the importance and order of the industrial sectors may vary. From the perspective of market organisation the rate of concentration of required labour is important. Moonlighting in the catering business may be as widespread as in agriculture, but only a few workers are engaged per enterprise. Recruitment usually occurs on the basis of networks of friends and acquaintances. During harvest time farmers need to recruit larger crews, for which they may need middlemen. This requires more market organisation than recruiting a Saturday-evening bar tender for a pub. Such market organisation is not only directed at connecting labour and employer, but also at fending off the law – a function that is an inherent component of any crime-market (Van Duyne *et al.*, 2002). The nature of the connections between this entrepreneurial 'underworld' and the 'licit' upperworld is only roughly known. Apart from frequent revelations in the press, case descriptions, like the 'building mafia' in Germany, are less empirical analyses than they are public warnings and expressions of indignation on the part of the law enforcement authorities.³ There are fraudulent (sub)contractors, while the phenomenon of empty front firms, behind which such (sub)contractors hide, is well known internationally (See, 1992). Nevertheless, these general notions are no substitute for more detailed insight into questions like: 'How do they operate in the various business sectors?' and, 'How do they interact with the labour laws and the bodies of law enforcement?'

In order to answer such questions empirically, researchers at the University of Tilburg undertook a project to collect and analyse data, which were gathered by the competent law enforcement agencies. The findings should be viewed against the backgrounds of this dynamic underground 'human capital' market. Therefore we describe these backgrounds and some of their Dutch history first.

Backgrounds of an unruly commodity

The reasons for the existence of the black labour market are, as mentioned above, obvious and unvarying across time and place. The costs of labour account for the lion's share of the costs of many production processes. Labour costs do

³ The indignation does not appear to be shared by unions, labourers or citizens (Mateman and Renooy, 2001).

not just consist of the net earnings of employees (their market value), but also of the accumulated costs of the welfare state. Employer and employee share these 'social' costs through the direct contributions paid by employers to the tax authorities and social insurance agencies.⁴ This simple financial picture makes it clear that we have at least two 'obvious suspects': the employer and employee, both engaged in a perfectly consensual, 'victimless' crime. They may not be the only beneficiaries, as together they may provide cheap services to other market players in need of fulfilling, in complex or swiftly changing market situations, contractual obligations requiring the ad hoc deployment of much labour. Examples are business sectors like agri- and horticulture, the building industry, the garment and catering industry. Builders have to meet contractual deadlines; farmers need to harvest crops during unpredictable good weather spells; innkeepers may expect sudden rushes of tourists. To meet these entrepreneurial demands many are frequently willing to hire moonlighters, either on a personal basis or from subcontractors.

Meeting this demand there is a regular supply of workmen/women of a very heterogeneous composition, ranging from highly skilled operators and craftsmen to unskilled labourers in agriculture or the cleaning business. Skilled labour may be a scarce 'commodity' during economic booms. For example, skilled bricklayers were scarce in West Germany during the 1990s, which induced Dutch craftsmen to seek employment with Dutch criminal subcontracting firms, which then lent the craftsmen to German builders (Van Duyne *et al.*, 1990; Van Duyne, 1995). Among unskilled labourers we often find very high degrees of mobility, with workers moving to seek their fortunes or to flee from unemployment in poor regions, often in countries outside the European Union (Hönekopp, 1997). Some of them enter the EU legally on tourist visas and find temporary (illegal) jobs for the period specified by their residence permits. Other foreigners are asylum seekers (genuine or otherwise) whose applications have been rejected. Very few return to the countries from which they flee, instead remaining to eke out a living in the 'grey' economy, often in the illegal labour market. With the message about stricter asylum rules in the Netherlands having spread to the countries of origin of asylum seekers (or economic refugees), many may have decided to try their luck with tourist visas. To this segment of the underground labour market we should add the numerous resident workers, who are officially unemployed and receive social security benefits, but who 'moonlight' illegally. Finally, there are workers whose employment is partly undeclared: 'licit' workers who receive substantial parts of their payment (such as

⁴ Such contributions are related to wage levels and to occupations. For example, as the chances of suffering disability are higher in construction than in the catering industry, construction employers have to pay larger insurance contributions. It was for this reason that a motel chain in the Netherlands had its bricklayers fraudulently registered as cooks.

overtime) ‘in cash’.⁵ Some workers prefer to remain unregistered altogether.

It is clear that the supply side of mobile, illegal labour is very complex and difficult to determine. Based on various studies, the numbers of illegal workers in the Netherlands in the last five years have been plausibly estimated as 60,000 in 1999 and 78,000 in 2004 (Zuidam and Grijpstra, 2004).

To connect demand and supply a host of employment agencies offer their services. The legally operating temporary (‘temp’) employment agencies, about 2,500, deal with approximately 650,000 persons. These registered agencies do not provide regular employment for illegal job seekers. This service is provided by the approximately 5,000 unregistered ‘temp’ offices, which apparently provide an unknown number of employers with about 80,000 illegal workers. In addition to these illicit enterprises, an unknown number of registered temp offices systematically dodge their social security obligations. Apart from the firms that engage workers ‘unintentionally’, because the latter submit false identity documents or otherwise incidentally avoid their obligations, some systematically devise complex constructions designed to mislead tax inspectors and social security agencies. Though carefully disguised as legitimate firms, they actually operate as ‘crime-enterprises’.

As remarked above, the Dutch situation is merely an example in a continuous European-wide flow of cross-border labour supply and demand. The flow of this commodity perpetuates itself, despite the efforts of the agencies of law enforcement. Strictly regulated (or rather enforced) economies, like those in North-western Europe, face illegal labour markets that are similar to those faced by countries, like Italy, that are more tolerant of the informal economy. The local or temporary employment situation may add different shades and colours, but it does not change the phenomenon itself. On the one hand, unemployment will increase the number of available (illegal) ‘fortune seekers’ (regional as well as international). On the other hand, full employment may be accompanied by a scarcity of labour, which will encourage workers and employers to meet obligations ‘in cash’. It may also stimulate illegal subcontractors who succeed in organising this labour supply more efficiently. The labour commodity remains difficult to control in virtually any regulatory regime as will be illustrated in the following sections.

Criminal subcontractors in Dutch history

The history of the phenomenon of illegal subcontracting in the Netherlands covers about 35 years: from about 1970 until the present. During that period the phenomenon waxed and waned, to re-emerge again at the turn of the century.

⁵ In the Netherlands and Germany (fiscally) unrecorded work is called ‘black’: ‘zwartarbeid’ and ‘Schwarzarbeit’, respectively.

It never really disappeared, even if the authorities seemed to have succeeded in subduing it for much of the time.

The terms 'subcontracting' and 'subcontractor' are misleading substitutions for what in Dutch is called '*koppelbaas*'. As a matter of fact, there is no real subcontracting: all a *koppelbaas* does is to match or couple ('*koppelen*') the demand for temporary labour to a crew of workers he is able to deliver. So he is actually a 'matching' or 'coupling-boss'. What about that 'subcontracting'?

During the 1960s *koppelbazen* (plural of *koppelbaas*) played a significant role in the quickly expanding economy in the Netherlands. This expansion exceeded the available labour supply, which was only partly met by an influx of migrant labourers from Turkey and Morocco: the 'guest labourers' ('*gastarbeiders*'). The guest labourers proved to be anything but guests, because they did not leave, as guests do. However, providing only unskilled labour, they could not meet the demand, which was continuous in the construction industry, for people to carry out more skilled tasks. Skilled tilers and bricklayers, among others, were in especially short supply in Germany, where the building industry was booming. As the German construction firms valued the Dutch tilers and bricklayers, there was a strong economic incentive for these workers to move to Germany, joining the massive illegal labour force flowing into that country (See, 1992). This supply was legitimate as well as illegal. The latter manifested itself in various ways, from efforts of individual workers to defraud the Social Security Service and the Industrial Insurance Board, to the organised forms of labour supply arranged by the Dutch *koppelbazen*. The latter were especially active in the eastern Dutch provinces of Limburg and Gelderland (Meurs and de la Combé, 1993; Reijntjes, 1988; Van Duyne, 1983).

Meanwhile, by the later 1960s, the *koppelbaas* phenomenon had spread, for example, to the harbour in Rotterdam, where it created labour unrest, because of wage differences. The labourers hired by these entrepreneurs got higher wages than employees on regular payrolls, and this led to a strike. In order to stem such unrest and the spread of small labour intermediaries, who often dodged their fiscal obligations and subsequently went bankrupt, in 1970 a new regime of licences was introduced through the 'Labour Availability Act' (TBA).⁶ The TBA was effective in the sense that the *koppelbazen* did not get licences. However, its success was undermined by the response of the *koppelbazen*, who started to operate under the guise of *subcontractors*. Instead of issuing an invoice for the number of working hours, they drafted invoices for *contract work*: a fictitious amount of work replaced the total of working hours. Already working on (or partly over) the edge of legality, the *koppelbaas* became an illegal (labour) 'subcontractor', though he did not mention any labour in his contracts or invoices. This implied that he did not pay his social contributions. If possible, he also evaded paying VAT.

⁶ Wet Terbeschikkingstelling Arbeidskrachten.

Within the social-fiscal system, the first signs of a potential scam are bound to come to light because of the VAT balance. Entrepreneurs (e.g. the main contractor) who pay VAT to another entrepreneur (subcontractor) are entitled to reclaim it. This means that the tax office know the names of firms receiving VAT. The latter are obliged to hand the money over when they settle their VAT obligations. However, the fraudulent subcontractor has no intention of settling anything with the authorities. While receiving various summons to submit his tax forms, he is already in the process of setting up new (limited liability) corporations to take over the business of the firm that is about to be 'besieged' by the usual debtors: the tax office and the Insurance Board, which has not received its share either. These institute bankruptcy proceedings and, entering the premises, they find them deserted or else, if the firm is still operating, they find the proverbial drunk straw man, who only knows that a man called 'John' had him sign blank invoices.

This is the basic pattern of fraud which emerged in the 1970s and which is the trusted method of VAT, excise or long-firm fraudsters alike (Levi, 1981). The basic requirement is the ability to juggle 'front firms', which are destined to go bankrupt, and to staff them with ignorant straw men. For this reason, these entrepreneurs have been nicknamed 'front firm jugglers' (Van Duyne, 1997). Various factors contributed to the success of the *koppelbazen*. In the first place, there was much tacit complicity among building contractors. As long as their obligations to the principal were met by whoever subcontracted the work cheaply and delivered it properly, they benefited handsomely. 'Black' labour was the responsibility of the 'subcontractor', who submitted 'real' invoices, including VAT. In the second place, at that time, the authorities did not show much alertness either. Fraud in general and fraud against the public fund in particular was and still is (internationally) an undervalued problem (Levi, 1995; Ludwig, 1992, Savelsberg, 1987). As far as fiscal and social security fraud was concerned, it took years before the responsible ministries (Finance and Social Affairs) reluctantly admitted that there was a problem at all (Van Duyne, 1983). That admission was not followed by an active law enforcement policy, but by verbal proclamations of concern and the announcement of 'stern measures'. Six years passed before legislation to stem the *koppelbaas* problem was forthcoming (1982). A factor that almost paralysed the will of policy makers was the social and economic aspect of the fraud problem. Clamping down on fraud would have to be directed against employers as well as employees. However, both parties are represented on the Insurance Boards⁷ and in the political parties. This induced them to 'pass the buck', while exhausting themselves in blaming each other for 'not doing enough'. The parties on the political right did not like increased anti-fraud measures directed against the entrepreneurs. Among the parties on the left,

⁷ The Industrial Insurance Boards are private entities endowed with powers to execute social insurance regulations. Each industrial sector has its own Insurance Board. Employers have to contribute to these boards a certain percentage of the wages of their employees.

there was concern that the financial misdemeanours of the 'weaker members of society' would be more vigorously pursued than the crimes of the powerful. Later developments proved these concerns not unrealistic.⁸

In the third place, the competent law enforcement agencies, like the fiscal police (FIOD) and the Insurance Boards (which have investigative powers), as well as the regional police forces, were divided. Organised subcontracting fraud schemes can be very time-consuming to unravel. While local police forces were frequently not unwilling to invest time and labour in the investigation of such schemes, they tended not to have the technical know-how to collate relevant evidence from the confiscated remains of the unsorted paper work of suspect firms. In addition, they tended to consider the Inland Revenue and the Insurance Boards to be the real victims. Hence they would ask these 'victims' to invest investigative capacity too – which typically resulted in the formation of multi-disciplinary teams of variable cohesion. Sometimes the teams would disintegrate with their work only half complete, because of the emergence of diverging interests during the protracted investigations. Detectives from the contributing agencies would sometimes be withdrawn as it was realised that continued investigative effort could yield no more added value for the fiscal service or the Insurance Board. The police force and an (often) non-specialist public prosecutor would then have to cope with what was left of the investigation. If, after one or two years, they finally succeeded in initiating court proceedings, they would find that the *koppelbaas* was already operating his successor schemes.⁹

A contributing economic and social factor in the south of the Netherlands and nearby in Belgium was the closing of the coal mines in Limburg, creating many redundancies.¹⁰ Dutch *koppelbazen* operating in Limburg had the advantage of easy access to the nearby German market, which they could supply with cheap Dutch and Belgian miners, complementing their social benefit.

In the second half of the 1970s the problem grew worse and attracted more attention. A factor that helped to raise public awareness was the supposed involvement of 'organised crime', though at that time few knew anything about the organised crime phenomenon. Actually, most of the *koppelbazen* were lower class figures, and many had criminal records as well (Berghuis *et al.*, 1985). Such

⁸ A similar ambiguous situation about legislative measures against fraud and business crime was observed by Savelberg (1987) in Germany.

⁹ In fraud cases suspects are rarely remanded in custody when the police have seized all the paper work. After all, the evidence must be constructed from inconsistencies in the bookkeeping rather than from interviews with usually silent suspects. At that time suspects had available an effective legal instrument with which they could delay proceedings. This consisted in raising objections against the preliminary charge, pursuing matters as far as the Supreme Court, a process which could easily take two years to complete.

¹⁰ Limburg has consisted, since 1838, of a Belgian and a Dutch province. From the point of view of illegal cross-border undertakings, Dutch Limburg, bordering Belgium in the west and Germany in the east, is ideally situated.

unsavoury entrepreneurs could easily be portrayed as representatives of ‘organised crime’ – which could in turn thus be portrayed as having penetrated the construction industry – and this helped to raise public awareness of the problem (Brants and Brants, 1984). A few vigorous public prosecutors succeeded in attracting public and therefore (temporary) political attention. The cases they handled were big indeed. These concerned well-organised labour subcontracting schemes, involving strings of front (bust) firms and having extensive ramifications. A number of the leading figures had careers of fraud and deceit, and most were well acquainted with the building industry.

Acting as a *koppelbaas* is not a leisurely job: it involves the supply of many workers to impatient contractors, while new projects have to be brought in continuously (the task of the ‘pit-seeker’). Meanwhile workers have to be moved from the firms that have just gone bankrupt to new corporations, which in their turn will be busted in the future. At the same time, the movements of the fiscal police, Insurance Boards and Social Services have to be watched in order that incriminating evidence (like invoices and payrolls) can be destroyed in time. Being a *koppelbaas* is tantamount to the continuous organisation of crime.

The on going, large-scale labour subcontracting frauds; the perceived audacity of the *koppelbazen*; the complexity of the problem (for which, despite its sensitivity, an inter-ministerial commission was established); the increased workload of the public prosecution office and the courts: all these factors contributed to maintenance of public and political awareness of the problem (Brants and Brants, 1984). The inter-ministerial commission drafted proposals designed to sever the profitable symbiosis between the main contractors and the fraudulent subcontractors. Three ‘anti-abuse’ laws were proposed.

The ‘Law on Chain Liability’, made the contractor financially liable for the non-compliance of any of his subcontractors, unless he had displayed due diligence. This liability was applied to the whole ‘chain of subcontracting’: each ‘link’ could be held liable for the unpaid dues of any subcontracting firm lower in the chain. Creating strings of ‘bust firms’ did not provide protection anymore.¹¹

The law on *fraudulent bankruptcy* was tightened too: the term of imprisonment for illegally prejudicing creditors was extended retrospectively to one year from the moment the bankruptcy became unavoidable.

The third law made the managers of the boards of corporations *personally liable* for ‘apparent’ mismanagement, and applied a retroactive term of three years. They could no longer hide behind the veil of their corporations or behind straw men, unless they had planned their fraud scheme three years in advance. Few fraudsters think that far ahead.

¹¹ In principle the WKA only applies to activities on Dutch territory. However, the European Court of Justice made an exception in the *Rheinhold-Mahla case*: the WKA has a cross-border application if fraudulent conduct can be demonstrated.

As far as the illegal labour market was concerned, the most important 'disruptor' was the civil liability of contractors for the unpaid taxes and social contributions of any firm lower down the chain of subcontracting. Suddenly the mutual interest of subcontractors was broken up. Indeed, as soon as the three 'Abuse Laws' came into force in 1982, the *koppelbaas* phenomenon waned. Though loopholes continued to be taken advantage of, the problem receded (Berghuis et al., 1985; Van Duyne *et al.*, 1990; Van Duyne, 1995). Surveying the documentary evidence, in the second half of the 1980s the problem no longer figured as a social or economic problem.

Had the *koppelbaas* really disappeared or was it only a matter of shifting priorities or a decline in the attention being paid to fraud? After the mid 1980s fraud as a public and policy issue was actually losing priority (Brants and Brants, 1991). The *koppelbaas* was no longer mentioned: 'organised crime' had taken his place. In addition, there were also other, more mundane personal reasons for the waning attention to (organised) fraud. Many highly motivated public prosecutors, who had upheld the 'anti-fraud banner', shifted their attention to other issues. Tired of fighting for basic material support and being promoted to higher positions, they were not replaced by equally ardently motivated successors. With this outflow of 'problem owners' it proved difficult to sustain anti-fraud efforts at the same level. Perhaps the *koppelbaas* survived 'unobserved',¹² lingering on in the border regions, roaming around his traditional regions in Western Germany and Limburg, as described ten years ago in Van Duyne (1995). He would emerge again as soon as the social and economic environment grew more favourable.

Investigating the re-emerged *koppelbaas*

As mentioned above, the three 'anti-abuse laws' disrupted the illegal labour subcontracting market. Nevertheless, the significant contribution to labour costs made by taxes and social insurance payments continued to structure the incentives operating on employers and workers. Apart from this, the economically successful 1990s witnessed a labour shortage in some countries, on the one hand, and an increase in the supply of illegal labour, on the other. Illegal labour was partly offered by indigenous residents, partly by non-EU migrant labour roaming all over Europe. Residents engaged in 'black labour' range from students supplementing their allowances to recipients of social/unemployment benefit who defraud the Social Service or the Insurance Board. Foreigners, seeking out a (temporary) livelihood, come from all quarters and backgrounds. Most attention is devoted to rejected asylum seekers and economic fortune-

¹² This is only partly correct: signs of (cross-border) *koppelbazerij* continued to be registered by the Insurance Boards, indicating the abuse of foreign 'legal persons' and the European posting system to be discussed later (Meurs and de la Combé, 1993).

seekers who smuggle themselves or are smuggled by others into Europe. We have also mentioned the many visitors on tourist visas or legal project workers, who remain after their terms of residence have expired. Particularly significant was the increase in the supply of labour from Central and Eastern Europe after 1989 (Hönekopp, 1997).

The social-demographic, economic and law-enforcement aspects of this development attracted a great deal of attention. However, few detailed empirical studies have been carried out. Statistics are scarce and by their very nature unreliable as far as the illegal side of the labour market is concerned. The receiving economic sectors are roughly known (construction, agriculture, catering and in some countries the garment industry), but neither studies, nor reports from the competent departments, clarify the organisation or structure of the illegal labour market. The reports mention that illegal subcontracting plays an important role, and they continue to outline plans of action against the illegal hiring of labour. But who does what and how, remain only vaguely known.

Method

To obtain insight into the phenomenon, which is geographically widespread and covered by various agencies, we approached three of the most important investigative services: the fiscal police (FIOD) office operating in South Limburg, the FIOD office in Rijswijk near The Hague, and the International Bureau of Fraud in Arnhem. The Ministries of Finance and Social Affairs as well as the Public Prosecution Office allowed us full access to their criminal files. The only condition they imposed was the usual one concerning the anonymity of the persons involved, that is, the suspects, investigators, prosecutors and judges. All names were coded and in the descriptions were replaced by pseudonyms.

The material that was available for our analyses varied according to the agency concerned. The South Limburg unit of the FIOD, which initially raised our interest, had a few very large cases with many ramifications. Because of the extensive networks of those under suspicion, the unit's investigations proceeded so slowly that earlier observations and information became too old to be of use in construction of the evidence required for a successful prosecution. The investigating team therefore thought that it had to re-launch its investigations from the start and as a result, it constantly discovered new ramifications and front firms. Therefore, while it was able to give us only one big case, the case was one that touched almost every sector of the construction industry in South Limburg.

The FIOD Rijswijk had formed an intervention team against *koppelbazen* in the Westland. In the course of about five years it carried out about 45 criminal investigations. From these we selected 10 cases, which had been brought to trial. After a short introduction by the team leader we selected and studied the cases, starting with the most extensive and ramified ones.

The fraud department of the UWV mainly handles cases with *cross-border* ramifications, and from these we also selected 10 cases.

Given the ever changing criminal landscape and the fluidity of illegal labour relations, it is difficult to determine the extent to which this selection was truly representative in a statistical sense. Given the decentralisation of information and cases over many agencies, at the time of the research representative sampling (random or stratified) proved not to be feasible.

The cases described below have been anonymised by changing names or recognisable features. Investigations have, in all the cases considered, now been finalised, and at the time of writing the cases had either reached the prosecution phase or had already been dealt with by the courts.

Findings

General features

The population of perpetrators differed according to the investigative agency and the region involved. The criminal actors in the Westland consisted mainly of male ethnic Turks and Kurds, administratively assisted by a few Dutch accountants. The average age of the 54 suspects was around 30. There were 16 legal entities (legal persons) involved as suspects. The recorded offences took place between 1998 and 2001.

The age of the small population of suspects in South Limburg – 7 persons – ranges from 40 to 70, testifying to the unabated criminal drive of some senior crime-entrepreneurs. They handled 6 legal persons. Though there are no indications that these veterans ever interrupted their criminal exploits, the observations of the FIOD started in 1995 and resulted in prosecution.

The group of suspects investigated by the fraud department of the UWV consists of 16 persons and 14 legal persons. The average age of the suspects is 50 and their nationality is Dutch, German, Belgian and British. The investigations started in 1998 and are still in progress.

The evidence provided by the fiscal police (FIOD) and the criminal cases we analysed confirmed the re-emergence of the *koppelbaas* phenomenon (or at any rate the renewed attention paid to it). However, this does not imply a simple repetition of the patterns of the 1970s and 1980s. Actually, the methods of abusing the fiscal and social insurance regime had become more diversified, mixing the trusted juggling of 'front firms' with new approaches. The main observations are:

- alongside the 'old' *koppelbaas* method of bringing labour into contact with licit entrepreneurs, there is now a more intricate involvement of 'licit' entrepreneurs, with the latter creating or shaping their own *koppelbaas*, in this way reflecting the existence of a new symbiosis between the entrepreneurial underworld and upperworld;
- foreign legal persons are frequently used, demonstrating an international use of legal security measures;

- fraud constructions are keenly adopted by colleague-*koppelbazen*;
- more cross-border fraud constructions, particularly abusing the EU posting regulations: the E101 posting;
- the Dutch, indigenous *koppelbaas* appears to be accompanied by Turks, particularly in the labour intensive horticulture of Western Holland ('Westland').

Making your own *koppelbaas*

One of the most remarkable findings is not that the *koppelbaas* is lingering at the margins, ready to expand his operations again in a more favourable economic climate, recruiting new staff and 'subcontracting' to indifferent principal contractors. We found that too, but more surprising were the licit entrepreneurs who were being served by their 'own' *koppelbaas*. In its essentials the system works as follows. Builders who want to reduce their staff but nonetheless like to have them to hand, transfer their employees onto the payroll of an employment agency, which (for a fee) will handle the taxes and social contributions. The workers are subsequently 'loaned' back to their original employees at an attractive rate, due to non-payment of the taxes by the employment agency. This means that the latter accumulates huge debts with the authorities, which eventually institute bankruptcy proceedings. The manager appears to be the traditional know-nothing straw man. Needless to say, there are no assets left with which to recover the debts. The following case description clarifies the method and describes the actors involved.

The Limburg Matrix

An entrepreneur in the office cleaning business, William Sweep, decided to shift his interests to the field of 'employment and personnel service'. His friend, Bert Blister, specialised in the creation and delivery legal entities of any nationality, wherever registered. So they established the Belgian corporation, *Matrix NV*, in Antwerp, which specialised in handling the fiscal and social insurance obligations of a number of building companies. They were facilitated in this endeavour by the person who was actually the main figure in this quickly ramifying enterprise: *Dorus Darkman*, the leading background figure, who looked after the books, and Paulus the Deutscher, who established contacts with building firms in Germany. Darkman liked order and regrouped the executive subcontracting firms into sections.

German contracts were valuable, because they provided opportunities to move the 'white' and 'black' labour employed by legitimate Dutch building firms. The latter required 'white' workers to be legitimately employed in Germany, while their social security-fiscal codes were used to cover moonlighters employed in the Netherlands. It goes without saying that the turnover in Germany was unrecorded. An important major builder who used *Matrix NV* was Barend Builder. To provide for a smooth flow of invoices, he provided a cover in the form of a financial consultancy firm.

The accumulation of debts resulted in the predictable bankruptcy. While the investigators and the receiver were still sifting through the unsorted paper

work of Matrix NV, Dorus Darkman and Barend Builder continued business in the name of a resurrected Matrix: 'Matrix NV Inc.', a corporation established in Nevada (US) by an octogenarian Dutch fraudster. Though it was somewhat daring to do so, they preserved the name, because it was known in building circles and few would notice the 'Inc' added to it. Neither would anyone meet the new director, an alcoholic picked up near Antwerp railway station. Whether the principals who dealt with the subcontracting *koppelbazen* were aware of their illegal nature, remained uncertain.

The resurrected Matrix NV Inc met the same fate of insolvency and bankruptcy, after which Dorus Darkman and Paulus the Deutscher went their own (fraudulent) ways.

Actually, legitimate building firms, like those of Barend Builders, maintain(ed) a separate fraudulent 'invoice processing firm', headed by their own *koppelbaas*. The latter was well connected with numerous building firms in Limburg and Germany and did not need to wander around, chasing contracts by offering workers. On the contrary: he was frequently offered the opportunity of putting employed construction workers on his firm's payroll in exchange for a 'head-fee'. Apart from the change in the stamp on their pay slips (the reason for which they were aware of), the workers' jobs did not change very much.

The *koppelbaas* is not only a fraudulent 'false invoice processor' for building firms. Traditionally he is well integrated into the local construction workers' society, where moonlighting and social insurance/security fraud is considered a normal way of supplementing one's income. In this position the *koppelbaas* can also offer personal services, such as the fabrication of a pay slip if needed to obtain a mortgage, for example. The workers themselves often operate within family circles, passing their craft from father to son, or in small crews of craftsmen. They are not exclusively tied to any one *koppelbaas*. Among them there is much social control, which may become intimidating for those who want to be employed in accordance with the legal requirements. 'You won't get a job anywhere around here' is likely to be considered a friendly reminder to step into line. As there are many illegal, but well-connected, subcontractors in the region, the worker who refused to step into line would indeed find it difficult to get a job.

Fleecing the E101

The E101 is not one of the main motorways connecting European countries or cities, but a certificate concerning applicable legislation. It concerns the temporary posting of staff to other countries in the EU, where the E101 confirms that the legislation of the posting country will apply. This declaration can be obtained if a number of conditions are met. For the purposes of our study three conditions are important: (a) the employing firm must undertake a substantial part of its activities within the country from which the posting of employees takes place; (b) workers cannot be given an E101 certificate if they are not insured in the posting country prior to posting, and (c) in order for an

E101 to be issued, there must exist a direct relationship between the employer and employee concerned. In addition, the E101 can be given to subjects of third countries based on EC-VO 859/2003. These conditions aim to prevent the evasion of social insurance payments in countries where such costs are lower. As the reader will already have surmised, fraudulent entrepreneurs aim to reduce their social insurance expenses by the misuse of E101 certificates and the manipulation of issuing agencies. This requires deceit within two countries. Country A, the posting country, must not be aware that it has issued E101s for workers who are never in the country. This is only profitable if country A can be further cheated through the contribution of low premiums or nothing at all, the choice depending on perceptions of the likelihood of being detected. Country B is cheated because the E101 declaration prevents it from receiving employer's contributions. This profitability will be enhanced if the cross-border information exchange between insurance authorities is poor. This proves to be the rule rather than the exception.

Abuse of the E101 regulation by *koppelbazen* is not restricted to the building industry. The cases under investigation by the Dutch fraud department of the UWV also concern shipping companies involved in European inland navigation. In addition to the traditional Dutch-German interconnection we also discovered the involvement of Britons and a posting of Poles in Belgium. This indicates that abuse spreads beyond the provincial *koppelbaas* phenomenon in Limburg. From the cases being investigated we have selected three extensive cross-border crime operations. The first case description involves an overlap with the previous category: fleecing the E101 regulation by a company's 'own' *koppelbaas*.

White Mountain Ltd

The Dutch brothers *De Blanck* are well acquainted with British construction workers residing in the Netherlands and with the German construction market. Hence, they decided to take advantage of the situation by requesting the issue of E101 certificates for a few hundred British workers who are self employed and working in Germany. As the self-employed undertake no activities in the UK, they are not entitled to E101 certificates. The brothers established numerous UK corporations, each of which succeeded the other to mislead the Inland Revenue, the British issuing agency. Their staff in Britain amount to about 3, with a turnover of £15,000, while about 400 persons are employed in Germany with a turnover of about €1 million. The large turnover in Germany is kept partly unrecorded, while the declared wages are much too low, even being below the official minimum wage. After the scheme was unveiled the brothers shifted their activities to Belgium.

Given the mobility of labour within Europe, the *koppelbazen* are not only interested in workers from the 'old' EU member states. Since the coming into force of EC-VO 859/2003, and the ruling of 21 October 2004 in the Commission versus Luxembourg, it has been possible for workers from third countries also to be posted. However, Poles, some of whom also had German nationality, previously figured frequently as workers for *koppelbazen*.

Poles on the Move

The Dutch firm *POM*, belonging to the Polakki brothers, had relations with Poles carrying German passports. The brothers worked out a scheme by which the Poles could, under the E101 regulation, be posted as steelworkers to Belgium. They requested E101 certificates in the Netherlands for dozens of Poles, did not wait for the certificates to be issued and did not have the workers registered at the Dutch insurance board for the metal sector. In cases of detection, the registrations were made post hoc, though that implied that no E101 certificate could be issued. The Antwerp shipyards, where the Poles repaired containers, were happy to pay the Poles the low *Polish* salary levels, thus engaging in 'social dumping' at rock-bottom prices and certainly not showing due diligence.

After detection and withdrawal of the licenses, the Polakki brothers continued with a German and a Luxembourg corporation, to which they transferred their Polish workers.

The overlap between the phenomenon of 'creating your own *koppelbaas*' and fleeing the E101 regulation was observed within the Dutch carrier branch of European inland shipping. A number of licit entrepreneurs apparently discovered how to reduce their labour costs by transferring their staff to a foreign company and hiring their employees back again on E101 certificates requested in Luxembourg. In this way a number of companies succeeded in keeping dozens of boats afloat without a single employee and therefore without paying any employers' contributions.

Rhine Barge Sarl.

Mr. Sander owns a small shipping firm for the transport of dangerous substances on the Rhine and for the provision of staff to other companies. In Luxembourg, he and his wife established another shipping (postbox) company, which provides the same service as the Limburg *koppelbazen*: taking the staff of numerous other shipping companies onto their payroll and posting them again on E101 certificates requested in Luxembourg to the very companies from which they received the employees. The employees have never been to Luxembourg and no contributions, or inadequate contributions are paid.

After it had discovered some other cases, the fraud department of the UWV launched an investigation into the whole of the inland shipping sector, the investigation being still in progress at the time of writing.¹³

Though these observations are too limited to allow more general conclusions about criminal labour schemes and illegal labour mobility, they nevertheless reveal a high degree of geographical mobility and flexibility on the part of the

¹³ At present this fraudulent method has been made more difficult due to an agreement of the 'Rhine states' which stipulates that the social security legislation to be applied to employees will, irrespective of their nationality, be the legislation of the country where the company owning the ship is registered.

workers. This is matched by the *koppelbazen* who operate flexibly in a number of different countries simultaneously. To a certain extent this is reflective of a sophisticated attitude. However, the *koppelbaas* phenomenon is not necessarily an instance of 'transnational' crime, to use that popular but worn term. Depending on the circumstances of the local market, it can be a quite circumscribed affair, at any rate at the level of the crime entrepreneurs, as was revealed by the Turkish-Kurdish entrepreneurs in The Hague.

Turkish *koppelbazen*

The criminal commercial activity of *koppelbazerij* is not the preserve of indigenous Dutchmen. Ethnic minorities look for opportunities on the other side of the blue line as well. Though the illicit exploits of Turks are usually associated with drug trafficking, the more integrated (or more intelligent) Turks venture into other types of commercial crime. Many of their countrymen, residing legally or illegally in The Netherlands, are desperate to be employed and are easily recruited. The urban agglomeration of Western Holland in particular has a sizable Turkish minority: young, often badly educated and ready to be recruited. When the law on temporary employment agencies was relaxed in July 1998, new opportunities arose. Establishing a 'temp' office does not require much capital, which means a low threshold for newcomers. This offered opportunities for Turkish entrepreneurs to enter this sector. And why should the Turkish 'temp' offices not recruit their unemployed countrymen for work in the greenhouses in the nearby Westland and other horticultural areas near The Hague?¹⁴ During the 1990s, when unskilled labour was scarce, the economy was booming and prices were high, many market gardeners took whomever they could get to pick tomatoes and cucumbers or to cut lettuce.

This social and economic situation led to the kind of scenes familiar to the inhabitants of American border towns near Mexico. Early in the morning just after sunrise, in the quiet 'civil service' town of The Hague, an unusual scene could be observed in the working-class 'Painters Quarter' around the market. The streets bristle with the first wave of workers looking for, or going to, their jobs. These men and women are not regular workers but Bulgarians (of Turkish descent) and Turks/Kurds timorously looking around to see whether the passing minibus of some *koppelbaas*, like Mahmut or Selim, might stop to pick them up.

Most of the Turkish *koppelbazen* in our investigation operated effectively, but with little sophistication. With one exception, they did not use limited liability corporations, but partnerships, which made them personally liable for the debts the firm accumulated. This did not deter them. Perhaps they (correctly) thought that the collection of debts by the Inland Revenue would yield little anyhow, as most of their personal assets were usually transferred to Turkey. It goes without

¹⁴ The Westland is a district between The Hague, Rotterdam and the North Sea, where many of the vegetables for the Netherlands and (particularly) for export to Germany are grown. Traditionally it offers many temporary employment opportunities, such as holiday jobs for students.

saying that firms that succeeded in expanding their operations, required more robust management. The need for 'support firms', for example for sub-contracting and the delivery of false invoices to cover wage expenses grew along with the increased turnover and the number of workers. This, in turn, increased the need for pliable accountants.

In accordance with Turkish traditions, the enterprises were mainly composed of members of the 'extended family': one of the older or most business-oriented males headed the firm, aided by his brothers, nephews and other relatives. This did not imply that the enterprise was an entirely closed circle. Pragmatic relationships had to be maintained, for example to exchange invoices with other firms or to engage a straw man for some front firm. The Turkish entrepreneurs, who displayed few administrative skills, turned to a variety of administrative offices to handle their paper work and their tax declarations. Many of these offices knew, or at least should have known, that the turnover and payroll data they received were flawed. Despite that, few Turkish customers were turned away and in a few cases the administrative office was clearly accessory to the scheme concerned. In one large case the administrative office was evidently a part of the criminal organisation, sitting alongside the *koppelbaas* and the principals during secret meetings to discuss strategy.

As many workers were either illegally resident in the Netherlands, had no work permit, received social security benefit, simply worked without declaring it, or were not allowed to work for other reasons, the registration of their identity had to be tampered with. Employers have to identify and register each worker, supplying in the process his passport and social security-fiscal (SoFi) numbers. This problem was solved in various ways. During house searches, many false passports were found. The SoFi numbers were also fabricated or simply 'stolen': ads would be placed in local newspapers, inviting applications for a job. During the interview the 'candidate' would be asked to show his or her passport (or provide the number) and supply his or her SoFi number. The candidate would never hear anything further – apart from when the Inland Revenue gave notice that s/he had not mentioned his or her employment in some horticultural firm the person had never heard of. Needless to say that this would cause much embarrassment and potential problems in applications for social-security benefits or rent subsidies.

Again, the most important symbiotic relationship was the one that existed between the labour providers – the Turkish *koppelbazen* – and the labour hirers – the market gardeners. The latter could not have been unaware that many of their labour providers were bending the rules. Newspaper stories about Turks and Bulgarians roaming the streets for work in The Hague at dawn, were published regularly. Knowing this, the market gardeners stated that they 'had taken due action to prevent the hiring of illegal labour'. In their statements to detectives they outlined extensively their companies' strict control procedures to

prevent this kind of abuse.¹⁵ The practice in the greenhouses proved different though, and provided a livelihood to thousands of Turks, Kurds, Bulgarians and other migrant labourers.

Of the 45 ‘Westland cases’, we selected ten for further analysis. Some of the general characteristics have already been outlined above. The exploits of two Turkish *koppelbazen* (operating on a middle-ranking and a large scale), in addition to those of one of their ‘administrative service providers’, are described below.

The Ali-brothers

The 35 year-old Mehmet Ali Pasha ran a number of partnerships, one of which was owned by his brother Murat. He was supported by a fellow-countryman who played an important executive role. In addition, he had a changing staff of about six persons,¹⁶ three of whom performed managerial tasks, such as maintaining relations with the customers, solving problems with the employees and so forth. Two of them were his nephew and brother-in-law. His wife and a handful of female staff looked after the paper work.

His enterprise did rather well. He supplied to market gardeners in the Westland some 50 to 70 workers who were employed to pick tomatoes and cut flowers. In order to reduce the turnover recorded in his accounts, he ‘subcontracted’ work to a value of about €250,000. Actually, false invoices for this amount of money were found, along with letter headings for five shell firms. The firm’s paper work would be submitted on disk to an administration office, where no checks were made, but where the employees merely processed all the data passively. Afterwards they expressed their amazement about the colossal losses inflicted on the Inland Revenue. His brother operated a (semi) independent firm, which appeared to have a hidden turnover of about €225,000.

It was difficult to estimate the damage to the Inland Revenue and the Insurance Board, as for several years no books were kept (or else were destroyed). The damage caused by Mehmet amounted to about €562,000; that caused by his brother to about €229,000.

The brothers had a history of criminal violence. Mehmet’s police record mentions: attempted manslaughter, robbery and grievous bodily harm. His brother’s merely mentions shooting on a public road. Given this background, when the police raided their premises at dawn, they were fully armed. If the Ali brothers could be rated as moderately successful, the *Janissar* enterprise with its 800 employees could certainly be classified as one of the most successful. In addition to operating wholesale, the firm was well embedded in a criminal

¹⁵ One of the systems is the ‘pad-registration system’, in which the hours worked by each worker are registered. Pad registers must be kept for five years.

¹⁶ Surprisingly, these were not designated as suspects.

conspiracy in which chartered accountants and five large market gardeners fully participated.

Janissar Ltd

Mustafa Kemal was the absolute controller of *Janissar Ltd*. Beneath this main firm a number of phony subcontracting firms were created by four previous employees for the sole purpose of providing false invoices to cover cash expenses. *Tansu Çiller* who headed a separate administration office (see below) functioned as 'service provider' looking after the 'proper' handling of the paper work. She was supported by two other administrative aids, who fabricated new and destroyed old documents. Çiller and her aids were not the only persons involved in the fraudulent administration of *Janissar Ltd*. A partner and a chartered accountant employed by the respected firm of accountants, *Straight Line*, kept an eye on the operations of *Mustafa Kemal*. They knew he had invoices and hour sheets destroyed. Two other employees of *Straight Line* were posted to *Janissar* to support the clerical staff. A *Straight Line* employee who objected to being asked to perform tasks that amounted to fraudulent accounting activities was soon replaced. The huge extent of the labour scam required closer cooperation and more mutual fine-tuning than was necessary in the other cases. In order to remain in control of the scheme the four principal market gardeners, the *Straight Line* accountants and *Mustafa Kemal* had three-monthly meetings at the offices of the most important market gardener, who also chaired these meetings. For the market gardeners it was important that the percentage of false names did not exceed 20%. This did not imply that the correct names on the lists corresponded to the actual workers. Again many names and So-Fi numbers were simply stolen. Sometimes people who had once worked for *Janissar* or who knew *Mustafa Kemal* in another capacity, provided their names and IDs because they were in need of an employment record. In three years the *Janissar* firm inflicted a loss of €9.5 million on the public exchequer.

The firms we investigated required large numbers of false invoices to cover their unaccountable wage expenses. Therefore, firms were established to create such administrative veils. Related to the first case are the statements of an imprisoned witness, who described the ways shell partnership firms were established and used for the selling of false or rather blank invoices carrying only the signature of the seller. The companies appeared to operate in the names of all sorts of marginal figures: psychiatric patients, tramps or simply non-existent people. The invoices were sold for 8 to 10% of the figure for which they were applied. Stealthily inserting a higher figure was definitely advised against, lest 'you may be shot through the windows'. The invoices of one of the firms were used by an entrepreneur to cover expenses of €40,000 for the renovation of his office. Obtaining invoices for phony subcontracting or to justify cash expenses is an important facet of the fraud business and sometimes the *koppelbazen* ran out of firms to provide such a service. Hence, some of the fraudsters fabricated their own false invoices, sometimes even digitally counterfeiting existing false invoices they obtained from other Turkish *koppelbazen*, though without their knowledge!

This led to the detection of some *koppelbazen* as a result of inspectors recognising the invoices of front firms they had dismantled earlier. The crime entrepreneurs could also turn to the administrative office of the above-mentioned *Tansu Çiller*, who produced whatever false documents were required.

The Docu-service firm

Tansu Çiller is one of the many emancipated second-generation Turkish women who surfaced in the predominantly male circles of Turkish criminal activity in The Hague and surroundings. Intelligent, handsome, but with a keen feeling for the wrong business, she established an administration office, which provided any service the fraudulent among her countrymen needed. She 'ironed out' inconsistencies in the paper work of many Turkish *koppelbazen*: payrolls were adapted, working hours and lists of names were 'corrected'. Apart from that, she produced a massive quantity of false invoices, which service amounted to a figure of about €1.5 million. Her direct aids were a Dutchman, *Hein Donner* and a mentally unstable Surinam national, *Sam Dropper*, who thought the moon was made of cheese and who in the end died from an overdose of cocaine. She complained that she had been abused behind her back, but given the quality of her staff and her assertive nature, this statement appeared implausible.

Having analysed the cases of about one quarter of the known *koppelbazen* operating in Southwestern Holland, we can conclude that within a relatively short time span a group of Turkish criminal entrepreneurs was able successfully to take advantage of the imbalance in the horticultural labour market. Having ample access to a host of unemployed men and women wandering the streets of the poor quarters of The Hague where they lived too, they could effectively meet a demand that was insatiable. Compared with the *koppelbazen* in the building market, they did not stand out for their fiscal or financial sophistication. Their backgrounds did not show much in the way of previous fraudulent commercial activity. Rather many of them had a background of violence and property crime. Despite this history they developed the entrepreneurial spirit that is typical of the *koppelbaas*: recruiting and supervising workers, sorting out problems with employers, finding subterfuges to keep up a legitimate appearance, and so forth. A few of them grew into major crime entrepreneurs, able to attract legitimate and 'respectable' market players as components of their organised fraud schemes.

Conclusion

The re-emergence of the illegal subcontractor as 'employment office' in various guises reveals the influence of tradition as well as innovation. Some regions and industrial sectors have known the phenomenon of *koppelbazerij* for decades. Being driven back for some time it expanded again under favourable market

conditions and established new symbiotic relations with underworld entrepreneurs. Instead of being merely the 'unknowing' receivers of cheap workers, the latter now showed more initiative, dismissing their employees only to hire them again from fraudulent firms of their own making. These schemes were facilitated by veteran fraudsters from the old *koppelbaas* generation, and by local manpower traditionally used to moonlighting. However, this practice extended to inland shipping. Whether other industrial sectors adopted the practice is unknown, but there are few reasons assume that other labour intensive sectors will have been immune to this method of cost reduction.

When re-emerging, the 'old' *koppelbaas* found themselves in the company of birds of various feathers. Abusing the posting regulations and the E101 certificate, Dutchmen together with Poles and Britons, could be observed at work in Germany, Belgium and the Netherlands. A number of indications (unfortunately without additional empirical underpinning) in reports about abuse of the EU posting system lend plausibility to the assumption that this phenomenon is not limited to the Low Countries, Germany or Britain. More extensive empirical research may very well reveal the phenomenon of *koppelbazerij* to be EU-wide.

It should be stressed that illegal labourers may or may not also be illegal immigrants. As a matter of fact, the involvement of illegal immigrants depends on the industrial sector and the skills that are required. In the building sector, *koppelbazerij* concerned scarce skilled labourers, who knew their worth and (black market) price. Only in the agricultural sector, in which the required education and skills are low, did we observe the systematic engagement of wandering illegal immigrants. They may be considered exploited, not only because of their working conditions, their miserable and expensive housing and the low levels of their wages, but also because they are excluded from any labour protection. However, it is a 'consensual exploitation'. Sometimes employees are cheated by being paid less than their licit colleagues and sometimes they receive higher net wages than the latter. For example, the Janissar enterprise paid well above the union rate. Returning home, the employees of such firms invest their savings in local enterprises and show them with pride.¹⁷

The social or psychological characteristics of persons operating in this market are difficult to describe. Looking at the perpetrators from the outside, one observes a huge variety: legitimate entrepreneurs operating internationally (and remaining behind the scenes); straw men; crooked bookkeepers; local veterans for whom their place in the illegal labour market is just an economic way of (family) life; ethnic minority entrepreneurs. As the social and psychological backgrounds of suspects are usually only investigated in cases of violent and sexual crime, and such offences are rare in this field, we lack basic personality data. Apart from this lack of violence, another observation has to be made, and it

¹⁷ A television documentary portrayed a proud Bulgarian, who saved enough (living in miserable cheap housing conditions in The Hague) to start his own taxi firm.

is one concerning specialisation. Most fraud markets, whether they involve VAT, cigarettes, excise or labour, seem in principle to be open to newcomers. Nevertheless, in our investigations we found hardly any overlap, in terms of personnel, with the crime entrepreneurs involved in the drugs market (Van Duyne, 2003; Von Lampe, 2003). This contradicts the statements frequently made by detectives that criminals are always on the look out for new opportunities. That may be the case, but successfully seizing opportunities requires skills. Granted, it is somewhat speculative, but it is plausible to assume that the characteristics of the labour market are such as to require the deployment of skills that are different to those required in the drugs market. Leading a subcontracting firm entails the maintenance of daily labour routine and discipline, social skills for negotiating with the principals, supervision of the numerous employees, checking of the weekly payments, juggling with So-Fi numbers etc. A member of one of the Turkish family enterprises did not possess these qualities and failed as a *koppelbaas*. Instead, he preferred the drug market (where he failed too). Detectives observed that this switch was accompanied by a marked change in his conduct: a change that could be seen in the way he spent time, in his movements, and in his stealthier pattern of telephone communication.

Most of the cases we analysed could have been subsumed under the heading 'participation in a criminal organisation', in short, *organised crime*. Nevertheless, this term was rarely used by public prosecutors. Only in the *Janissar* cases did the prosecutor decide to indict the defendant for 'organised crime', given the overwhelming evidence of well-planned cooperation between the *koppelbaas*, the market gardeners and the firm of accountants. Should *koppelbazen* be considered as organised criminals? Without reopening the fruitless discussion about the essence of organised crime (see Van Duyne, 2003), one can say that they could certainly be qualified as such if one wanted to maintain this concept. This applies particularly to the background entrepreneurs who either installed and/or maintained their own *koppelbaas*. It does not, however, add much to our understanding of the criminal behaviour typically found in this market.

The characteristics of the illegal labour market are determined by the demands of the entrepreneurial upperworld, and they are not likely to evaporate in the face of moral crusades on the part of the authorities.¹⁸ Most important is the repeated re-occurrence of opportunities for the establishment of symbiotic relations between the licit entrepreneurial community, illegal labour organisers (under a licit guise) and labourers. This symbiosis is rarely felt to be 'criminal': it is 'doing business'; it maybe somewhat illegal – but can it really be described as 'organised crime'? The accountants in the *Janissar* case knew that they had

¹⁸ Recently the German authorities launched a campaign against black-market labour (*Schwarzarbeit*), pointing to the damage done by such labour, while using a fiscal carrot in the form of tax reductions for 'mini-jobs', and intensified investigations of organised illegal employment. See: <http://www.mini-jobzentrale.de>

broken the law, but expressed extreme indignation at being charged with 'participating in a criminal organisation'.

An important facet of the perceived opportunities is the assessment of risk. According to the detectives we interviewed during our research, many entrepreneurs show little concern at the prospect of being held liable for the unpaid taxes of their labour providers, let alone at the prospect of penal sanctions. Actually, the procedure for reclaiming money in such cases, set out in the Law on Chain Liability, is time consuming and arduous, and by no means guaranteed to be successful. However, this is a matter of perception, which for some of the unconcerned entrepreneurs was distorted by a successful reclaim of taxes and a prison sentence.

Despite the small number of such successes, the licit entrepreneur hiring labour from a *koppelbaas* can rationally calculate his losses and benefits against the chances of a successful liability suit and perhaps criminal prosecution. On the one hand, the immediate rewards, cheap labour plus certainty that the work will get done, have to be set against the uncertain costs of a fine and reclamation. On the other hand, expensive, too few, or no labourers at all, are certain losses to be balanced against the likelihood of no fine and no liability proceedings. Weighing the odds, hiring from a *koppelbaas* may not be the worst bet. Granted, few entrepreneurs perform such cognitively precise acts of rational decision-making. More important is their assessment of the immediate gain (cheap labour) against the infrequently successful and therefore psychologically 'distant' threat of the law. For this reason the Law on Chain Liability has proved to be less of a deterrent than was imagined twenty years ago. It goes without saying that this law is certainly ineffective in the cases of organised business criminals, setting up their own *koppelbaas*.

Economic regional approach

Much attention has been paid in the recent literature to the dreaded phenomenon of 'transnational organised crime'. Most of the attention has been directed at phenomena whose wickedness is taken for granted, such as drug trafficking and trafficking in human beings. Given national price differences and concomitant profit opportunities, one may wonder what is really special about 'transnational' crime. Compared with this artificially stimulated concern, which has created its own stream of recycled quotations from policy makers and scholars alike, the daily business of cross-border (organised) economic crime, quietly pursued on an ongoing basis, has received little attention, or has simply been subsumed under less heavily value-laden titles, such as 'corporate' or 'organisational' crime. Given the repetitiveness of this discussion, we shall not join this choric hymn.

It may be of more interest to approach these phenomena from the more mundane economic angle. Like prohibited or highly taxed substances, such as drugs or tobacco, labour is a highly taxed commodity which can be taken advantage of by taking a slice out of the 'price wedge'. One of the smart ways of

doing this is to operate across borders, which reduces the chances of getting caught. This requires a fair degree of knowledge of the social and economic characteristics of regions extending across jurisdictions. It is within geographical ‘orbits’ such as these that the ‘transnational’ crime-entrepreneur develops his activities. In the case of the labour market, such activities require the setting up of real criminal organisations, but with the carefully staged appearance of legitimacy and often with corporate structures that include off-shore components. This multi-country regional crime-market phenomenon may be a common and natural way of doing illegal business, but this is not obvious: we have observed, for example, that the Turks in The Hague did not use this type of cross-border cover with its concomitant (international) corporate legal tools, maybe because they felt safe enough in their social environment and family networks.

If such crime-entrepreneurs are best described empirically as operating within an economic multi-country ‘crime region’, strategies to stem the phenomenon should also start from this notion. However, national authorities do not work from such a perspective. *Koppelbazerij* is defined as tax fraud and therefore the fiscal police and the Insurance Boards are regarded as the competent agencies. This has far reaching consequences for the speed and flexibility with which the *koppelbazen* and their international networks can be identified, investigated and terminated. The problem is not the will to cooperate on the part of individual criminal investigators. Things can be expected to go as well or as badly in individual or agency interaction as the quite unpredictable factor of personal rivalries will allow. Rather, the main problem lies in the management of information, that is, in the content of what is exchanged. For example:

- there is a centralised database for the storage of information about administrative and criminal investigations, but it is not clear how efficiently it is used;
- imperfect exchanges of information between agencies in different countries is impeding timely action;
- such timely action is particularly required in cases which involve E101 postings;
- There is no central point for the storage of data concerning posted employees, causing delays in mutual administrative assistance.

Needless to say, the *koppelbaas* enterprise known to the authorities continues to accumulate financial losses: its front firm is destined to go bankrupt anyhow.

Technically, the establishment of such a system is at present less of a problem than its legal foundation and its institutional acceptance. When we extrapolate our experience with data management in the area of money-laundering or VAT fraud to fraud in the field of organised labour, we conclude that institutional reluctance will prove harder to overcome than the potential legal problems. Until that time the illegal organisation of the commodity labour will continue to thrive.

References

- Berghuis, A.C., P.C. van Duyne and J.A.A. Essers, *Effecten van de Wet Ketenaansprakelijkheid op malafiditeit*. Den Haag, Staatsuitgeverij, 1985
- Brants, C.H. and K.L.K. Brants, *De sociale constructie van de fraude*. Arnhem, Gouda Quint, 1991
- Brants, C.H. and K.L.K. Brants, Fraudebwustzijn in Nederland: over de sociale constructie van de witteboorden-criminaliteit. In: *Witteboorden-criminaliteit*. Nijmegen, Ars Aequi, 1984
- Duyne, P.C. van, Organizing cigarette smuggling and policy making, ending up in smoke. *Crime, Law and Social Change*, no. 3, 263-283, 2003(a)
- Duyne, P.C. van, Medieval thinking and organized crime economy. In: E. Viano, J. Magallanes and L. Bridel (eds.), *International organized crime: myth, power and profit*. Anderson Publishing, 2003(b)
- Duyne, P.C. van, M. Pheijffer, H.G. Kuijl, Th.H. van Dijk and G. Bakker, *Financial Investigation of Crime, A tool of the integral law enforcement approach*. Nijmegen, Wolf Legal Publishers, 2002
- Duyne, P.C. van, Organized crime, corruption and power. *Crime, Law and Social Change*, no. 26, 201-238, 1997
- Duyne, P.C. van, Definitie en kompaswerking. In: C. Fijnaut, F. Bovenkerk, G. Bruinsma and H.G. van de Bunt (red.) *De georganiseerde criminaliteit in Nederland*. Arnhem, Gouda Quint, 1996
- Duyne, P.C. van, *Het spook en de dreiging van de georganiseerde misdaad*. Den Haag, SDU-uitgeverij, 1995
- Duyne, P.C. van, R.F. Kouwenberg and G. Romeijn, *Misdaadondernemingen, Ondernemende misdadigers in Nederland*. Arnhem, Gouda Quint, 1990
- Duyne, P.C. van, Tien jaar fraudebeleid. *Justitiële Verkenningen*, no. 3, 5-59, 1997
- Enbersen, G., R.H.J.M. Staring, J. de Boom, P. van der Heijden and M. Cruijff, *Illegale vreemdelingen in Nederland. Omvang, overkomst, verblijf en uitzetting*. Rotterdam, 2002
- Esope Project, *Managing labour related risks in Europe: Policy implications*. European Commission, Brussels, 2004
- Hönekopp, E., Labour migration from Central and Eastern Europe. Old and new trends. *IAB Labour Market Research Topics*, no. 23, 1997
- Horjkovi, M., *Legal and illegal labour migration in the Czech Republic: background and current trends*. Geneva, ILO, International Migration Branch, 1997
- Lampe, K. von, Organising the nicotine racket. Patterns of criminal cooperation in the cigarette black market in Germany. In: P.C. van Duyne, K. Von Lampe and J. Newell (eds.), *Criminal finances and organising crime in Europe*, Nijmegen. Wolf Legal Productions, 2003
- Levi, M., Serious fraud in Britain: criminal justice versus regulation. In: F. Pearce and L. Snider (eds.), *Corporate crime, Contemporary debates*. Toronto, University of Toronto Press, 1995

- Levi, M., *The phantom capitalists: the organisation and control of long firm fraud*. London, Heinemann, 1981
- Ludwig, J., *Wirtschaftskriminalität. Schleichwege zum grossen Geld*. Frankfurt am Main, Fischer Taschenbuch Verlag, 1992
- Mateman, S. and P.H. Renooy, *Undeclared labour in Europe. Towards an integrated approach of combatting undeclared labour. Final report*. Amsterdam, Regioplan, Research and Advice, 2001
- Meurs, G.J. and L. de la Combé, *Greep op de grens?* Zoetermeer, Sociale Verzekeringsraad, 1993
- Reijntjes, J.M., *Fraudebestrijding in de Europese "Gouden Driehoek". Justitiële Verkenningen, no. 1, 53-69, 1988*
- Savelsberg, J.J., *The making of criminal law norms in welfare states: economic crime in West Germany. Law and Society Review, 1987, no. 4, 1987*
- See, H., *Illegale Beschäftigungsverhältnisse*. In: H. See and D. Schenk (eds.), *Wirtschaftsverbrechen. Der innere Feind der freien Marktwirtschaft*. Cologne, Kiepenheuer & Witsch, 1992
- Zuidam, M. and D.H. Grijpstra, *Over de grens. Een onderzoek naar illegale activiteiten op het gebied van uitzendarbeid*. Leiden, Research voor Beleid, 2004

Organised crime, Norwegian style

Per Ole Johansen¹

“While other fluids follow the force of gravity and sink vertically, alcohol has a magical ability to spread horizontally and find invisible ways into society’s inner corners.”

*The Commander of Police, Southern Varanger
to The Regional Commissioner, Finnmark
14 December 1919*

The Devil’s Mirror

The *legal* consumption of alcohol in Norway is relatively low as compared to Europe in general. The Norwegian official consumption per capita in 2001 was 4.4 litres of pure alcohol, compared to 9.5 in Denmark, 10.5 in France and 10.8 in Ireland. The availability of alcohol in Norway is restricted and the level of taxation is high. Thus, a bottle of *Balantine Finest*, for example, costs 292 Norwegian kroner (approximately €36), a bottle of *Courvoisier V. V.*, 332 kroner, and a bottle of *Smirnoff* 349 kroner. The correlation between moderate alcohol consumption and heavy taxation looks pretty good then, seen from a temperance point of view. But ‘the Devil’s Mirror’ shows something else – or something more at least. ‘The Devil’s Mirror’, which I was told about as a child, was a mirror that showed the ugly and/or unforeseen parts of reality we would rather close our eyes to. Illegal alcohol market is such a mirror, in that it shows cheap, *illegal* and strong alcohol, including alcohol up to 96 % proof, being smuggled to Norway from Spain, Portugal and Italy. The illegal alcohol is distributed around the country and stored in private homes. It is consumed in huge quantities in closed circles, out of sight and out of control, far removed from licensed bars and restaurants. Smuggling of alcohol and illegal distilling has been the principal types of organised crime in Norway since the beginning of the Prohibition era, which lasted from 1917 to 1927 (Johansen, 1994, 2004). The history and the economics of the illegal alcohol market is the topic of this chapter.

The illegal alcohol market is partly a *replication* economy, due to the taxes, restricted availability and the state monopoly on the distribution and sale of wines and spirits. But it may be seen as a *supplementary*, an *alternative* or a *criminal* economy too, depending on the modus operandi and links to other networks. The stock of *cultural* capital, with a tradition of self-reliance stemming back to

¹ Per Ole Johansen is Professor of Criminology at the University of Oslo, Norway.

the Prohibition era, has been another important stimulus to the illegal alcohol market. *Political* capital on the other hand is almost nonexistent due to Norway's tradition as a civic society, with no demand whatsoever for organised criminals as 'election workers' or powerful middlemen in the local society, as in places like Sicily. Given the illegal nature of this market, some comparative comments will also be made on another illegal market, namely the drugs market, which in Norway is a much smaller and more recent market.

Method of data collection

The data for this paper were collected from various sources. In the first place, for more than ten years I interviewed smugglers, illegal distillers, police officers and customs officers. The interviews were open and informal. Some questions were standard, while others were adjusted to the career of the individual bootlegger or officer. The majority were interviewed only once, a minority on both sides of the law being interviewed up to 10 to 15 times over a number of years. Some questions were more easily answered than others. Money laundering was a taboo for most bootleggers, while the police officers disliked talking about their failures before the courts. I told all my interviewees that I was talking with both bootleggers and officers, although not about what. I may have lost some information for that reason, but receiving information from both sides, prevented me from 'going native'. Other data were obtained from historical archives and contemporary court files.

Illegal alcohol from Prohibition to the present

Fortified wines were prohibited in Norway from 1917 to 1924, and spirits from 1917 to 1927, due to the very strong influence of the Norwegian temperance movement. The temperance societies had more members than any other organisation at that time, with several very influential politicians in the lead. Active support from both the leaders of the labour movement and the Christian middle class was an important reason for their political success. The labour leaders warned against alcohol as the "the class enemy", while the Christians crusaded against "the Bottle of the Devil." Consequently, a huge black market developed from a modest, amateurish start in 1917-1919, to a relatively well organised market in the mid 1920s with smuggling and illegal distilleries as the main channels for illicit alcohol. In this bootlegger's market the Norwegians were the dominant force while some of them worked on even terms in teams with German businessmen, shipping people, and ex-officers from the German navy. Most of those Germans were ruined or unemployed after First World War, and eager to make new money by smuggling alcohol, which was very inexpensive in Germany at that time. The Germans shipped their spirits or 96%

proof alcohol from Hamburg and other northern German harbours to meeting points in international waters off the Norwegian coast, from where the Norwegians undertook the risky task of bringing the cargo ashore.

Prohibition was a violent period, compared to Norway's tradition as a peaceful society. Norwegian customs cruisers had the right to use guns if smugglers tried to escape, and they were even more likely to open fire if the smugglers behaved in a way that cast aspersions on their honour. Experienced smugglers were not eager to shoot back, but they nevertheless had their own weapons, to fight off gangs that might try to steal their cargo on its way from the shore to the warehouse. The favourite scheme of these predatory gangs was to act as police officers – which placed real police officers in considerable danger.

Alcohol smuggling was not just a national issue. Norwegian shipping companies were also heavily involved in smuggling alcohol to America's Rum Row in the 1920s. They never saw it as a crime, just 'business as usual' in a competitive, international market. Illegal distilling, which was an almost forgotten craft in most of Norway before the First World War, was reborn after the beginning of Prohibition, and it is still very much alive today.

The illegal alcohol market did not disappear after repeal in 1927 (Johansen, 2004). Heavy taxes were imposed on legal alcohol and its distribution was restricted to a semi-state monopoly. But while an unholy alliance of Christian fundamentalists and teetotal labour-movement leaders tried their very best to keep farmers and workers away from alcohol, illegal distilling seemed to increase in the 1930s. For a shipping nation like Norway with its long coastline and excellent hiding places for illegal cargoes, smuggling was not much of a challenge either. The boys from Prohibition times were still alive and eager to make money, as were their friends in Germany, Britain, Holland and the Baltic countries. As mentioned above, Norwegian ship owners kept *their* American Dream alive by smuggling huge quantities of spirits to the East Coast of the USA. One of them was Hilmar Reksten, who became a well-known and controversial figure in European shipping after the Second World War.

Professional smuggling of alcohol in Norway was very limited during the Second World War. It was extremely dangerous to cross the oceans without legal papers. But new roles emerged for cunning smugglers who knew the coast and knew how to organise and handle stressful situations. Several veterans were recruited by German naval intelligence as infiltrators and provocateurs, drawing on ties between the German naval intelligence officers and Norwegian smugglers that had been established during the 1920s. A second group of Norwegian ex-smugglers joined the resistance movement, while some worked on both sides alternately depending on who seemed to be gaining the upper hand.

Licit alcohol was rationed in Norway from the German invasion to the winter of 1946. Adults with a clean record received cards entitling them to purchase one or two bottles a month. The consequence of the rationing was a huge illegal market for the *illegal* re-sale of *legal* alcohol. The suppliers bought legal quotas and sold them illegally at much higher prices. Alcohol was used also in barter, where a bottle of spirits might exchange for a pound of meat or a

hundred cigarettes, for example. Forged rationing cards became a very lucrative side-business for printers in need of easy money, and a tempting business for professional criminals to join.

The supply of moonshine declined, but survived due to black market sugar, and organised stealing of sugar from German military stores in collaboration with German foremen. The illegal markets of the Second World War functioned as a link between the illegal markets of the 1930s and the illegal post-war markets, both in terms of networks and oral history.

The war did not change Norwegian politicians as far as their traditional belief in the heavy taxation of alcohol and restricted availability was concerned. Smuggling and illegal markets seemed to be concepts unknown to them. Consequently, it could not really come as a surprise when, in the 1950s, organised smuggling became a common occurrence on passenger ships, which sailed regularly from foreign ports. Likewise, it was foreseeable that the end of sugar rationing in 1952 would mark the beginning of a high season for illegal distilling.

Several of my informants whom I have interviewed over the years, were freshmen in illegal alcohol in the early 1950s, with veterans from the Prohibition period serving as their role models. The freshmen from the early 1950s are the veterans of today, still active and more cunning, better organised and more effectively covered by their legal businesses than ever. No police officer or customs officer has been in business for that long. Guess who represents tradition and continuity!

The period from the early 1960s to the late 1970s was a mixture of tradition and modernity in the profession of smuggling. It says a lot about the smugglers' ability to adjust. Civil airlines carried more and more passengers, while the trailers became involved in the transport of cargo from the continent to Norway. The smugglers adjusted either by switching to traditional smuggling with smaller ships bought just for that purpose, or by investing in trailers which combined legal and illegal shipments. A new generation of smugglers made their debut with the trailer business. They got pretty clever after a while, and they still are. The illegal distillers were expanding too – even in big cities – aided by modern technology and improved distribution (Johansen, 2004).

The year 1978 gave a new impetus to the black market when the employees of the Norwegian Wine and Liquor State Monopoly embarked on a long strike. Similar labour disputes ensued in 1982 and 1986. In the aftermath of these strikes, the volume of the illegal alcohol market grew even larger. The veterans got used to handling extraordinarily large orders, while young men acted as their assistants, or even acted on their own account, taking care of orders the veterans did not have time for. The huge illegal alcohol market of the 1990s owed much to the networks in existence prior to 1978, and to the knowledge and criminal capital that were acquired when the liquor workers went on strike in 1978, 1982 and 1986.

A sidelong glance at drugs

While illegal alcohol has a long tradition in Norway, illicit drugs are a more recent phenomenon. The marijuana market had a very modest start in the late 1960s and early 1970s, amphetamines in the late 1970s and heroin in the 1980s. The market for cocaine and synthetic drugs did not emerge until the 1990s (Skog, 1992). The links between the black markets for alcohol and drugs are weak, confined for the most part to criminal generalists who dabble in both illegal alcohol and drugs, and a handful of drug dealers who converted to the smuggling of alcohol after a while, due to the lower risks involved, the higher status and the fact that it is at least as lucrative (Johansen, 1996; 2004). The alcohol market is still ‘ethnically Norwegian’, in spite of the immigration that has taken place since the 1970s, especially from Islamic countries. As Muslims have no relation to alcohol, drugs have been their obvious choice if they have decided to go into illegal business. The drugs market is more multi-ethnic today than it was at its beginning. Different immigrant groups and Norwegians work together, once trust has been established in deals made outside and inside the prisons, according to my interviewees. Norwegians are not very heavily involved in smuggling drugs, except hashish, which has been a Norwegian turf for years, but they are very important when it comes to supplying in areas where a foreigner would appear out of place. A fact often forgotten when blame is put on foreigners is that there would be no immigrant wholesaler or importer without Norwegian retailers (information from interviews).

Alternative or supplementary economies?

The Norwegian illegal alcohol market has no debt to other *illegal* markets. Its only “creditor” is the *legal* alcohol market. Prohibition, rationing, heavy taxation, restricted availability, and strikes have made smuggling and the production of moonshine into lucrative businesses. Smugglers and distillers have been aware of who their benefactors are. During the 1920s some of them gave anonymous financial support to temperance groups, which defended the Prohibition, and likewise to the liquor employees when they created the big slowdown in 1982.² “The price of illegal booze is always related to the price of legal alcohol, about half of it in general,” according to Gunnar, a veteran smuggler. “I vote for the Christian Party,” says Tore, another informant, the Christian Party being against the EU and believing in expensive alcohol. “Cheap alcohol from the EU and the high taxation of booze in Norway gives me my living as a smuggler.”

² B. Sveinung Berg: ‘Det er typisk norsk å kjøpe smuglersprit.’ *Aftenposten* 25. oktober 2003.

Aside from the issue of the political context of the illegal alcohol market the question arises as to the nature of the relation between the black market and the legal economy: is the illegal alcohol market an alternative economy, or is it supplementary to the legal economy.

Stuart Henry is critical of the idea of an alternative informal economic system. What he sees is “a replication of the dominant capitalist structure” (Henry, 1982: 430). In the Devil’s Mirror the illegal alcohol market looks like a *replication* of the legal market, although not excluding other kinds of economies when it comes to sublevels and to the question of who is doing what and how.

The illegal alcohol market is a *supplementary* economy for an important group of smugglers, like the ‘company smugglers’ who are the top dogs in illegal alcohol, with their legal companies, infrastructure and business networks, which are excellent for importing, distribution and laundering. There is no success in business like a good old *legal* success (Johansen, 1996). It makes no sense to start a company with some strange kind of import just for cover, explains Gunnar who has been in business for almost fifty years:

“Customs officers have everything on computer. What’s going to work is an old, legal company, which has been in business for many years. The first ten legal containers go in, and then the eleventh with illegal alcohol. Respectable companies with legal imports which the customs take no notice of”.

Christian, another company smuggler, compares the legal and illegal alcohol businesses:

“Just the same actually, it’s about a normal product, alcohol. A risk, yes, but one kind of product is just like another. We have importers, wholesalers and so on down the line; people with a discreet lifestyle. Duty and tax evasion, that’s the limit for what we are doing”.

Peter, a car dealer and wholesaler in illegal alcohol, is not very secretive about how his illegal profit is used. “It is very nice to have my bills paid, the legal ones.” Investing “black” money in a legal company is very easily done, while ignored by the tax authorities. While there is a lot of concern among public officials about traditional forms of tax evasion – in other words, personal or company income that is hidden from the tax inspector – the laundering of “black” money through legal companies has never been a target, although known among criminals since the 1920s.

Money laundering has traditionally been seen as an exotic affair in tax havens in the sun. “Company smugglers” have been the winners in illegal alcohol since Prohibition, due to their legal covers and the way they have paid or manipulated assistants from labour-class districts to front for them in court. Some “company smugglers” have actually been caught though, because they have behaved like legal businessmen in their illegal businesses, with routines, archives and internal accounts. Doing time is not their strongest side. Nervous businessmen have a

certain reputation for “talking” their way out of custody (Johansen, 2004 and interviews with police officers and smugglers).

Illegal alcohol as a supplementary economy is common among middlemen in transport and distribution too. Truck drivers act as “supplementary” middlemen by smuggling part-time on behalf of professional smugglers or their bosses, or by smuggling on their own account while driving legal cargo from the continent to Norway. Smuggling of alcohol is something that comes extra depending on the available spare capacity and the outlook of the driver. Experienced drivers stick to small quantities smuggled over several trips rather than one huge, though profitable, shipment. “In the long run the small ones are usually just as lucrative,” according to one of them. The smaller ones are less risky, and not defined as “professional” crime by the courts. The police see more challenge and excitement too in going after the big crooks, as far as alcohol is concerned.

Wholesalers in illegal alcohol are often legal businessmen themselves while retail dealers may have various kinds of profession or business. What is important is that it brings them into contact with potential customers. “Cunning men, who are well connected and know their way around,” is Paul’s definition of ideal retail dealers.

In comparison to the illicit alcohol market, the *illegal drug market* is smaller, and so is the accompanying grey zone of drugs, here defined as a mixture of drug money and legal business. The grey zone of drugs is much more heavily concentrated in one or two sectors, first among these being the restaurant business where drug money may serve as starting capital. Big fish in that side stream are not always a myth. Occasionally they may actually make some pretty big money, like the team that in 2003 got caught in Oslo with 21 million kroner in untaxed profits stashed in bags in their flat. The small fish in drugs are typically former drug addicts and part-timers who, in a rather improvised way, combine sporadic dealings with ordinary jobs, social security and a variety of other criminal activities.

What about the *alternative* economy then? Jeremy Alden, among others, is sceptical of the reality of such an ‘alternative’ regarding moon-shining (Alden, 1977). He argues that illegal extra jobs require particular skills, and are often of short duration. ‘Dynamic’ persons with legal jobs and time for extra work are more active in illegal markets than are the unemployed. ‘Black’ economies, as J.I. Gershuny sees them, ‘exist in the interstices of the formal economy, consisting largely of economic activities also undertaken in the formal economy, often by the same people’ (Gershuny, 1979: 7). Alden and Gershuny may be right and wrong at the same time when it comes to generalisations. Truck drivers and businessmen have a financial advantage with both legal incomes and the illegal incomes derived from alcohol smuggling. The illegal income itself is not always enough to make a living, but nice for extra luxuries or to have their bills paid.

At the same time it is possible to perceive parts of the black alcohol market as an alternative economy. There are probably between 150 and 200 professional smugglers of alcohol in Norway who used to derive all of their income from

smuggling. ‘Smugglers for life’ we may call them. They are proud of their profession, and they are willing to talk about it if they trust you. It goes without saying that these ‘smugglers for life’ are very familiar with the borders and the coast and know exactly where to drive or sail at what time without legal covers. Sensing danger, remembering faces, knowing people and ‘reading’ their characters are other talents that enable them to make a living out of smuggling. “I have smuggled for fifty years,” recounts Hans. “You may call it an immoral life, but it has been much fun too.” Bernhard, a former student of economics, who got a driver’s license and a truck to do professional smuggling, was rather philosophical about the risks: “We knew that sooner or later it would go to pieces, but it would not be a major disaster, not the end of the world!” “Why pretend to be someone else?” Gabriel, a veteran in illegal distilling, asked rhetorically. “With my reputation there is no sense in acting as if I have come up with something better. I have never sailed under false colours.” Money and knowing people is the formula, he goes on: “One has to have a lot of money in order to have a lot of contacts all around. Nobody is going to do anything for you for free. It is just like normal business. In the business community they sit in each other’s board committees. Between crooks, we do each other favours, but it is always a question of money.”

It is possible to work one’s way up from the bottom to a professional level, at least for a few talented ones. Skills may be learned while financial means do not constitute a real barrier to entry for smugglers either, provided they are willing to start small, and know subsequently how to reinvest their illegal profits. Whether the time scale is long or short is partly up to the smuggler or distiller. To quote one of them, “The demand is endless; it’s a market for everyone.” Almost, we should add, because it is a pretty tough game sometimes and there is no reason to buy into the romantic appeal of the informal economies. Stuart Henry properly warns that they “are themselves subject to some of the worst problems of formal institutions; inequalities, injustices and abuses...” (Henry, 1982: 472).

Vincenzo Ruggiero’s top dogs and underdogs in organised crime are as well known in the illegal alcohol market as they are in legal business (Ruggiero, 1996). Some of our smuggling ‘top dogs’ who engage in smuggling as an ‘alternative’ economy have a past in legal business, while more of them have worked their way up from the bottom:

“Dad was tired of slaving for other people, and started on his own, with fruit, cigarettes and booze. Mostly ‘black’. He had no driver’s license, by the way, and asked me to transport the booze for him. Here you see the coincidence of life. That’s how *I* got my start!”

Other underground entrepreneurs start and end their careers in illegal alcohol on the same shabby level as low-paid drivers, “black” workers, “muscles” and retail dealers with no pension rights or other licit employee benefits.

Criminal economy

Smuggling and illegal distilling are not seen as morally wrong by the professionals and their customers, although these activities are illegal and therefore constitute a *criminal* economy in certain ways. Smugglers and distillers have to take the precautions that are characteristic of an illegal market, and they have to keep a lower profile than legal businesses. The market is not really violent or tough. Customers have never posed a problem, and the elite of illegal alcohol smugglers used in the past – as one police officer explained in an interview – to be much harder on each other. Hijacking is a problem now and then, however. As the police officer complains: “no one calls us to inform”. Partners who cheat and mistrust each other are more important reasons for incrimination within illegal markets, even more so in the aftermath of arrests and interceptions.

The cumulative effect of prosecution efforts is well known. “Who will take the rap?” “Whose fault was it?” “Who has been informing?” are the questions that are asked. Buddies turn into enemies and hire “muscles” to fight each other. Trustful relations come to an end. Revenge and confrontation may take place in the worst of cases, but they are not common. The illegal alcohol market with its many ordinary, grown up and hardworking customers would not tolerate such situations for long. Robert S. Davis and Gary W. Potter, among others, see employees as one of the major security risks.

“Employees of illicit enterprises constitute the single greatest threat to their continuing operations because it is employees who make the best (and often the only) witnesses against the group. So, it is in the best interests of the illicit enterprise to limit the number of people who have knowledge about their operations” (Davis and Potter, 1991: 149)

Norwegian smugglers, it seems, do not like to fire people, although they have to now and then. Informing on their employers may be the revenge of the sacked, a risk which can be lowered by reducing staff and remaining small.

There are individuals who combine different criminal *modus operandi* or switch from one criminal arena to another depending on profits and risks. They are known as ‘criminal generalists’ (Johansen, 1996; Morselli, 2002). Most of them are rather confrontational after years in gangs and prisons, with no more respectability to lose, spreading their violent methods and mentality from one milieu to the other. Illegal alcohol, with its low risks and high profits has always been a honey pot for this type of offender. Drug money is invested in alcohol, alcohol money in drugs, and money from fencing in both drugs and alcohol (information from court files and interviews). Of course, there is some disagreement between the alcohol and drug entrepreneurs: “You cannot trust criminals. They have no limits”, warns a company smuggler. “The criminals draw attention”. Bill, a generalist who is as familiar with the supply of drugs as

with the supply of alcohol, disagrees: “Suppliers of alcohol are hypocrites, blaming drug dealers while selling bad booze to elderly alcoholics.”

The heroin and amphetamine markets, in comparison, are closer to being a ‘criminal’ economy according to some of the participants. Drug addicts may betray their best friends to free themselves from debts and prosecutions, says Rolf, a veteran supplier. Suppliers may sell fake drugs to addicts who are too weak to stand up for themselves. Bullies who specialise in hijacking are also a much bigger problem in the drugs business than in illegal alcohol. Rolf explains:

“That’s not very risky. Who calls the police? It is very easy to scare and rob a low class pusher who is scared as hell already. Cynical individualism is what counts. You can’t trust people.”

Rolf gives an old buddy who is down and blue, some extra drugs to get rid of him. Further down on the street the buddy meets a police patrol who knows him:

“He is high already, and can’t take another night in the cell. Police may have something on him, ratting or a crime he has not answered for, so he rats again to get off the hook.”

Rolf is presenting his worst-case scenario here. Not all addicts behave that way. Even a junky has a reputation to maintain in small markets like the Norwegian one, but there are more of these worst-case scenarios in drugs than in the illegal alcohol market, according to insiders who are familiar with both worlds. We are talking about very different customers then. Illegal alcohol dealers usually shy away from alcoholics and minors, well aware of the risks they run if they do not stick to the unwritten rules of the market. As a matter of fact, many intermediate dealers do not like to sell to junkies either (Reuter and Haaga, 1989). But in the Norwegian drugs market at least, some do, among them dealers who are addicts themselves.

“Company smugglers” with legal companies and covers, “professional smugglers” who see their activity as their main source of livelihood, and “criminal generalists” who are willing to engage in most kinds of criminal activity as long as there is money in it, have been well known roles and niches in Norwegian bootlegging all the way back to Prohibition. The differences between these roles and the economic sublevels are not always clear cut however. Company smugglers, professional smugglers and criminal generalists may work on their own, they may compete, or they may cooperate. In part, the nature of the illegal alcohol economy depends on the efforts of the police. More than one ‘company smuggler’ or ‘professional smuggler’ of yesterday has woken up as the ‘criminal’ or amateur of today after the police really went after them.

Illegal enterprises seem to have been small scale, informal, flexible and short lived. Mark H. Haller gives an example in his classic work on illegal alcohol and Prohibition in the US. “Even activities involving large sums of money and

substantial profits are often carried out by relatively small and informally structured groups” (Haller, 1990: 228). Letizia Paoli’s overview of European drugs markets in the 1990s makes observations similar to those of Haller:

“In Germany as well as in Italy and in Russia, many drugs enterprises are ‘crews’: loose associations of people, which form, split, and come together as each opportunity arises. In crews, positions and tasks are usually interchangeable and exclusivity is not required. Indeed, many crew members frequently have overlapping roles in other criminal enterprises” (Paoli, 2003: 22)

Klaus von Lampe has studied the illegal cigarette market:

“Taken as a whole, the cigarette black market in Germany seems to be characterised by low-density networks comprising small, simply structured enterprises and individual entrepreneurs, who perform relatively simple tasks. Group structures, to the extent they become visible, in general display little vertical or horizontal differentiation” (von Lampe, 2003: 59)

Small companies may have an advantage in having independent market positions and profitable subcontracting, which is one of the stated reasons for staying small, according to Linda Weiss (1987).

The stories about monopolistic criminal organisations in illegal alcohol in Norway are myths. “It’s not the way it works and not in our interest either”, a smuggler explained in an interview. “There has been enough for everyone and there have always been costumers who have asked for more”. Most smugglers and illegal distillers would agree, except for a handful in faraway districts with a limited number of customers. A regular business over time, monopoly or not, would be rather visible and risky. “There is no regularity in the transportation,” says one wholesaler. “That would have made the job too simple for the police. Irregularity is the answer, as much irregularity as possible”.

Small scale, informality, flexibility, decentralisation and coming and going are the main components of the picture of the illegal alcohol market, though not the *whole* picture either. Peter Reuter’s work on organised crime is interesting, but his concept of ‘disorganized crime’ (Reuter, 1983) is confusing in a way. Small size and flexible organisation may actually be the result of great organisational talent, and a very clever way of doing business in many markets, legal or illegal. A large, hierarchical organisation with factions difficult to control would operate very amateurishly in unpredictable markets like drugs or alcohol. The professionals among smugglers and distillers know exactly what they are doing when they prefer small scale and short time horizons.

Some regularity, at least in social terms, is not excluded though. Some teams have been in business with the same design and partners for a long while, even compared to legal companies. Ronny and his jailbird buddies were on the road with alcohol from Germany and to Norway for three or four years before they were caught. Edward and his sons and some old friends had a maritime alcohol

import undertaking going on from the Netherlands for at least three years. Christian, his partner and two drivers had imported 96 % proof alcohol from Spain for more than ten years prior to their downfall. Sales of illegal alcohol on the wholesale and retail levels show greater stability in districts where the police have been relaxed about illegal alcohol as long as certain unwritten rules have been respected (such as avoiding violence and the sale of narcotic drugs, and not selling alcohol to minors).

“The distribution level, that’s where you really see organisational stability, and even some hierarchy too”, says an insider. The wholesalers have for long periods been able to buy alcohol for a fair price due to their having a stronger market position than the importers.

Aside from stable co-operatives, many cunning smugglers change their criminal partners and organisational designs frequently for security reasons, starting over again with new partners, though from the same networks with the same kind of alcohol from the same contacts abroad. Veterans who have been in the business for more than a generation know how to start all over again after a break. What is of short duration and what is stable over time seen from that perspective? And what is the most interesting level of analysis, the single teams or the illegal alcohol market as a whole? Teams have been coming and going, while the illegal alcohol market has been in existence for more than seventy years, due to the competitive benefits such as the availability of alcohol at half the official price, the absence of taxes, sales to “dry” counties, workplace deliveries and some very liberal “opening hours.”

Cultural and political capital

Alcohol is legal in Norway, unlike drugs. Alcohol is Norwegian mainstream, narcotic drugs are “side-stream” and outlandish. The fear of drugs has grown to extreme proportions in Norway. About 100 officers worked in the anti-drugs division of the Oslo police in the 1990s, and only five in the team that investigated alcohol smugglers and illegal distillers. The maximum penalty for the smuggling of drugs is 21 years, while a professional smuggler of alcohol risks a maximum prison term of six years.

Illegal alcohol is an integrated part of mainstream culture in the way it is distributed via legal business infrastructures, to workplaces, voluntary organisations, sports clubs and other networks based on neighbourhood, kinship and friendship. It goes without saying that most of these networks were already there and smugglers and distillers began to ‘infiltrate’ them. Huge cargoes of illegal alcohol have been split up and distributed to customers through these networks, while the nature of the trade ranges from something ‘criminally organised’ to small-scale dealing or just a favour between friends. The low level of trust tends to be a problem in illegal markets, which Norwegian smugglers and dealers try to compensate for by “infiltrating” and recruiting partners and

customers from legal networks and meeting places where they are known and trusted as a result of activities other than the supply of illegal alcohol. (Von Lampe and Johansen, 2004). “No one in the business of illegal alcohol trusts each other unless they have been buddies for many years”, says Einar who has been importing for about 30 years.

Alcohol smuggling and illegal distilling have traditionally been viewed as having a ‘relative dignity’ compared to most other crimes. Traditional criminals see themselves as ‘rehabilitated’ after converting to illegal alcohol. Drug dealers sent to prison have been known to tell their families they were caught smuggling *alcohol*, knowing that illegal alcohol is less of a stigma for the family to have to bear.

Illegal alcohol has been associated with ‘relative dignity’ even among police officers who have observed cynical white-collar criminals victimise innocent people. Illegal alcohol was considered a ‘crime without victims’, until an import of methanol (instead of pure alcohol) from Portugal in 2002 cost 17 customers their lives. The smugglers lost face and prestige, but the market seems to be recovering again, as it has always done. The collective Norwegian memory is a very short one when it comes to alcohol. About 140 Norwegians died of drinking methanol in 1942 and 1943, when alcohol was rationed and much in demand. Those deaths did not have a substantial influence on the level of illegal demand either.

“Smuggling alcohol is the least criminal of the things we (the criminal generalists) are doing, the way we see it”, says informant Carl. The moral defence of the suppliers of illegal alcohol has always been ‘denial of injury’ and ‘condemnation of the condemners’. High taxation has made ‘the drinking majority’ pretty upset, even more so since they started spending their holidays in southern Europe, where alcohol is cheap and available. However, Norwegians are rather timid about their politically ‘incorrect’ attitudes and illegal dealings, if an unknown interviewer knocks on their doors. Protestant Norwegians with their strong feelings of guilt have always been reluctant to expose their liberal habits if they are unsure about the attitudes of a stranger. What you say or do not say may depend on whom you are talking to. The willingness to buy illegal alcohol and the way Norwegians drink it, however, says a lot more about the illegal demand, and that is what matters when it comes to the economic realities of an illegal market.

Corruption is not completely unknown in the business of ‘organised crime’ in Norway, but there was more of it a generation or two ago, as a sub-cultural phenomenon in the customs service. Customs officers with ‘wet’ habits who worked the same pier year after year in the 1950s got too familiar with their clients and were easy to approach for a favour. Corruption related to organised crime is not a big issue at the present time. It is quite possible to make large sums of money through smuggling without the need for bribes or corrupt protection.

Contemporary smuggling enterprises are very mobile, and this too reduces the need for corruption. The logistics are impressive. 20,000 litres of 98% proof alcohol crossing the boarder in the morning may be taken over by the

wholesalers by noon, and the retail dealers the same night. A stationary illegal business has a much greater need for protection. Illegal distillers who expanded from small-scale operations to the industrial level in the 1990s were taught that harsh lesson in the form of arrests and disastrous seizures. An illegal distiller will be successful as long as he keeps his business small, and moves his premises after a while.

Most smugglers and illegal distillers are ambivalent about corruption. They know that bribes may work, but that a corrupt offer can be a trap too. A veteran smuggler explains:

“I don’t believe in bribes. I want the police to be on one side of the wall, and my team on the other. The common customs officer does not have that much influence either, compared to the ‘Death Squadron’ with plans no one knows about.³ Guys who tell stories about corruption are liars who try to impress their crime partners.”

Grassing is an alternative to bribing. A police officer who gets upset if a smuggler tries to bribe him may be quite keen on obtaining ‘inside information’ and will know how to pay for it. Sometimes it seems that the bigger the crook the bigger the snitch. Though there is no money involved, it may have a bear a certain to corruption, with information being exchanged for favours, though in such cases the officer agrees to the exchange for the sake of combating crime rather than for his or her personal benefit. Whether such information exchange is ‘corrupt’ will depend on internal regulations and the way it can be accounted for. Reformers may be upset the first time they learn about grassing and the deals between crooks and police investigators. Such deals are, however, informal and have been standard among police investigators in most countries for generations. (Johansen, 1996; Gunnlaugsson and Thorsdottir, 1999).

Norway has a long history as civic society with horizontal democratic parties and organizations, with leaders and members who believe in their political ideologies and the general rules for politics and government. The political system is characterised by a high level of trust. There are at least seven relatively strong parties, which respect each other’s rights and are willing to enter into the necessary compromises. Criminal ‘muscle’ has never been in demand in Norwegian politics or labour conflicts, not even in the 1920s, which were a rather antagonistic era. Police leaders, sheriffs, judges and public prosecutors are appointed. They have never been elected, unlike their American counterparts who made deals with gangsters to win their elections (Potter and Lyman, 1997). The revolutionary wing of the Norwegian labour movement was critical of the police in the 1920s as far as crowd control was concerned, but neither the movement nor its leaders were antagonistic towards the police as such. Political

³ The ‘Death Squadron’ is an investigative unit which employs covert tactics and has broad jurisdiction, and which smugglers can only dream about neutralising

activists who fought the police in demonstrations had no doubts about calling the local police if they were victimised by a criminal. Asking the police for assistance has been a natural thing to do for most people and it still is.

The Norwegian peculiarity

There are a few aspects that set the Norwegian, or more generally, the Scandinavian, experience apart from the organised crime experience of other countries:

Principal organised crime problem

Illegal distilling and smuggling of alcohol, not drug trafficking, has been Norway's principal organised crime problem for many years. Finland and Sweden are not unfamiliar with illegal alcohol markets either. The Finns had their prohibition from 1919 to 1933 and the Swedes a rationing system for many years, and this too led to the development of black markets. Iceland banned fortified wines from 1915 to 1922, spirits from 1915 to 1933, and beer from 1915 to 1988. The Icelanders have their own smuggling tradition, involving fishermen returning from England and Scotland or legal maritime transport with alcohol as an unofficial extra, but they have never had professional smuggling like Finland, Norway and Sweden. The drugs trade is a developing business in all the Scandinavian countries, but it is much younger and smaller compared to the illegal alcohol market. As far as the market for 'private security' is concerned, none of the Scandinavian countries have traditions of criminal extortion or 'protection'. Given the legitimacy and efficiency of the police and the courts, private protection is redundant. The few contemporary examples of 'protection' mostly concern immigrants with a tradition of mistrust of the police.

Network-based organised crime, with something extra

Most teams involved in the supply of illegal alcohol have been flexible, informal, autonomous and short lived, but there is something more to the illegal alcohol market, however. The scale of operations and the stability of a criminal enterprise depend, among other things, on the level of interest on the part of the police and the customs service, which has changed over time and from district to district. Attempts at control have been focused more on the importer than on the local wholesalers and retailers. Some teams have been in the market for long periods. Other teams have had their rise and fall, but the illegal market as such has been a 'winner' throughout the period since the start of the Prohibition era.

Organised crime does not constitute a threat to Norwegian democracy

The civic political system of Norway has always been free of 'organised crime'. As mentioned above, politicians have never been in need of criminal muscle.

‘Organised criminals’ have not even dreamt about local power monopolies of the kind enjoyed by the Sicilian Mafia.

Corruption has been a minor problem as far as organised crime is concerned

The smuggling of alcohol or drugs can be fairly successfully organised without corrupt protection. Besides, criminals do not have that much to offer to officials and politicians either, except money. Corruption related to politics is not unknown, but then we have to turn to legal business and the bureaucracy to find the ‘meat-eaters’ of Norwegian corruption. High-level corruption in Norway seems to be concentrated in *certain* sectors, like shipping, oil and county administration (Andvig, 1994; Christophersen, 1997).

A Scandinavian irony

Ironically, the only significant case of alcohol related corruption in Norway so far occurred back in the early 1930s in the *legal* alcohol business. The sinners were the board of the Wine and Liquor State Monopoly. Most members were former wine importers who had been appointed because the Norwegian state wanted their professional expertise. Relatives and friends of these members, who were still in the private wine import business and depended on the State Monopoly for quotas, always got the best deals. As a result of the consequent scandal, the board resigned in disgrace. Another, contemporary, Scandinavian example concerns Systembolaget, Sweden’s state-owned monopoly for retail sales of alcohol. To be registered on the ordering lists and have their bottles displayed in Systembolaget’s stores has been a matter of life or death for private importers. Therefore they have been known to lobby the managers of these stores by offering dinners, luxury hotel weekends, tickets for sports events, free alcohol and some cash. The corruption is petty, but as long as it works, why pay more than you have to?

What about the future, then?

The long-established grey zone and the traditional collaboration between legal business and organised crime will probably grow in significance in the years to come. The grey zone has been well established in several legal branches for many years, and for new generations it is easy to enter. “That is my problem; I cannot see the difference”, a smuggler answered when I asked him about the morality of smugglers and legal businesses. “Legal business has dirty tricks and short-cuts of its own”. A successful legal entrepreneur was asked if he would ever befriend a business partner. “No, I don’t think so”, he answered after a moment of silence. “Sooner or later you may have to make decisions which are as cynical as they are unethical”.

There is no reason to think that there will be any increase in the level of violence in the illegal alcohol market in Norway, unless it is for short periods as the result of more aggressive police tactics, which may provoke conflicts among smugglers and illegal distillers. Organised crime has, however, recently taken a more violent turn in the area of armed robbery. About 100 hard-core veterans have been active in armed robbery for a while. Not surprisingly for a 'profession' of that kind, they are much more violent than the smugglers. They show less empathy and identify more closely with their criminal activities than the smugglers who are in their business for pure profit.

Talking of money, the two groups did actually 'meet' a short time ago, following a bank robbery in Oslo. One of the safes in the bank contained a million kroner belonging to an alcohol smuggler who became depressed and complained about his loss. The robber understood him very well and returned the money. Maybe there is some empathy and morality among crooks after all.

Apart from this heart-warming anecdote, when we view the two groups against the background of the traditional debate on organised crime, it is evident that alcohol smuggling and related crimes are still pretty peaceful in Norway, unlike crimes of commission, such as armed robbery which is a booming business. Of course, the latter has to be violent, at least potentially. But the two groups are still worlds apart. Neither has ever influenced the other, which casts doubt on the appropriateness of bringing them under the same confusing denominator of 'organised crime'.

References

- Alden, J.D., The extent and nature of double-jobholding in Britain. *Industrial Relations Journal*, vol. 8, 1-33, 1977
- Andvig, Jens Chr., *Økonomisk utroskap og trusler i oljeindustrien* (transl.: Financial illoyalty and threats in the Oil Industry). NUPI no. 187, Oslo, 1994
- Chirstophersen, Jan Georg, *Bestikkelser og utpressing i norsk utenriksfart – fortalt fra innsiden* (Transl.: Bribes and extortion in Norwegian Shipping. Told from the inside). Norges Forskningsråd, Oslo, 1997
- Davis, Robert S. and Garry Potter, Bootlegging and Rural Criminal Entrepreneurship. *Journal of Crime & Justice*, no. 1, 145-159, 1991
- Gershuny, J.G., The informal economy. Its role in post-industrial society. *Futures*, February Issue, 3-15, 1979
- Gunnaugsson, Helgi and Rannveig Thorisdottir, Iceland and the Nordic Drug survey. Drug use, Public Attitudes and Youth. *YOUTH*, vol. 7, no. 1, 1-18, 1999
- Haller, Mark H., Illegal enterprise. A theoretical and historical interpretation. *Criminology*, no. 2, 207 – 235, 1990
- Henry, S., The Working unemployed: perspectives on the informal economy and unemployment. *The Sociological Review*, no. 1, 460-477, 1982
- Johansen, P.O., *Markedet som ikke ville dø, Forbudstiden og de illegale alkoholmarkedene i Norge og USA* (Transl.: The never dying market, the Prohibition in Norway and USA). Oslo, Rusmiddeldirektoratet, 1994
- Johansen, P.O., *Den illegale spriten* (Transl.: The illegal booze). Oslo, Unipub, 2004
- Johansen, P.O., *Nettverk i gråsonen* (Transl.: Networks in the grey zone). Oslo, Ad Notam, 1996
- Lampe, Klaus von, Organising the nicotine racket. Patterns of criminal cooperation in the cigarette black market in Germany. In: P.C. van Duyne, K. von Lampe and James L. Newell (eds.), *Criminal finances and organizing crime in Europe*. Nijmegen, Wolf Legal Publishers, 2003
- Lampe, Klaus von, and Per Ole Johansen, Criminal Networks and Trust. In: S. Nevala and K. Aromaa (eds.), *Organised Crime, Trafficking, Drugs*. Helsinki, Heuni, 2004
- Lyman, Michael D. and Gary Potter, *Organized Crime*. Upper Saddle River NJ, Prentice Hall, 1997
- Morselli, C., ‘Structuring Mr. Nice’: entrepreneurial opportunities and brokerage in the cannabis trade. *Crime, Law and Social Change*, no. 2, 203-233, 2001
- Paoli, Letizia, The “invisible hand of the market”: The illegal drugs trade in Germany, Italy and Russia. In: P.C. van Duyne, K. von Lampe and James L. Newell (eds.), *Criminal finances and organising crime in Europe*. Nijmegen, Wolf Legal Publishers, 2003
- Reuter, Peter, *Disorganized crime, Illegal markets and the Mafia*. Cambridge MA, The MIT Press, 1983

- Reuter, P. and J. Haaga, *The organization of high-level drug markets: an exploratory study*. Rand Corporation, 1989
- Ruggiero, Vincenzo, *Organized and Corporate crime in Europe, Offers you can't refuse*. Dartmouth, 1996
- Skog, Ole Jørgen, Utviklingen av det norske narkotikaproblemet (Transl.: The development of the Norwegian drugproblem). In: Helga Waal and Anne-Lise Middelthon (eds.), *Narkotikaforbygging mot år 2000*. Oslo, Universitetsforlaget, 1992
- Weiss, Linda, Explaining the Underground Economy: State and Social structure. *The British Journal of Sociology*, no. 2, 216-234, 1987

Explaining the emergence of the cigarette black market in Germany

Klaus von Lampe¹

Introduction

The illegal trade in untaxed cigarettes has come to be recognised as a significant problem around the world. According to some estimates, almost one third of global cigarette exports is funnelled into black markets (Joossens and Raw, 1998: 66), accounting for between 6 and 8.5 percent of all cigarette consumption (Merriman *et al.*, 2000: 383). However, the problem appears to be unevenly distributed across countries and regions, with Germany, the focal point of this chapter, falling into a middle category of countries that experience a considerable level of cigarette smuggling but not as much as the countries that are most affected (European Parliament, 1997, 63; Merriman *et al.*, 2000: 373–374).

A number of factors have been identified to explain why cigarette black markets emerge and why the problem is more substantial in some countries than in others (Joossens *et al.* 2000; Bundesministerium der Finanzen, 2003). The most obvious reason for cigarette smuggling in a broad sense is seen in the fact that cigarettes are typically subject to high taxation. The difference between net (duty-free) prices and legal retail prices provides an incentive for circumventing taxes. Those capable of procuring untaxed cigarettes for distribution can pocket a large share of the difference between the duty-free price and the duty-paid price as a profit. The profit margins are huge considering that the total incidence of tax on the purchase price of cigarettes in many countries, including Germany, exceeds the 70 percent mark and in some cases may even be above 80 percent (European Parliament, 1997: 61; Körner 1996: 30). A second major factor which is regularly named is the difference in retail prices between countries due to different levels of taxation (Beare, 2002, 2003; Van Duyne, 2003). Depending on the extent of the price disparity and on the transport costs involved, it can be lucrative to buy cigarettes in a low-tax country and to sell them in a high-tax country (Merriman *et al.*, 2000: 366).

Other factors that have been linked to cigarette black markets include “the presence of informal distribution networks, organized crime, industry participation, and corruption” (Joossens *et al.*, 2000: 403; see also Beare, 2002, 2003). It is not clear however, to what extent these factors are causes of black markets or factors that only come into play in later stages of the developmental

¹ Klaus von Lampe is researcher at the Faculty of Law of the Freie Universität Berlin, Germany.

process. While some argue that cigarette smuggling will almost automatically increase with increases in the levels of taxation and cross-national price disparities, others claim that the problem takes on substantial proportions only when smuggling activities move from small-scale ‘bootlegging’, meaning the smuggling of cigarettes purchased in low-tax countries, to ‘large-scale organised smuggling’ involving the diversion of container loads of untaxed cigarettes to the black market (Joossens *et al.*, 2000: 398). According to this latter view, smuggling is not restricted to regions where taxes and prices are high, and it becomes a problem only when domestic brands become available to smuggling networks (Joossens and Raw, 2000: 949), which implies an open or tacit agreement between tobacco manufacturers and black marketeers.

The purpose of this chapter is to examine some of the factors that account for the emergence of the cigarette black market in Germany in the early 1990s. In a previous paper drawing on a variety of mostly open sources (von Lampe, 2002), the cigarette black market in Germany was described as an example of the social embeddedness of illegal markets; and in another paper, using a small sample of criminal files (n=14) as a primary data source (von Lampe, 2003), it served as a case study for examining the structure of criminal enterprises.² This chapter explores the emergence of the cigarette black market in Germany using official statistics, unpublished law enforcement statistics, and a larger sample of criminal files (n=47). These data show some peculiarities in the temporal and spatial distribution of cigarette trafficking in Germany, and shed some light on the offenders and offender groups involved in black market activities. The evidence collected raises doubts about many assumptions concerning the root causes of cigarette smuggling on a grand scale. Specifically, it will be argued that high levels of taxation, cross-border price differences and the involvement of crime syndicates are not adequate or sufficient explanations.

Historical origins of the German cigarette black market

There are primarily two images associated with the illegal cigarette trade in Germany: one is that of Vietnamese street vendors openly selling contraband cigarettes in East Germany. The other image is that of huge amounts of contraband cigarettes being seized by the authorities in shipments ranging from a few cartons to entire container loads. Both images are closely linked to a specific historic period, namely the years following the fall of the Berlin Wall. As has been described elsewhere (von Lampe, 2002), the emergence of the cigarette black market in Germany can be pinpointed with some accuracy. While some cigarette smuggling, mostly involving merchandise purchased in Luxemburg and

² For a similar study of the structure of illegal enterprises involved in the cigarette black market in the Netherlands, see Van Duyne (2003).

in Eastern European valuta stores, had existed on a small scale for some time, it was only in the years 1990 and 1991 that an extensive street market for contraband cigarettes developed and the numbers of seized contraband cigarettes skyrocketed (Bundesministerium der Finanzen, 2003).

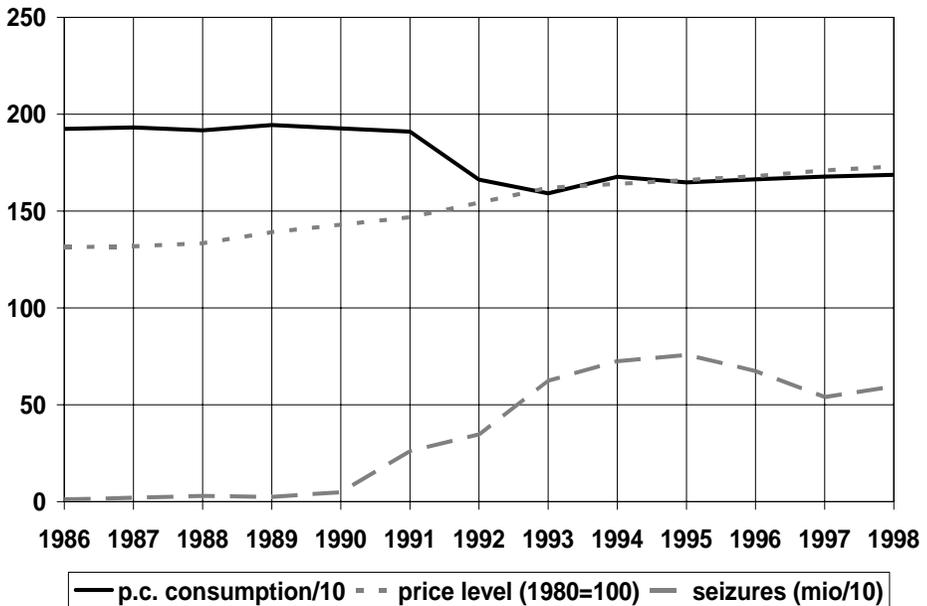
Before the question of causation is addressed it appears appropriate briefly to examine the history of the large-scale black market, again drawing on previous discussions (Von Lampe, 2002). The origins of the cigarette black market as it developed in the early 1990s can be traced back to the winter and spring of 1989. In January 1989 the visa obligation for Polish citizens travelling to the then capitalist enclave of West Berlin was lifted. This spawned an anarchic cross-border trade with a wide range of goods being brought from Poland to be sold on the streets or at make-shift, open-air markets. These goods included electronic appliances, tools, alcoholic beverages and cigarettes. In June of 1990, immediately after the currency union between the Federal Republic of Germany and the German Democratic Republic, and three months prior to German reunification, the open sale of contraband cigarettes shifted and spread to other places in Eastern Germany while the open market in West Berlin was successfully curbed through rigid police intervention. A year later, the illicit sale of cigarettes had become an established part of the economy, allegedly accounting for up to one third of the cigarettes consumed by East Germans (*Der Spiegel* 26/1991, 56). By then, in the summer of 1991, Polish vendors had largely given way to former Vietnamese guest workers, who had been recruited by the East German government and had lost their jobs in the course of economic reconstruction following the collapse of the socialist regime (Krebs, 1999). During the same period the annual number of contraband cigarettes seized by the Customs Service had risen from some 24 million in West Germany in 1989 to 260 million in unified Germany in 1991 and 346 million in 1992 (Von Lampe, 2002: 145-146).

Looking for explanations

The price argument

Having briefly outlined the origins of the cigarette black market, attention can be shifted to potential explanations. Let us begin with the price argument. We would expect the emergence of the cigarette black market to coincide with a marked increase in the price of cigarettes on the German retail market.

To test this assumption we are, as mentioned, in the advantageous position of being able to determine with some accuracy the point in time when the cigarette black market emerged as a large-scale phenomenon. When we look at figure 1 showing the trends in the per-capita consumption of taxed cigarettes, represented by the black line, and in the amounts of seized contraband cigarettes, represented by the grey broken line, significant changes taking place in the years 1991 and 1992 become discernible.

Figure 1. Trends in Retail Price, Legal Per-Capita Consumption and Seizures of Cigarettes

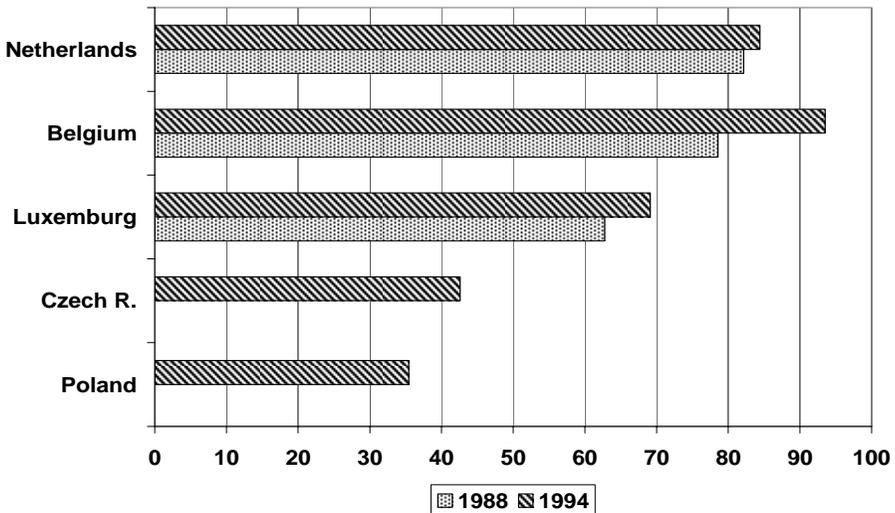
The drop in legal consumption (from around 1,900 in 1989 to around 1,600 in 1992) and the increase in the number of seized contraband cigarettes (from 24 million in 1989 to 346 million in 1992), which coincide with the mass appearance of street vendors of contraband cigarettes in East Germany, indicate a sudden growth in illicit cigarette trafficking. These developments, in turn, do indeed coincide with increases in the legal sales prices of cigarettes, represented in figure 1 by the dotted grey line. There is generally a high positive correlation of .94 (Spearman r) between legal prices and the number of seized cigarettes, and a high negative correlation of $-.89$ between legal prices and legal per-capita consumption in the time period to which this figure refers, 1986 through 1998. However, there is no *sharp* price increase in the early 1990s that would explain the turn of events that took place within this short time span. In fact, it is interesting to note that the price of cigarettes in East Germany was not affected by the currency union in June 1990 (Nierhaus, 1990).

Cross-national price disparities

Another factor seems to have more explanatory power: the increased difference between retail prices in Germany and neighbouring low-tax countries (figure 2). Whereas in the 1980s, the greatest price differential amounted to about 37 percent in the case of Luxemburg, after the fall of the Berlin Wall the differences in price levels increased to about 65 percent in the case of Poland and about 57 percent in the case of the Czech Republic (Eurostat, 1990; Körner, 1996). This

means that whereas in the 1980s, Germans could save only 37 percent on purchases of cigarettes in cross-border shopping, in the 1990s this margin increased to 65 percent. Quite obviously this has not only created incentives for shopping tours to neighbouring countries, but also opportunities for illicit profit making. However, the question remains: Does this sudden increase in cross-national price disparity provide an exhaustive explanation for the emergence of the cigarette black market in Germany? This would be the case if the factors that transformed Germany into a comparatively high-tax country had led to a more or less even spread of contraband cigarette trafficking nationwide. But this does not seem to have been the case.

Figure 2. Price Differentials between Germany and Selected Neighbouring Countries (Germany=100)



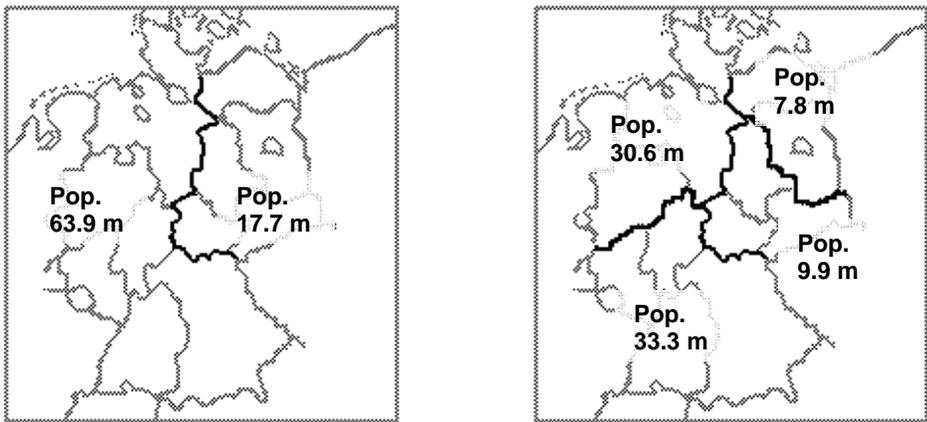
It has already been emphasised that the visible black market emerged in West-Berlin and later shifted to other parts of East Germany, but that it never took on similar proportions in West Germany. The available statistical evidence, derived from the Customs Service database INZOLL, confirms this geographical concentration.

Geographical concentration of the black market

The database INZOLL inter alia stores records on all cigarette-related proceedings initiated by the branches of the Customs Service across Germany. Apart from the investigations conducted by the central Customs agency Zollkriminalamt, which make up only a small share of the entire case load (between 0 and 5.5 percent per year), it is possible to determine the geographical

location of each investigation by looking at the branch office in charge. Using the records contained in the database as of November 2002 for the years 1989 through 1999 ($n = 216,612$), we were able roughly to group the cases into two categories, one comprising the investigations conducted by branch offices located in West Germany and the other comprising the investigations conducted by branch offices located in East Germany including Berlin (table 1). The East German branches cover an area with a population of 17.7 million, whereas the West German branches cover a territory that is about twice as large with a population that, at 63.9 million, is more than three times as large.

Figure 3. Dividing Germany for Analytical Purposes

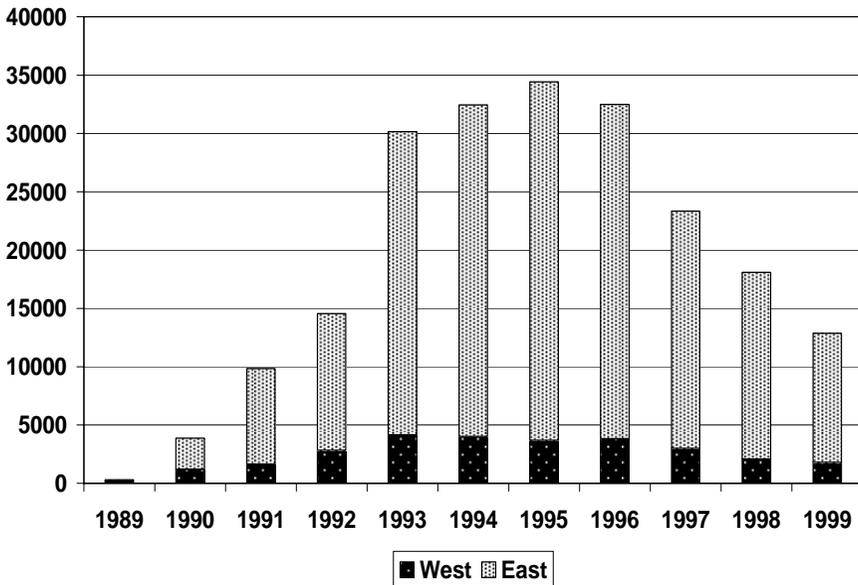


The analysis (figure 4) shows that despite the significantly smaller territory and smaller population of East Germany, the number of cigarette-related investigations conducted by the East German branches of the Customs Service by far exceed the number of investigations in West Germany in every year during the 1990s. Within limits these figures permit the conclusion that the cigarette black market has indeed been far more prevalent in East Germany than in West Germany.

Of course, law enforcement statistics are not a pure reflection of the crime picture. Other factors come into play, like the motivation to report crimes to the authorities and the willingness and ability of law enforcement agencies to respond to these reports and to initiate investigations. But considering that the Customs Service underwent fundamental reconstruction in East Germany during the early 1990s and thus was less well prepared to investigate cigarette smuggling than the Customs Service branches in West Germany, one would have expected these factors to contribute to higher numbers of recorded cigarette-related crimes in the West than in the East. Another aspect that points in the same direction is the fact that most of the cases centrally handled by the Zollkriminalamt pertain to the investigations of a special unit (“SOKO Blauer Dunst”) which was formed to support the East German branch offices of the

Customs Service in the fight against cigarette smuggling. So in sum, the actual geographical concentration in the East is likely to be even more substantial than indicated by the data presented in figure 4.

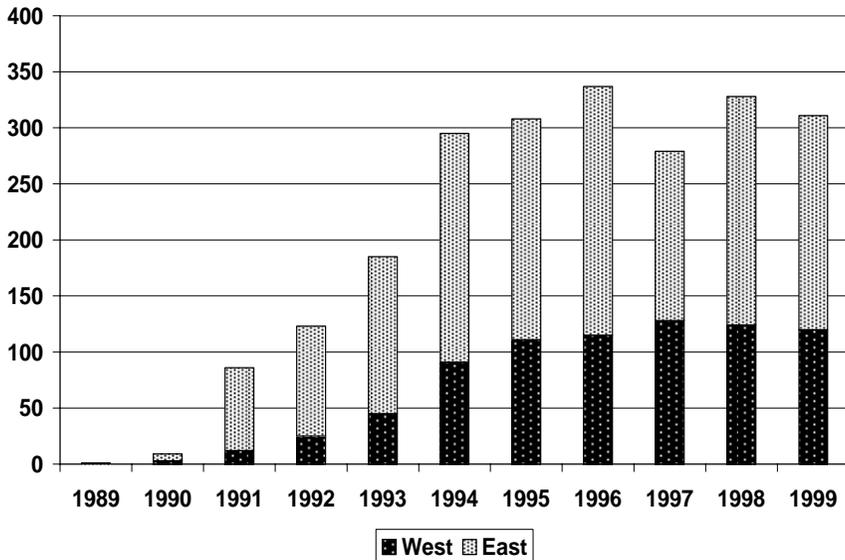
Figure 4. Number of Cigarette-Related Investigations by Branch Offices of the Customs Service in East Germany (incl. Berlin) and West Germany, 1989-1999



A less dramatic but still considerable difference between East and West Germany exists when the analysis is confined to cases involving bulk loads of 150,000 cigarettes and more (figure 5). This indicates that there is a higher regional concentration of the retail market than of the wholesale market.

At the same time, a comparison between the two graphs shows that bulk shipments make up only a small fraction of cigarette-related investigations by the Customs Service, which suggests that what has been termed 'large-scale organised smuggling' is not necessarily the dominating force in the German cigarette black market.

Figure 5. Investigations by Branch Offices of the Customs Service in East Germany (incl. Berlin) and West Germany Involving 150.000 Cigarettes or more, 1989-1999



Given the fact that the price differentials between Germany and its neighbouring low-tax countries affect the country as a whole (because there are no regional price differences within Germany) it needs to be explained why contraband cigarette trafficking emerged primarily as an East German problem. There are, in fact, some at first glance plausible explanations (von Lampe, 2002, 148-149), including:

- the greater geographical proximity of East Germany to the low-tax countries Poland and the Czech Republic;
- lower income levels and higher unemployment in East Germany as compared to West Germany;
- a legitimacy problem as regards the legal system which was quite rigidly transferred from West to East Germany;
- the structural weakness of law enforcement in the period of transition; and
- the existence of a Vietnamese community in East Germany that for peculiar reasons has provided a large workforce for the street sale of contraband cigarettes.

Some of these explanations are less convincing than others because they cannot explain the differences between East Berlin, with its extensive street selling of contraband cigarettes, and West Berlin, where the open black market has all but disappeared since 1989 and 1990. This is the case with regard to the explanations

that refer to the geographical proximity to Poland and the socio-economic situation. Berlin as a whole is only about an hour away by car or train from the Polish border and the unemployment rate, to take one socio-economic indicator as an example, has consistently been above the national average in both parts of Berlin with the West Berlin rate even exceeding the unemployment rate in East Berlin by 1994.

Leaving aside the special case of West Berlin, the factors listed could explain the geographical concentration of the cigarette black market in East Germany only if there were an even distribution across that area, because all the factors would seem to apply equally to all parts of East Germany. But again, the Customs Service records show a different picture. When for analytical purposes the set of cigarette-related investigations is broken down into smaller territorial categories (see table 1 above), a more specific geographical concentration surfaces.

East and West Germany, respectively, can be subdivided along state lines into two territories of roughly equal size (table 1): Northwest Germany (population 30.6 million) and Southwest Germany (33.3 million), and Northeast Germany (7.8 million) and Southeast Germany (9.9 million). On this level of analysis it becomes apparent that what at first had seemed to be an East-West difference is in fact to a large degree a difference between Northeast Germany and the rest of the country.

Figure 6 shows the number of cigarette-related investigations of the Customs Service branches located in Berlin, Brandenburg and Mecklenburg-Western Pomerania (Northeast) on one hand, and in Saxony-Anhalt, Thuringia and Saxony (Southeast) on the other. As can be seen, by far the largest number of cigarette-related investigations in East Germany were conducted in the Northeast. In 1991, the ratio was 6,171 : 2,022; in 1992, 9,194 : 2,524; in 1993, 18,392 : 7,611. Overall, the Northeast German branches of the Customs Service, which covered a territory with less than 10 percent of the national population, accounted for 43 percent of all cigarette-related investigations in Germany in 1989; 62 percent in 1990; 61 percent in 1991; 60 percent in 1992; 58 percent in 1993; 66 percent in 1994; 75 percent in 1995; 74 percent in 1996; 75 percent in 1997; 77 percent in 1998, and 74 percent in 1999.

The difference is less drastic but still considerable when we confine our attention to the up to 350 cases nationwide each year that involve bulk loads of 150,000 cigarettes and more. Figure 7 shows the comparative figures for Northeast and Southeast Germany, suggesting that the geographical concentration in the larger Berlin area applies more to retail sales than to bulk smuggling and wholesale trafficking.

Figure 6. Cigarette-Related Investigations by Branch Offices of the Customs Service in Northeast and Southeast Germany, 1989-1999

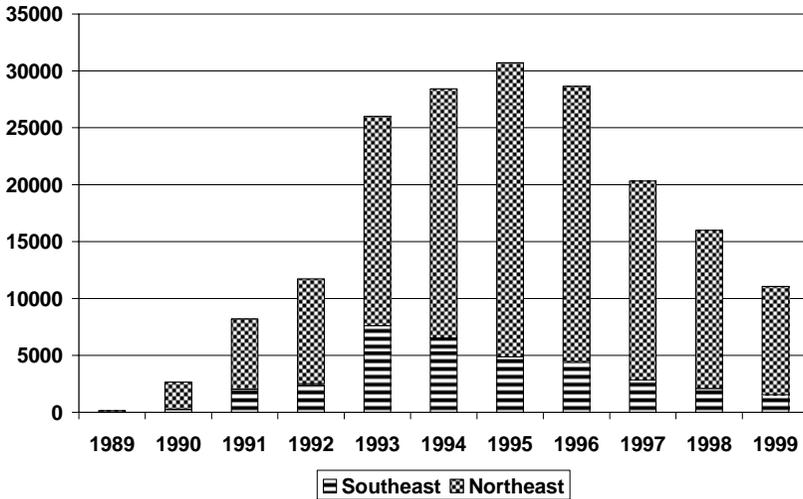
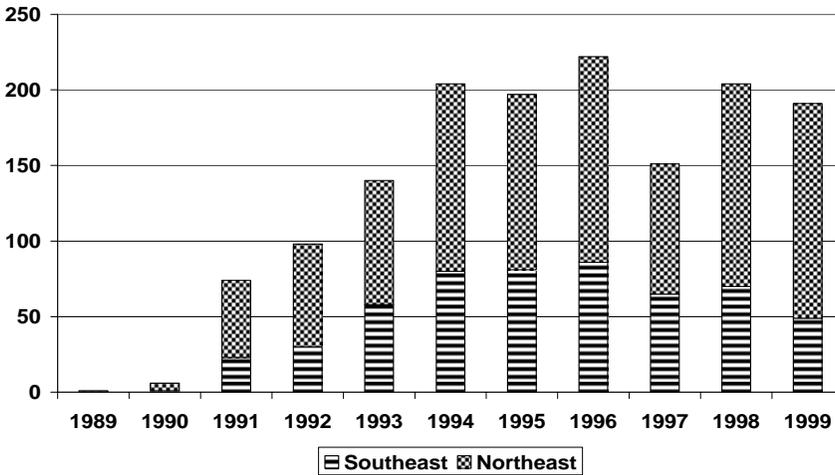
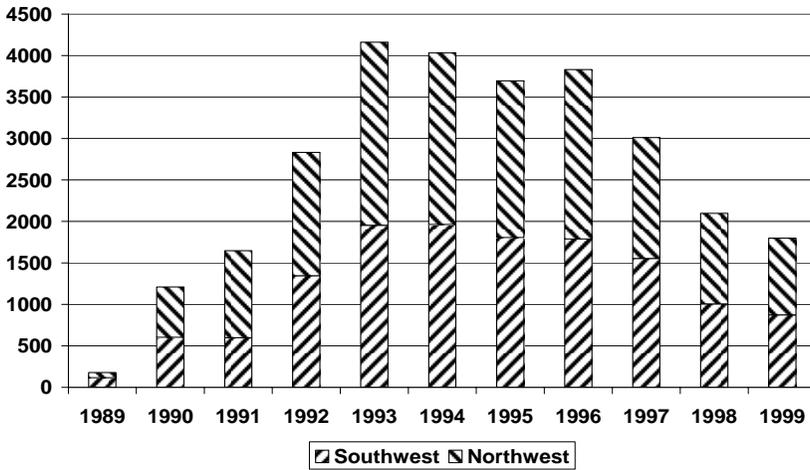


Figure 7. Investigations by Branch Offices of the Customs Service Involving 150.000 Cigarettes or more in Northeast and Southeast Germany, 1989-1999



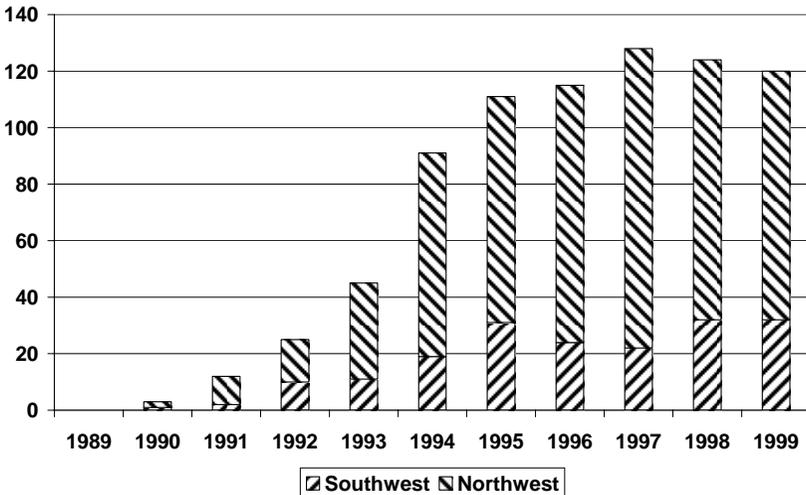
Interestingly, the opposite picture is provided by the statistics for the Western parts of the country (figure 8). Here, the investigations are evenly distributed between the Northwest and Southwest.

Figure 8. Cigarette-Related Investigations by Branch Offices of the Customs Service in Northwest and Southwest Germany, 1989-1999



However, a clear geographical concentration in the Northwest can be discerned for cases involving bulk shipments (figure 9). Without being able to go into details, we think it peculiar to find a concentration of bulk shipments in Northwest Germany from 1991 onwards – that is, long before a large scale black market for cigarettes developed in Britain and transit through Germany and the Benelux countries became a characteristic component of the cigarette smuggling picture in Northwest Europe (Joossens and Raw, 2000: 949).

Figure 9. Investigations by Branch Offices of the Customs Service Involving 150.000 Cigarettes and more in Northwest and Southwest Germany, 1989-1999



The People Behind the Black Market

Turning back to the situation in East Germany it appears justified to conclude from the available evidence that there is a concentration of trafficking activities in the larger Berlin area. This suggests that the conditions here are particularly conducive to the emergence of a cigarette black market even though it must be taken into account that a major share of investigations (about 20 percent in 1993) in the Northeast relates to smuggling activities at the German-Polish border in and around Frankfurt (Oder) which has been one of the most important transit points for East-West commerce and travel.

Assuming that the basic socio-economic conditions are more or less identical across Eastern Germany there have to be other factors that come into play to explain the concentration in the larger Berlin area.

The Vietnamese Community in East Germany

One aspect that merits closer attention is the involvement of Vietnamese on the lower levels of the black market. The fact of the matter is that beginning in 1990 and 1991 Vietnamese vendors by and large took over the street sale of contraband cigarettes. This development can be explained by a number of factors which have been detailed elsewhere (von Lampe, 2002). Briefly summarised, many of the Vietnamese living as guest workers in East Germany by the time the currency union made it lucrative to sell contraband cigarettes, were willing and able to enter the black market. They had the necessary experience from wheeling and dealing under the socialist regime, and faced with unemployment they had an economic incentive. But most of all they proved particularly resistant to law enforcement pressure. Investigations were hampered by the language barrier, by the spatial seclusion of the Vietnamese community in designated housing projects, and by the fact that Vietnam displayed great reluctance to accept extradited citizens. This effectively removed the most pressing burden that existed for non-German illicit cigarette vendors. Finally, Vietnamese had a competitive advantage over other ethnic groups because of their distinct appearance. They could be easily recognised as cigarette dealers and a Vietnamese standing by a subway station equipped with a plastic bag or a pack of cigarettes quickly became something of a trademark for the sale of contraband cigarettes. Retrospectively one is inclined to say that it was only because of the simultaneous visibility and relative immunity of the Vietnamese street vendors that a large-scale black market could develop.

Against this background it seems obvious to ask whether the geographical concentration of the black market in Northeast Germany is related to a similar concentration of the Vietnamese community. But the available evidence does not corroborate this assumption. On the contrary, figures provided by the German office of statistics (Statistisches Bundesamt) suggest that more

Vietnamese lived in Southeast Germany than in Northeast Germany. In 1991, the year when Vietnamese vendors took over the illegal retail market for cigarettes, 11,830 Vietnamese citizens officially resided in Berlin, Brandenburg and Mecklenburg-Western Pomerania, compared to 16,792 in Saxony-Anhalt, Thuringia and Saxony.

A Sample of 47 Criminal Cases

Having more or less exhausted the possibilities of finding an explanation for the apparent geographical concentration of the cigarette black market in Germany on the statistical level, attention can be shifted to the available qualitative data. These have been obtained from the analysis of a sample of criminal cases pertaining to cigarette trafficking in Berlin in the years 1990 through 1994. The cases were selected from investigations conducted by the Berlin branch of the Customs Service. Using the INZOLL database, the ten investigations involving the largest numbers of cigarettes recorded or seized, and at least three suspects, were selected for each year. These selection criteria were chosen in order to make it possible to examine cases that represent the highest market levels and that involve potentially the most complex detected offender networks, in order to gain insight into the operation of those actors that may be regarded as being among the key players in the black market.

Because for 1990 only few cases fit the criteria and overall the selected files were not always available for analysis, the sample contains different numbers of files from each year (1990: 3; 1991: 13; 1992: 14; 1993: 10; 1994: 7). Contrary to initial expectations the 47 cases that were eventually analysed do not pertain exclusively to high echelon groups. Rather, the investigations deal with networks from all market levels:

- 4 cases involve suspects who smuggled cigarettes and then sold them directly to consumers;
- 24 cases deal with the smuggling of cigarettes for the purpose of supplying wholesale and retail dealers in Germany;
- 6 cases pertain to retail dealing;
- 8 cases are about wholesale dealers who supply retail dealers;
- and in another 5 cases smugglers were apprehended without the destination of the contraband cigarettes becoming apparent.

It appears to be worth looking at these cases in search of answers to the question of why the cigarette black market emerged and developed primarily in Northeast Germany. While the cases do not allow a comparison with other regions, the analysis may hint at possible explanations in the sense that characteristic features of black market operations showing up in the analysis of the Berlin cases may be unique to this region. Against the background of

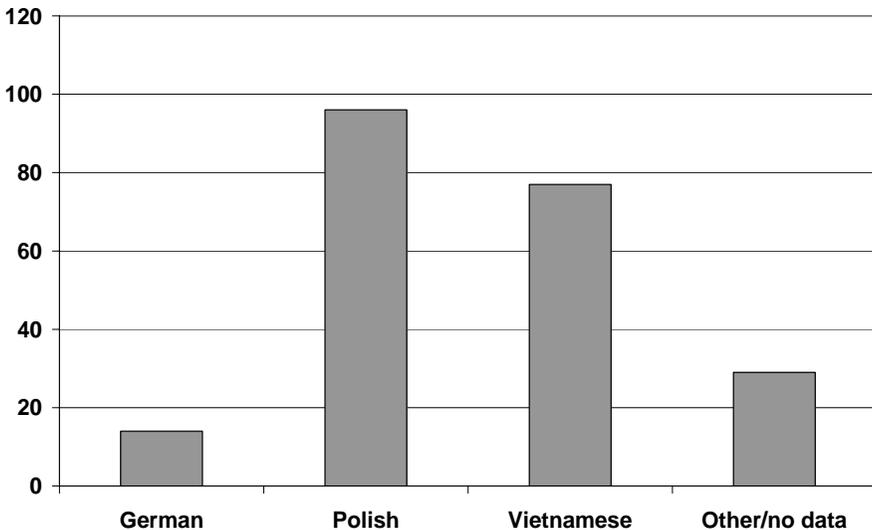
imagery linking large scale cigarette black markets with ‘organised crime’ the focus is on the individuals involved in the black market, the structure and sophistication of criminal enterprises and the linkage between different market levels.

Personal Characteristics

The 47 case files contain more or less complete information on 216 likely offenders. Drawing on the available information the average age of the suspects is 27 with a median age of 28. 11.7 percent of the suspects are women, mostly wives or relatives of co-offenders, and 93.4 percent are non-German nationals.

When we look at the nationality of these suspects (figure 10) we find two groups dominating: Polish citizens on the supply side and Vietnamese on the intermediate and retail levels. Typically, cases involve Polish smugglers supplying Vietnamese wholesale or retail dealers.

Figure 10. Nationality of Likely Offenders (n=216) in a Sample of 47 Cigarette Trafficking Cases from Berlin, 1990-1994



The clear dominance of these two groups is likely to conjure up images of ethnic mafias taking control of an illegal market and dividing it into zones of interest. But the information contained in the criminal files analysed paints a different picture. Most of the suspects do not seem to be hardened career criminals. According to the information contained in the criminal files, only 24 of the 216 suspects had been involved in crimes other than cigarette-related offences. Of these only 11 had been involved in property crimes and/or violent crimes. The remaining 13 had been charged with offences such as traffic

violations and infringement of migration laws. More specifically, evidence of criminal involvement outside the cigarette black market could be found for only 8 percent of the Polish smugglers and traffickers and for only 18 percent of the Vietnamese dealers. The shares for property crimes and violent crimes were 4.7 percent in the case of the Polish suspects and 3.5 percent in the case of the Vietnamese suspects. This is in line with the findings of Van Duyne (2003) concerning cigarette smuggling in the Netherlands.

A similar picture emerges with regard to legal employment. Of the 126 subjects for which the files contained information about their employment situation, there were 52 who held a legitimate job, went to school, or received a pension, and apparently used cigarette trafficking only to supplement their legitimate incomes. Interestingly, the share of suspects in this category was much higher in the first two years (77.8 percent in 1990 and 73.7 percent in 1991) than in the following three years (1992: 19 percent; 1993: 25 percent; 1994: 35.7 percent). In the case of Vietnamese dealers this is probably due in part to the fact that Vietnamese who had originally come to East Germany as guest workers were laid off during the transition period. Partly it is due to the fact that newly arriving Vietnamese who went into cigarette trafficking, typically relatives of Vietnamese guest workers, had to apply for political asylum and were not permitted to work.

Overall, it seems that market participants were drawn into crime through a combination of push and pull factors more or less specific to the illicit cigarette business.

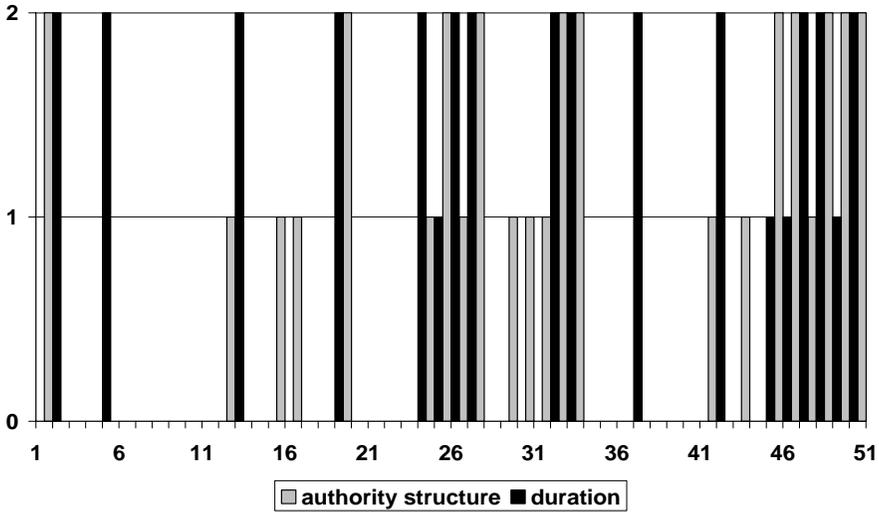
Patterns of Criminal Cooperation

The available evidence on the patterns of criminal cooperation corroborates this assessment. Cooperation seems to have been mostly opportunistic among actors who belong to fairly limited social networks. However, there appears to be a trend towards more durable and more complex patterns of cooperation over time.

In the 47 criminal files analysed, information was available concerning 51 different sub-networks. These can be tentatively classified along two dimensions: authority structure, meaning a vertical differentiation between leaders and followers; and duration, referring to the lifespan of the network beyond a single endeavour.

Given the fact that the information contained in criminal files is often ambiguous, the classification refers to indicators that suggest the possibility that a given network has reached a certain level of structural sophistication. Figure 11 lists the 51 identified sub-networks in chronological order and shows the presence or absence of information hinting at the existence of durable network links and authority relations.

Figure 11. Indications of Authority Structure and Duration for 51 (Sub-) Networks (in Chronological Order)



A grey column with a value of 1 indicates that there is an evidence that in the particular network one member stands out as *primus inter pares*, whereas a values of 2 stands for an outright command structure, as is the case when a trafficker hires a helping hand to unload a shipment of contraband cigarettes. A black column with a value of 1 indicates that the offenders concerned cooperate repeatedly though sporadically, while a value of 2 stands for continuous cooperation. If no columns are assigned to a case it means that there is no evidence contained in the file that the cooperation was anything other than a one-off joint venture among equals.

The graph suggests mainly two things. First, that the overall structural sophistication of the networks involved in the cigarette black market was low in the initial phase of development between 1990 and 1994: 24 out of the 51 identified networks show neither vertical differentiation nor existence beyond a single endeavour. Second, the graph hints at a trend towards increasing sophistication. The networks that fall into the period that runs from the second half of 1992 to the end of 1994 (networks 23 through 51) are more likely to show signs of some form of authority structure and/or a longer life span than the networks detected between 1990 and the first half of 1992 (networks 1 through 22).

Given these tentative findings it seems that the black market is not so much the product of sophisticated criminal networks but rather, that the sophistication of market participants has increased over time along with or following the growth of the black market. We can also find evidence of this trend on the biographical level. In the 47 criminal files analysed there are several examples of market participants who originally started out as unsophisticated amateur black

marketeers and then moved up from small-scale smuggling and selling to bulk smuggling and wholesale trafficking.

Thus, the explanation for the emergence of the cigarette black market in Germany and especially in the greater Berlin area apparently has to be sought elsewhere than in the alleged presence of crime syndicates.

The Link Between Polish Suppliers and Vietnamese Dealers

While the analysis of case files does not produce any conclusive results, the one feature that stands out is the link between Polish suppliers and Vietnamese dealers. It can be hypothesised that this cooperation has been crucial for the development of the black market and that the best conditions for this supply channel have been in existence in the Berlin area.

Indeed, from a purely statistical point of view it is noteworthy that the size of the Polish community is a factor that distinguishes Northeast Germany from Southeast Germany. Whereas 32,800 Polish Nationals officially resided in the Northeast in 1991, most of them (25,800) in Berlin, in the Southeast the number was only 16,500 (Statistisches Bundesamt, 1993: 72). Beyond pure statistics, the early history of the black market gives credence to the claim that the Polish-Vietnamese connection is vitally important. When the street selling of contraband cigarettes emerged in East Germany in mid 1990, supply lines from Poland had already existed in Berlin for more than a year while similar channels had yet to be established in other parts of the country. This probably allowed the black market to grow more rapidly in the Berlin area while also turning Berlin into a transshipment centre for contraband cigarettes going to other local black markets. In fact, in three of the 47 criminal files analysed, cigarettes were first brought to Berlin and then passed on to Vietnamese dealers in other cities, namely Halle and Magdeburg in the state of Saxony-Anhalt and Dresden in the state of Saxony, which are between 155 and 190 km away from Berlin.

Summary and Conclusion

According to conventional wisdom, high levels of taxation, cross-border price differences and the involvement of 'crime syndicates' explain the incidence of cigarette smuggling on a grand scale. The data collected for this study show that the emergence of the cigarette black market in Germany in the early 1990s indeed coincides with increasing discrepancies between duty-free and duty paid-prices on the one hand, and between retail prices in Germany and neighbouring low-tax countries on the other. These factors, however, cannot explain the geographical concentration of the cigarette black market in Northeast Germany and more specifically in the greater Berlin area. The records on cigarette-related investigations conducted by the German Customs Service show that despite the

small territory and a combined share of less than 10 percent of the national population, the three states of Berlin, Brandenburg and Mecklenburg-Western Pomerania account for between 58 and 66 percent of all cigarette-related cases per year in the period from 1990 until 1994. This geographical concentration can neither be explained by price discrepancies, nor by the presence of 'crime syndicates', because the available evidence, drawn from an analysis of 47 complex cases of cigarette trafficking in Berlin in the years from 1990 until 1994, suggests that more sophisticated patterns of criminal cooperation are a product of the emerging black market, rather than being the driving force behind it. A more prominent feature that surfaces in the case file analysis is the connection between Polish suppliers and Vietnamese distributors that in Berlin may have been stronger and more efficient than elsewhere. Supply channels for contraband cigarettes from Poland to West Berlin had been established as early as the winter and spring of 1989, i.e. more than a year before the sale of contraband cigarettes spread across the Eastern parts of Germany following the currency union between the German Democratic Republic and the Federal Republic of Germany.

The data presented do not reveal the role that legitimate tobacco manufacturers (may) have played. While allegations of conscious or unconscious collaboration with black marketeers have repeatedly been raised, there are indications, such as the relatively broad brand diversity in the black market and the small share of bulk shipments of contraband cigarettes in the overall case load of the Customs Service, that at least in the first few years of the black market, large-scale smuggling with the tacit agreement of cigarette manufactures was not a dominating aspect. Even less is there any indication that links between illegal entrepreneurs and the tobacco industry can explain the geographical concentration of the black market. Likewise, there is no evidence that widespread corruption has facilitated the black market or contributed in any way to the apparent fact that the black market is far more prevalent in Northeast Germany than in any other part of the country. So, while these factors cannot be ruled out as having had an impact on the scale and shape of the German cigarette black market, in light of the geographical concentration of the latter, explanations must go deeper.

Without being able to give any definite answers, the following tentative conclusions can be drawn:

The difference between duty-free and duty-paid prices, and between high-tax and low-tax countries, may be important factors, but they cannot fully explain the phenomenon because, at least in the German case, they are unable to account for the fact that the black market is highly concentrated in a particular region, namely the greater Berlin area.

It seems that factors other than price differentials have to come into play: in the case of Germany it appears that cooperation between Polish suppliers and Vietnamese retail dealers has been crucial in the creation of a large-scale black market. Given the fact that this constellation of ethnically defined supply and distribution networks, Polish and Vietnamese, respectively, cannot be found in

other retail markets, for example in the UK (Wiltshire *et al.*, 2001), these additional factors obviously vary across space and time.

Consequently, predicting the emergence of a cigarette black market on a grand scale requires more than a foreseeable increase in price discrepancies: it requires an understanding of the general conditions under which the supply of and demand for untaxed or low-taxed cigarettes can be linked up in an efficient way, and it requires an assessment of the extent to which these conditions are concretely manifested in a particular jurisdiction faced with an increase in price differentials.

References

- Beare, M. E., Organized corporate criminality: Tobacco smuggling between Canada and the US. *Crime, Law & Social Change*, no. 3, 225-243, 2002
- Beare, M. E., Organized Corporate Criminality: Corporate Complicity in Tobacco Smuggling. In: M. E. Beare (ed.), *Critical Reflections on Transnational Organized Crime. Money Laundering. and Corruption*. 183-206, Toronto, University of Toronto Press, 2003
- Bundesministerium der Finanzen, Zigarettenschmuggel – eine fast unendliche Geschichte (Transl.: Cigarette smuggling – an almost never ending story). *Monatsbericht*, no. 6, 57-62, 2003, available at: <http://www.bundesfinanzministerium.de/Anlage19001/Zigarettenschmuggel-ein-fast-unendliche-Geschichte.pdf>
- Duyne, P.C. van, Organizing cigarette smuggling and policy making, ending up in smoke. *Crime, Law & Social Change*, no. 3, 285-317, 2003
- European Parliament, Committee of Inquiry into the Community Transit System, *Report on the Community Transit System*. A4-0053/97, Strasbourg, European Parliament, 1997
- Eurostat, *Consumer Prices in the EEC 1988*. Luxembourg, Office for Official Publications of the European Communities, 1990
- Joossens, L., F. J. Chaloupka, D. Merriman and A. Yurekli, Issues in the smuggling of tobacco products. In: P. Jha and F. Chaloupka (eds.), *Tobacco Control in Developing Countries*. 393-406, Oxford, Oxford University Press, 2000
- Joossens, L. and M. Raw, Cigarette smuggling in Europe: who really benefits? *Tobacco Control*, no. 1, 66-71, 1998
- Joossens, L. and M. Raw, How can cigarette smuggling be reduced? *British Medical Journal*, vol. 321, 947-950, 2000
- Körner, J., Verbraucherreaktionen auf Erhöhungen der Tabaksteuer (Transl.: Consumer reactions to tobacco tax increases). *Ifö Schnelldienst*, no. 32, 27-35, 1996
- Krebs, A., *Daheimgeblieben in der Fremde: Vietnamesische VertragsarbeitnehmerInnen zwischen sozialistischer Anwerbung und marktwirtschaftlicher Abschiebung* (Transl.: Staying home abroad: Vietnamese contract labourers between socialist recruitment and market economic extradition). Diplomarbeit, Fachhochschule für Sozialarbeit und Sozialpädagogik „Alice Salomon“, Berlin, 1999
- Lampe, K. von, The trafficking in untaxed cigarettes in Germany: A case study of the social embeddedness of illegal markets. In: P. C. van Duyne, K. von Lampe, N. Passas (eds.), *Upperworld and Underworld in Cross-Border Crime*. 141-161, Nijmegen, Wolf Legal Publishers, 2002
- Lampe, K. von, Organising the nicotine racket: Patterns of cooperation in the cigarette black market in Germany. In: P. C. van Duyne, M. Jager, K. von

- Lampe, J. Newell (eds.), *Criminal Finances and Organising Crime in Europe*. 41-65, Nijmegen, Wolf Legal Publishers, 2003
- Merriman, D., A. Yurekli and F. J. Chaloupka, How big is the worldwide cigarette-smuggling problem? In: P. Jha and F. Chaloupka (eds.), *Tobacco Control in Developing Countries*. 365-392, Oxford, Oxford University Press, 2000
- Nierhaus, W., DDR: Währungsunion bringt Kaufkraftplus (Transl.: GDR: currency union brings additional purchasing power). *Ifo Schnelldienst*, vol. 43, no. 25, 9-11, 1990
- Statistisches Bundesamt, *Statistisches Jahrbuch 1993*. Wiesbaden, Statistisches Bundesamt, 1993
- Wiltshire, S., A. Bancroft, A. Amos and O. Parry, "They're doing people a service" - qualitative study of smoking, smuggling, and social deprivation. *British Medical Journal*, vol. 323, 203-207, 2001

The ecstasy industry in the Netherlands in a global perspective

Tom Blickman¹

Introduction

Most, if not all, law enforcement and international drug control agencies consider the Netherlands to be the world's major production and trafficking centre for ecstasy. According to the United States Drug Enforcement Administration (DEA), in its 2001 report 'Ecstasy: Rolling Across Europe', "*80 percent of the world's ecstasy is produced in clandestine laboratories in the Netherlands and, to a lesser extent, Belgium*" (DEA, 2001a). The Netherlands is also alleged to be the main source in Europe for amphetamines. However, it was not clear on which basis this assumption was made. At the time, attempts to measure the global ecstasy industry were non-existent. Statistics relied on fragmentary information based on seizures, police operations against specific trafficking and production organisations, and soft intelligence information. Notwithstanding the scant information available, the DEA's '80 percent' is still quoted almost everywhere nowadays.²

In the US, the numbers indicating the Netherlands as the source for ecstasy are uneven. For 2001, the Bureau for International Narcotics and Law Enforcement Affairs (INLEA) of the US State Department calculated a lower percentage than the 80% of the DEA. In 2001, more than 25,6 million ecstasy pills seized worldwide could be related to the Netherlands, either having been produced or merely transiting the country. Coupled with Interpol figures on world seizures of ecstasy for that year (over 37 million) that amounted to approximately 68%, according to the INLEA's 2002 International Narcotics Control Strategy Report (INCSR).³

The figures for the US market vary between US and Dutch law enforcement agencies. The DEA seized approximately 9,5 million MDMA tablets domestically in 2001. According to figures of the Dutch USD, however, only about 4 million pills seized in 2001 in the US could be related to the Netherlands (USD 2001, 2002). This implies that approximately 42% of the pills seized in the US may originate from the Netherlands. Looking at the destination of the pills

¹ Tom Blickman is researcher with the Crime & Globalisation project of the Transnational Institute (TNI) in Amsterdam, the Netherlands. He is working on international crime and drug control policies, drug trafficking and transnational organised crime.

² It is not always clear in subsequent testimonies of DEA officials if the 80% indicated the Dutch share of the global or the US market.

³ In 2000 worldwide seizure amounted to about 30 million ecstasy pills (BKA, 2002). According to the USD 21,7 millions pills seized worldwide could be related to the Netherlands (USD, 2002). That would imply that 72% of the pills originated in the Netherlands.

seized worldwide with a Dutch connection, about 6 million were bound for the US (63%), but not necessarily seized in the US. The example shows that different law enforcement agencies use different data, rendering a realistic estimate of market shares difficult.

Even in the Netherlands at the time, officials acknowledged they had no real overview of the ecstasy industry, despite the existence of a specialised inter-agency law enforcement task force – the Unit Synthetic Drugs (USD). It was established in 1997 to combat synthetic drug production and trafficking. The USD became a centre of expertise and an information-clearing house for foreign law enforcement agencies. Despite the information gathered over the years, the public prosecutor coordinating the USD, Martin Witteveen, admitted the business volume or even identity of the major traffickers were still unknown (Witteveen, 2001). Though seizures connected to the Netherlands have increased considerably and many laboratories were dismantled,⁴ what happened elsewhere in the trade flow remained generally unknown.

In 2003, the United Nations Office on Drugs and Crime (UNODC) tried to compose a global overview on ecstasy-type substances. Until then, the UNODC had been unable to produce reliable statistics due to incomplete reporting in which (meth)amphetamines was not differentiated. In order to obtain a clearer picture, the office undertook a global survey on amphetamine-type-stimulants (ATS).⁵ The first results were published in UNODC's 2003 'Global Illicit Drug Trends' (UNODC, 2003a) and its 'Ecstasy and Amphetamines Global Survey 2003' (UNODC, 2003b). The latest figures were made available in UNODC's 'World Drug Report 2004'. Despite the lack of valid data, in its 2003 global survey, the UNODC concluded that "*until recently*" the Netherlands was the world's leader of illicit amphetamine and ecstasy manufacture and trade, but also that the Netherlands and Belgium are still "*considered to be the major global source of ecstasy*". However, the figures produced by the UNODC seem to be over-exaggerated.

Ironically, the paradox of successful law enforcement was that it triggered stigmatisation: the more you seize, the more you appear to be the source of the problem. In a recent threat analysis, the Dutch National Criminal Investigation Service (DNRI) – a newly established national police agency in which the USD was incorporated – estimates the Dutch ecstasy share at approximately 32–42% of the global demand (DNRI, 2004). Although the Netherlands and to a lesser extent Belgium (in particular the north bordering the Netherlands) are

⁴ Even before the creation of the USD in 1997 the seizures of ecstasy and amphetamine labs had increased. In 1995, 20 labs were dismantled while from 1998–2002 on average 16 ecstasy labs and 7 amphetamine labs were seized. (Van der Heijden, 2003) According to a law enforcement officer just as many labs were dismantled just before the creation of the USD, but the USD was more successful in its public relations efforts to claim achievements.

⁵ Amphetamine-type-stimulants (ATS) are synthetic drugs including the chemically related amphetamine, methamphetamine and ecstasy and a range of analogues.

significant producer countries, their importance might be less than is generally assumed, or otherwise it is losing its primary position.

The labyrinth of global ecstasy production figures

The UNODC calculates that nearly 8,3 million people use ecstasy (0,21% of the global population age 15–64), according to the 2004 World Drug Report. More than a third is concentrated in Europe and more than 40% in North America. The industrialised states in North America, Europe and Oceania account for some 80% of global ecstasy use. According to the UN, the global market for ecstasy continues to expand, although at a much slower pace than in the 1990s. While there are signs of stabilisation or contraction in some of the more established markets of Western Europe and North America, and a loss of momentum in the increases reported from Oceania, the market is expanding in Eastern Europe as well as developing countries, notably in the Americas, southern Africa, and the Near and Middle East as well as South East Asia (UNODC, 2004a). China's synthetic drug market, which is relatively recent, has been characterized by a steep increase since 1997. There are indications that ecstasy might be overtaking methamphetamine (UNODC, 2004a).⁶ It is not always clear, however, what is considered ecstasy (known as *yaotouwan* or 'head-shaking' pills) in China: ecstasy-type drugs or drugs that in some way lead to a state of 'ecstasy' (UNODC, 2004b).

The ecstasy market

Unlike traditional plant-based drugs, the production of ATS starts with readily available chemicals, in easily concealed laboratories. This makes an assessment of the location, extent and evolution of the production of such illicit drugs extremely difficult. Acknowledging the difficulty of quantifying the volume of the illicit ecstasy industry, the UNODC nevertheless made an attempt in 2003 and 2004. Based on three estimates of consumption, pill seizures and precursor seizures the office calculated an annual production of about 1,4 billion tablets (UNODC, 2004a).⁷ Based on an average wholesale and retail price of respectively \$ 7 and \$ 16,63 per pill that amounts to a wholesale market value of \$ 9,8 billion and a retail market value of \$ 23,38 billion (UNODC, 2003b).

⁶ According to the DEA, Chinese law enforcement officials report significant increases in domestic production of ecstasy. Most production in China is for domestic consumption, but ecstasy tablets also are imported from the Netherlands into China to meet the demand. (DEA, 2004a)

⁷ The UNODC estimates that 10% of pills and precursors are seized, which may be considered the generally accepted 'golden 10% rule', quoted since 1935 (Van Duyn, 1994, 2003).

Table 1. Estimated annual production of ecstasy (metric tons)

Consumption	100 – 125
Pill seizures	50 – 75
Precursor seizures	130 – 200
Mean and range	113 (50 – 200) 1.4 billion tablets at 80 mg per tablet

Source: UN World Drug Report 2004

How reliable are these figures? Looking at the figures about consumption the estimate appears to be over-exaggerated. According to the UNODC, taking into account occasional, moderate and heavy use, studies show that, on average, ecstasy users consume about three tablets per week – or about 150 a year. This amounts to an annual requirement of about 1.250 million tablets, or 100 to 125 tons of MDMA (each tablet contains 80-100 mg) (UNODC, 2004). However, the UNODC seems to confuse annual prevalence – that includes the one-time user taking a pill to experiment – with a much smaller group of ‘experienced users’. In a study on the Dutch drug market commissioned by the Dutch National Criminal Investigation Service (DNRI), it was estimated that the consumption per user is more likely in the range of 20-40 pills per year, based on studies in Canada, the UK, Germany and the Netherlands (Van der Heijden, 2003). According to experts that figure is much more realistic and would even lean to the lower end of the range. Using the UNODC’s estimate of 8,3 million users worldwide that would amount to a global demand of 166-332 million pills per year. This is significantly lower than the 1,4 billion pills per year of the UNODC.

Calculating market values depends on what is considered wholesale, intermediate or retail level and the different market settings around the world. In the Netherlands (after all, the largest producer according to the UN), wholesale prices are much lower than the \$ 7 of the UN, which would be equal to the higher range of retail price in the Netherlands. According to the USD, ecstasy prices per tablet on the wholesale and intermediate markets are € 0,90 (from production ‘off tableting’ locations), € 1,50 (wholesale) and € 2,70 (intermediate level) (USD, 2002).⁸ During field research, informants said the price per pill depended on amounts purchased. At the wholesale and intermediate levels prices ranged between € 0,35–0,40 (for lots of 100.000 pills) and € 1,50 for 100 pills (Blickman *et al.* 2003). Street prices in the major consumption countries are not a good indicator either, because it depends on the setting. Research in several countries found that users tend to buy larger quantities at a lower price to be distributed among friends and acquaintances, resulting in lower average retail prices in these circles.

⁸ Based on quantities of 750.000.

A rough estimate by an analyst of the Dutch USD calculated an annual world market of 500 million pills with a wholesale market value of € 0,8 billion and a retail market value of € 5 billion (Fossen, 2003).⁹ The average wholesale price (€ 1,60) and retail price (€ 10) per pill used by the USD analyst are much more realistic. The study for the DNRI did not try to estimate market values, but using the figures of the USD analyst the market values would be a € 266-532 million wholesale market value and € 1,7-3,3 billion retail market value. In other words, calculations are significantly lower than the UN estimates. However, scarcity of reliable data leads to generally inadequate guesstimates.

Production and trafficking

All the UN reports state that the Netherlands and Belgium still are the main centres of global ecstasy production. However, its relative importance seems to be declining as ecstasy production is appearing in other parts of the world (UNODC, 2003a: 9). In its *2003 Global Illicit Drug Trends* the UNODC looked at three indicators:

- detection and dismantling of laboratories;
- seizures of precursors; and
- seizures of ecstasy pills related to country of origin.

On all three indicators the Netherlands, followed by Belgium, scores 'best'. How reliable are these indicators? The global surveys are just an approximation, and the UN will be the first to admit that. First of all, the analysis depends on the completion of reporting obligations and how these obligations are met. Also, they are sometimes subject of negotiations with member states who fear to be pinpointed as 'narco-states', because of the UN reports.

According to the 2003 global survey "over the 1999-2001 period, 75% of all seizures of clandestine laboratories producing ecstasy took place in the Netherlands and 14% in Belgium. The two next prominent production sites of ecstasy are the UK (6%) and Germany (4%)". The 75% of seized laboratories relates to the total seizures in Europe only. Curiously, the 2003 'Global Illicit Drug Trends' report does not give percentages for worldwide seizures of laboratories. In that case the percentage would go down to 46%. The difference is largely due to laboratories in the US and Canada, where a third of all detected labs are found (1996-2001). A number of countries do not or hardly appear in the UN statistics while ecstasy production is suspected. For example, Australia does not appear in the UN statistics, but according to Australian Bureau of Criminal

⁹ Based on 40 million pills seized worldwide and average seized percentage of 8%, combined with a estimated weekend use of 10 million pills worldwide and 20% of the 200 tons of PMK illegally produced annually (according to the World Customs Organisation).

Intelligence (ABCI) at least 12 labs were dismantled in the years 1999–2002. The chemicals seized at the labs originated from locations throughout South-East Asia.

The UNODC's 'World Drug Report 2004' looked at the years 2001–2002, the first years for which the results of the revised questionnaire were available. The most striking trend was the increase of ecstasy production in East and South-East Asia, while the number of dismantled ecstasy laboratories declined in Europe and remained more or less stable in North America.¹⁰ However, the number of laboratories seized is a poor indicator if one does not know the output capacity combined with the production time span as well as its nature (just tableting or genuine MDMA production). For example, according to the UN, 25 ecstasy labs were seized in the Netherlands in 2001, while in fact only 15 actually produced MDMA (USD 2001, 2002).

In terms of seizures of ecstasy precursors, the UN mentions that the highest figures have been reported in recent years from the Netherlands (63% of all such seizures over the 1999–2001 period), followed by Belgium (21%). As an indicator precursor seizures are not very reliable too. Seizure data typically reflect individual large seizures, or a small number of related cases, resulting in wild fluctuations in the statistics (UNODC, 2003b). Seizures often also take place in transit countries. For instance, most precursor seizures in Belgium and Germany have the Netherlands as their destination. However, it is difficult to calculate production figures based on seizures of precursors. Producers may order more than they need to have some reserve, as the UNODC (2003a) observed in the case of potassium permanganate.

Regarding the country-of-origin pill seizure indicator, the UN reported: "Three quarters of the countries reported that their imported ecstasy originated in the Netherlands. If only the responses of the countries within Europe are considered, the proportion of the Netherlands as a source country rises to 86% .

The next most frequently mentioned country of origin was Belgium, apparently reflecting a shift of criminal groups from the Netherlands as controls were tightened" (UNODC, 2003a). Meanwhile, the relative importance of Europe may be declining. In the mid-1990's West European countries reported around 80% of all ecstasy seizures; today that proportion is around 50% (UNODC, 2003b). However, once again, the statistics are not reliable and comparison of various national figures is difficult due to different means of reporting.

¹⁰ Of all the reported seized labs (128) in 2001–2002, 43 were in the Netherlands (34%), 26 in the US (20%), 14 in China and Hong Kong (11%), 11 in Indonesia (9%), 10 in Canada (8%) and 8 in Belgium (6%).

Missing links

When one combines the quantitative information with qualitative data the picture becomes even more confusing. Without knowledge about the functioning of criminal networks involved in the illicit ecstasy industry quantitative data provide little insight. No single organisation controls all aspects of production, wholesale, midlevel, or retail sales – while the networks involved increasingly seem to globalise. Production and trafficking organisations arrange their activities across borders. Apart from trafficking ecstasy produced in Dutch laboratories, Israeli groups have been involved in production operations in the Netherlands.¹¹ As Dutch law enforcement pressure mounts, some Dutch producers either look for Belgian producers or establish their own facilities in Belgium. Involvement of Dutch organisations with laboratories seized in Germany has also been reported. The dismantling of a major ecstasy production operation in Indonesia in April 2002 and one in Surinam in May 2003, apparently to target the US market, indicates that significant production centres have been set up outside Europe with Dutch expertise. The DEA reports that Asian criminal groups also may be producing the drug in Belgian laboratories (NDIC, 2004).

There seems to be an increasing diversification in production. Different stages of production are conducted at different locations, sometimes even in different countries. That trend was already observed in the Netherlands, Belgium and Germany. In Canada, three tableting units were seized in 2003 in Toronto capable of producing more than 250.000 per day. A group of Chinese nationals was orchestrating the manufacture, made from powder allegedly imported from the Netherlands. At its height, according to law enforcement officers, the network was distributing a million ecstasy tablets a month, or about 15 per cent of all the ecstasy consumed in the US.¹²

Apparently, established criminal networks seem to add ecstasy to their repertoire using already existing trafficking routes. In June 2004 the first ecstasy producing unit in India was discovered using two ordinary pharmaceutical firms. The companies were manufacturing medicine such as paracetamol during daytime and synthetic drugs in the night. They had connections with one of the major crime-enterprises in the region, India, Pakistan (Karachi) and Dubai. They seemed to use established mandrax (a variant of methaqualone) smuggling lines

¹¹ In 1994, an Israeli group tried to set up a laboratory near Amsterdam, which was discovered when it exploded. (Jerusalem Post, 30 September 1994; Het Parool, 30 September 1994) Another Israeli group, together with Dutch, Turkish and British nationals were arrested in 2001. Their factory was equipped to produce 120.000 pills an hour. The Israelis were violently exporting money in Israel to operate the lab. (Jerusalem Post, 1 March 2001; Haarlems Dagblad, 9 May 2001)

¹² DEA and CFSEU Press Release, March 31, 2004; National Post, April 1, 2004; Globe and Mail, April 1, 2004.

to South Africa. Funds came from South Africa through 'hawala' brokers with Dubai as the nodal point.¹³

Another observation concerns the increased scale of production and grown professionalism outside the Netherlands. For example, in Canada clandestine synthetic drug laboratories are becoming larger and more sophisticated (RCMP 2003, 2004). The European Union reports that the number of production facilities is relatively stable, but due to improved production techniques, they have become increasingly more efficient (Europol, 2004).

Finally, there seems to be a growing differentiation in pill quality in several countries, with high quality pills from the Netherlands and Belgium and low quality pills produced domestically (Russia, Hong Kong, Vietnam). In addition, some reports suggest the importation of MDMA powder to be adapted to local needs in terms of both strength (MDMA content) and composition, as discovered in Thailand, Cambodia and Canada.

Production in the United States

Reported lab seizures and other indicators such as MDMA levels in pills in North America do not seem to allow for the assumption that 80% of the ecstasy in the US originated from the Netherlands. The US and Canada account for nearly 30% of worldwide laboratories seizures. Despite the prominent position on the UN list, the US National Drug Intelligence Center (NDIC) in its 'National Drug Threat Assessment 2004' stated that: "*Domestic MDMA production remains limited, as evidenced by very few domestic MDMA laboratory seizures*" (NDIC, 2004; emphasis added). True, the amount of seized ecstasy laboratories dwarfs in comparison with seized methamphetamine labs (12 against 9.024 in 2002), but is still substantive in a global context (20%). US authorities seem to suffer from a state of denial when domestic ecstasy production is concerned. The main concern is domestic methamphetamine production.

According to the NDIC, most clandestine ecstasy laboratories seized in the US are only capable of producing small amounts (gram quantities) per production cycle, although a few were capable of producing kilogram quantities. However, law enforcement information indicates the existence of large-scale laboratories capable of producing millions of pills.¹⁴ The NDIC admits that because of unsubstantiated or inclusive data concerning laboratory capacity estimates are highly uncertain.

¹³ Times of India, 8-9 and 12 June 2004; The Indian Express, 10 June 2004.

¹⁴ In October 2001, the DEA seized a major MDMA lab in north San Diego County. The sophisticated laboratory was capable of producing 1,5 million ecstasy tablets a month (ONDCP Drug Policy Information Clearinghouse, San Diego, California, June 2004). In December 2002 a lab that had been operating for or at least two years buried in a mountainside near Allentown (PA) was discovered capable of producing million-tablet batches of ecstasy. (The Philadelphia Inquirer, 19 December 2002; DEA Microgram Bulletin, June 2003).

Pill seizure data also show a sharp decline in imported pills. According to data collected by EPIC, the number of ecstasy tablets seized arriving from foreign source or transit countries has decreased sharply from 8 million in 2000, to 6.7 million in 2001, to 3.4 million in 2002. (NDIC, 2004) That might indicate that more importation through unidentified trafficking networks or more supply from domestic production, or both. A growing number of tablets are being sold as ecstasy that contains varied substances, or combinations. According to the UN, “it may also be that, with increased competition, drug trafficking organizations are also importing ecstasy tablets from South-East Asia, where tablets are more likely to be multi-drug combinations.” (UNODC, 2003b) Moreover, conclusions on the share of Dutch ecstasy on the US market are drawn on a limited amount of ecstasy seizures, which means that the conclusions are based on only 7,5–15% of the market.

Nevertheless, the main emphasis of US law enforcement is on ecstasy from the Netherlands and Belgium. An explanation could be that law enforcement agencies in the US have a partial overview based on specific operations. For a while they mainly targeted Israeli trafficking networks with suppliers in the Netherlands, in close collaboration with Dutch police. One operation typically produces additional leads for other similar operations, resulting in a ‘snowball’ of cases with the same or connected suppliers and trafficking networks, as became clear from case analyses and interviews with USD officials (Blickman *et al.*, 2003; Huisman *et al.*, 2003). A particular case started in 1996, but spin-off was still being used in 2003, based on so-called free-evidence gained from the initial investigations (Graafland, 2003). Another explanation could be that singling out the Netherlands is politically biased. The profound differences in drug policy and law enforcement methods between the two countries create problems.

Eastern Europe

According to several sources, significant ecstasy production is taking place in Eastern Europe and the Baltic countries, although very few ecstasy labs are reported to the UN as seized in the region. Ecstasy is produced in significant quantities in Poland, and law enforcement officials estimate that Poland is one of the leading suppliers of amphetamines to European markets (USD 2001, 2002; INCSR 2002, 2003; UNODC, 2003a). According to the European Monitoring Centre for Drugs and Drug Addiction (EMCDDA) synthetic drug production has grown in Central and Eastern European countries, due to weak control mechanisms (EMCDDA, 2002).

Organised crime groups in Poland produce some of the highest quality amphetamines in the world for both export and domestic consumption. These groups often make use of existing legal laboratories and employ experienced chemists to produce amphetamines that are 90–100% free of impurities. Synthetic drugs are sometimes produced in the legal, permanent laboratories of chemical companies and universities (INCSR 1999, 2000). European law

enforcement officials estimate that Poland fulfils more than 25 percent of Europe's amphetamine demand (INCSR 2000, 2001).

Swedish government figures in 2000 showed only 50% of ecstasy pills there came from the Netherlands, down from 90% a few years before. A similar development had taken place earlier with amphetamine production. Until the early 1990s, the supply of amphetamines in North Western Europe was largely in the hands of Dutch citizens residing in the southern provinces of Brabant and Limburg. After 1989 and the concomitant political changes in Eastern Europe, the market started to change and the Poles proved to be skilled competitors. Their share of the market in Germany and Scandinavia rose from less than 10% to 20–26% (Van Duyne, 1996; CDPC, 1999). According to Polish law enforcement 60% of the seized amphetamines in Scandinavia is produced in Poland nowadays (BKA, 2002). This pattern may repeat itself in the ecstasy trade. According to the UNODC, an eastward shift of ecstasy production is now under way, similar to the spread of clandestine amphetamine manufacture a decade ago. One or two laboratories have been seized on average the past years in Eastern Europe (UNODC, 2003b). Small ecstasy labs and marijuana plots are being set up for the local market, sometimes in collaboration with Dutch citizens (Bruinsma, 2004).

Western law enforcement officers feared that after the fall of the Soviet Union, Russia's thousands of experienced chemists would start mass producing synthetic drugs for the local and European markets. This hypothesis seems to have come true to a minimal extent, yet. Ecstasy is largely imported from Western European countries, particularly the Netherlands, and to a lesser extent from Poland (Paoli, 2000). However, the deputy head of the Russian Customs department predicted that the Baltic States would replace the Netherlands as the main supplier to Russia. The Baltic countries, formerly transit points for synthetic drugs, are evolving into major producers of ecstasy made from precursor chemicals imported from Russia. In 2003, there were reports by both the MVD and Federal Security Service (FSB) that MDMA laboratories now exist in Russia. Although ecstasy tablets produced in Russia are of low quality, the low prices (sometimes as low as \$ 5) are attractive in comparison to the \$ 20 typically charged for Dutch ecstasy tablets. In addition, a new trafficking route from Estonia has appeared, attracted by increasing demand and higher prices in Russia (INCSR 2003, 2004).

In 1999, the Estonian police found evidence of laboratories believed to be producing ecstasy. The region 'may' also be receiving ecstasy from nearby Latvia (DEA, 2001a; INCSR 2003, 2004). Ecstasy prices have remained low in Estonia; an indication of domestic manufacture. Finland fears that Estonia's accession to the EU and Schengen arrangements could lead to increased trafficking. In August 2003, Estonian officials seized a pill press, various chemicals and 150 kilograms of liquid MDMA in Tallinn that could have produced approximately 750.000 ecstasy tablets. The MDMA apparently originated in Russia. In the two-year period from 2000–2001, seven laboratories that were producing amphetamine, ecstasy, and precursor chemicals were shut down

in Lithuania. The labs produced for export and were well equipped, as were the ten labs dismantled in 2002–2003 (INCSR 2000–2003).

China and South-East Asia

Since the new reporting mechanism was introduced by the UNODC, the sudden appearance of China and South-East Asia – Indonesia in particular – as major producers is remarkable. According to the secretary of the INCB, H. Schaepe, Asian countries are gradually taking over ecstasy production from the Netherlands due to increased law enforcement.¹⁵ Europol noted that the involvement of organised crime groups in the production of synthetic drugs in China, while in general production in South-East Asia is likely to become a growing concern for global law enforcement agencies (Europol, 2004). However, very little information is available concerning MDMA production in Asian countries (NDIC, 2004).

As mentioned before, “ecstasy” in East and South-East Asia is used to describe any drug in tablet form, whether or not it contains MDMA. Reports indicate that tablets in the region contain mixtures of various substances and sometimes no MDMA at all. This contrasts with the situation in Europe and the US, where the trend over the past years has been towards high purity single entity ecstasy tablets. From a law enforcement perspective, the significant regional differences in tablet composition raises doubts about the widely held belief that the majority of ecstasy seen in East and South-East Asia, and in Australia, are imported from Europe, according to the UNODC. Evidence for MDMA powder manufacture in that region is still limited and anecdotal, suggesting a wide availability. In 2001, Hong Kong reported that cheap ecstasy tablets probably were manufactured in Asia rather than Europe, and that the amount of locally made tablets is increasing (UNODC, 2003b).

In 2000, the NDIC, the DEA and the US Customs Service (USCS) issued their ‘Joint Assessment of MDMA Trafficking Trends’ in which they voiced concern that crime groups from Mexico, Colombia, or China would become involved in ecstasy production and trafficking towards the US. Although, at the time, no organisations from these countries had made strong moves toward large-scale production, the same advantages found in the Netherlands – access to precursor chemicals and to smuggling routes to the US – were present in Mexico, Colombia, and China. The profits and relatively low threat associated with ecstasy production and trafficking could encourage these groups to enter the market. Mexican groups were probably the greater threat because of their experience in producing and distributing amphetamine and methamphetamine (NDIC, 2000). However, there is still little evidence of Colombians and

¹⁵ Trouw, 23 February 2001.

Mexicans entering the ecstasy market on a large scale, while Chinese ecstasy production and trafficking groups, in and outside the People's Republic, are increasingly involved.

Chinese crime groups have exceptional possibilities on the ecstasy market. Apart from access to essential precursors and trained chemists in China, there are connections with experienced producers in the Netherlands and distribution possibilities through Chinese communities abroad. Chinese groups are cooperating with Dutch groups supplying the precursors PMK and BMK for ecstasy and amphetamine production in the Netherlands and exporting pills.¹⁶ The Amsterdam police noticed Chinese groups in the ecstasy business already in 1997.¹⁷ A survey of organised crime in the Netherlands showed a mainly Chinese organisation (some with Dutch nationality), trafficking heroin from South-East Asia, diverging precursors, and producing and trafficking ecstasy and amphetamines (Kleemans *et al.*, 2002). In 2003 a Dutch-Chinese national was arrested who had been importing precursors and might have been involved with eight ecstasy labs in the Netherlands.¹⁸

Nationals of East and South-East Asia are often involved in producing and trafficking in third countries with substantive Asian communities such as Canada and Australia. DEA offices throughout South-East Asia have reported an increase in ecstasy trafficking throughout the region, including the discovery of significant MDMA labs in China, Hong Kong, Taiwan, Malaysia and, most notably, in Indonesia. The increasing demand for ecstasy and the availability of precursor chemicals from China and Vietnam – a major producer of sassafras oil¹⁹ – support the premise that large-scale MDMA manufacturing in South-East Asia is rising. The Chinese kingpin in Canada was linked to the Big Circle Boys gang, a Triad-like organisation. Some ecstasy traffickers in China are linked directly to the US. Australian police also noted an increase in ecstasy imports with links to Triad groups from South-East Asia.²⁰ Ethnic Chinese were invol-

¹⁶ In 2001, ethnic Chinese were involved in shipping 14,000 litres of BMK and 3,000 of PMK to a lab in Limburg through the port of Rotterdam. (Rotterdams Dagblad, 11 January 2002 and 10 April 2002). Established Dutch groups are importing precursors from China. A financial adviser to one of the major Dutch hash entrepreneurs of the 1990s was supplying precursors from China to five ecstasy laboratories (Het Parool, 17 March 2001).

¹⁷ Het Parool, 22 February 1997.

¹⁸ BN/DeStem, 4 June 2003. In a court case in the Netherlands the public prosecutor alleged that a Dutch based Chinese laboratory operator in the Netherlands was instructing two Chinese citizens to produce ecstasy for a fee of € 175,000 per person. Rotterdams Dagblad, 11 April 2003.

¹⁹ In Vietnam sassafras oil is illicitly produced and trafficked. Despite the government's 1999 export ban of sassafras oil, DEA information indicates that illegal harvesting of oil from trees is continuing. In 2002, Vietnamese companies were involved in sassafras oil production in Laos and Cambodia. Much of the illegal sassafras oil is bound for Europe. PMK is also produced in Vietnam (DEA, 2003).

²⁰ Sydney Morning Herald, 18 October 2001.

ved in a 340 kilogram MDMA shipment to Sydney, hidden in a container that originated in the Netherlands.²¹

A Dutch-Chinese operator who had been running the ecstasy laboratories in Indonesia that were seized in April 2002 had connections to Chinese in Malaysia and Hong Kong for the import of the PMK. Intelligence indicated that the laboratory had been in operation for about three years, processing about 3,5 metric tons of PMK, sufficient for, cautiously estimated, some 43.750.000 pills. Additional investigations of the DEA indicated widespread distribution of these Indonesian produced tablets in the US, Australia, Burma, China, and elsewhere.²² According to the UNODC, this case confirmed the growing cooperation between criminals in the region (UNODC, 2003b).

Nine ecstasy labs were seized in 2001, among them only two that were classified as small-scale or 'kitchen' laboratories. Jakarta's Police Narcotics Division chief Carlo Tewu remarked that many of the ecstasy pills were produced locally.²³ The seizure of the large-scale unit in 2002 seems to have given rise to a cottage industry, often producing fake pills. According to Tewu: "Many of the ecstasy producers we arrested recently are not part of larger syndicates . . . They are freelancers . . . entrepreneurs who see potential in the ecstasy business while the larger ones are not running. . . it's not mass production."²⁴ Nevertheless, occasional large-scale labs are still seized.

Other South-East Asian countries are also involved in ecstasy manufacturing often with a connection to Chinese nationals. An ecstasy-tabletting lab was seized in Thailand in 1999. Three Chinese citizens were arrested with connections to the Netherlands and Indonesia (USD 1999, 2000). There are unconfirmed reports that traffickers associated with the Burma-based United Wa State Army (UWSA), already involved in large-scale methamphetamine production, were producing ecstasy as well (INCB 2000, 2001; INCSR 2002, 2003). According to the Bangkok Post, "a naturalised Dutch Chinese chemist . . . has spent nearly two years in Wa laboratories experimenting with the initial production and training local chemists."²⁵ Apparently, the Wa succeeded in upgrading their ecstasy to European standards.

The ecstasy industry in the Netherlands

After this excursion through the labyrinth of global ecstasy production figures it becomes clear that, although the Netherlands and to a lesser extent Northern

²¹ Australian Associated Press, 21 June 2004; Sydney Morning Herald, 22 June 2004.

²² DEA Microgram Bulletin, January 2003.

²³ The Jakarta Post, 27 December 2001.

²⁴ Laksamana.net, 24 August 2002, quoting the *The Straits Times* from Singapore.

²⁵ According to unidentified security and narcotic officials (The Bangkok Post, 19 October 1998).

Belgium are important production countries, their importance might be less than is generally assumed, or otherwise declining. According to a study that was commissioned by the DNRI, the Dutch ecstasy industry supplies approximately 78–131 million pills annually worldwide (7–13 million for the domestic Dutch market, 43–73 million pills for the EU market, and 28–48 million pills to the rest of the world) of a calculated global demand of 155–310 million. Based on the consumed share of pills (on average 19 million are intercepted annually), the 65–99 million pills that are not intercepted would amount to 32–42% of the global demand supplied by Dutch production (Van der Heijden, 2003).²⁶ That is still a considerable amount and maintains the Netherlands at the top of the list of ecstasy producers.

Though the Netherlands seems to have lost some of its earlier leading position and original advantages, this will probably only lead to the displacement of laboratories to other regions abroad. Nonetheless, according to USD officials, the easy availability from local criminal groups and low prices of ecstasy in the Netherlands, as well as the connections to experienced trafficking organisations, are not always incentives for foreign ecstasy traffickers to set up their own production facilities (Blickman *et al.*, 2003). On the other hand, more and more laboratories have been discovered outside the Netherlands (USD, 2002).²⁷

According to the USD and Europol, Belgium, Germany and increasingly Poland are becoming more important production countries in Europe. Other countries in Eastern Europe also seem to emerge as producers. Outside Europe, the Dutch position is ‘challenged’ by increased production in China, South-East Asia and the Pacific, often with a link to Chinese crime networks and sometimes, Dutch expertise. North America seems to have maintained its own level of production. Nevertheless, supply in the Netherlands seems to be abundant and wholesale and retail prices dwindling (Korf, Nabben & Benschop, 2001; 2002).²⁸ The market in Amsterdam (allegedly one of the world’s major international marketplaces) is saturated and changing from a *seller’s market* into a *buyer’s market*. Retail prices in Belgium and Germany are reaching the low price level of the Netherlands (Blickman *et al.* 2003). A restructuring of the global

²⁶ The calculations were based on prevalence data combined with use patterns and analysis of chemical waste from ecstasy labs and illegal waste dumps. The lower estimate for global demand than used in paragraph 2.1 is because the DNRI figures are based on the estimate in the 2003 Global Illicit Drug Trends of 7.74 million users.

²⁷ Het Parool, 15 March 2002. The fact that Dutch citizens appear to be involved in ecstasy production abroad may also have to do with the assistance of the USD in dismantling laboratories across the border.

²⁸ According to an observer with contacts in the ecstasy scene in the south of the country and the *Randstad* the “*business is on its beam ends*”. At the wholesale level ecstasy pills go for € 0,45 or € 0,90, while they used to do € 2,25 or € 2,75. “*If you might sell them at all, because stocks are everywhere.*” (BN/DeStem, January 4, 2001).

ecstasy market seems to be taking place with more regional producers supplying their adjacent regional markets.

Why Dutch groups have gained and maintained prominence on the global ecstasy market since the late 1980s is still not clarified completely. Assuming that Dutch criminals are no more entrepreneurial than those of other nationalities, a combination of structural and accidental factors has plausibly contributed to a (probably momentary) advantage and predominance in the illicit ecstasy. None of these factors are unique for the Netherlands, but the combination at the right time created and reinforced a dynamic that led to a much earlier and quicker development than anywhere else.

The availability of ‘routine socio-economic activities’

The natural geographic position of the Netherlands has contributed to make it the distribution centre of (licit and illicit) goods inside Europe and to the rest of the world, and created a longstanding tradition as a trading and industrial nation. Excellent transport connections and several vital transport hubs along international trade routes offer traffickers great possibilities for moving illegal goods (Fijnaut *et al.*, 1996). Rotterdam is the second biggest seaport in the world (and an important transit point for chemical products) and Amsterdam ranks fifth. Yet another major port lies nearby in Antwerp in the north of Belgium. All three are smuggling centres for PMK, hidden in large shipments of chemicals from China (Kleemans *et al.*, 2002).

Schiphol International Airport near Amsterdam is a major hub and ranks fourth in Europe, behind London, Paris, and Frankfurt. These transport hubs are by nature extremely difficult to control due to the requirement of cargo rapid processing. In addition, there is an extensive logistics sector that redistributes goods overland throughout Europe via a large fleet of trucks. The Netherlands has a significant chemical production and trade sector with about 2.400 companies. Tablet machines and laboratory equipment are not under a licensing system. Illegal use of chemicals makes up only a small percentage of licit use and too many controls would not be in industry's interest.

Ecstasy producers set up front companies, such as paint factories or chemical waste removal companies, to acquire the necessary equipment and chemicals (or dispose of chemical by-products). The black market in precursors has become very lucrative because of administrative and police controls. Precursors are now purchased from chemical companies abroad: in Eastern Europe (sometimes co-owned by criminal groups) and China. Some producers have shifted to manufacturing their own precursors with chemicals or pre-precursors not scheduled under the law (Houben, 1996). Producers and traffickers also use employees of legal companies. Chemists who worked in large chemical companies have helped mediate the supply of chemicals, and the contacts of one chemist with Chinese chemical producers were used. Another way of disguising

activities is to invest in a moribund bonafide company and force it to perform supporting services (Kleemans *et al.*, 1998).

This range of so-called 'routine socio-economic activities' contributed to the Dutch emergence as an illicit distribution centre for all kinds of drugs (Farrell, 1998) even before ecstasy became a popular drug.²⁹ The licit economic structure is tapped by criminal entrepreneurs and over the last 25 years a semi-licit grey infrastructure has developed that uses the facilities of the licit economic for the illicit one.

The city of Amsterdam developed as an international marketplace for drug transactions (Huisman *et al.*, 2003). With every kind of drug smuggling present it functions as an '*an organisational centre, a central brokerage point and a safe haven*' and a meeting point for potential partners, according to a DEA report of June 2000 and Zaitch (2002, p. 252).³⁰ The Netherlands is probably one of the most important drug trafficking and transiting area in Europe, according to the DEA and the British National Criminal Intelligence Service (NCIS) (2002). The ecstasy business simply tagged along and Amsterdam became the 'logistical centre' for the ecstasy business. Because of the large number of different nationalities in the city, foreign export organisations have rather easy access to suppliers. Along with the goods, Amsterdam offers the necessary human resources, which makes it a 'full service' market. (Huisman *et al.*, 2003) and the above-mentioned meeting point.

Amsterdam is the centre of 'organised crime' in the Netherlands. The USD considers the local crime scene (mainly native Dutch at its top level) one of the world's main ecstasy producers. USD officials say 70% of their ecstasy investigations nationwide are linked with the Amsterdam area and production is shifting more and more to the capital and the adjacent region from the traditional southern provinces. International transactions, which are now the main outlet for the industry, are basically concentrated in the city (Blickman *et al.*, 2003). The USD discovered an increase in so-called 'cocktail' drug transports (USD, 2002: 16), indicating the existence of specialised trafficking organisations stockpiling several kinds of drugs for further cross-border distribution, mainly the UK.

For those familiar with the drug business, it is a simple matter to find the contacts needed to set up a trafficking line. Pills need not even be physically available when conducting business. During an investigation into an Israeli trafficking network, the main organiser acted as a broker arranging supply for

²⁹ Farrell noted a connection between the low prices for illicit drugs in the Netherlands and the importation of these substances that could be related to the volume of licit international trade. The main principle behind the theory of 'routine socio-economic activities' is that crime starts in areas where there are potentially motivated perpetrators and suitable targets while proper surveillance is lacking. Under these circumstances the routine activities of potential criminals offer opportunities for crime. From this theory one can deduce that the smuggling of illegal goods 'tags along' with the trade in legal goods (Van der Heijden, 2001).

³⁰ The Guardian, 29 August 2000.

different trafficking operations and an intermediate between Dutch producers and clients based in the US, Canada and Australia. He basically called around the world with his six or seven GSM phones and likely never even saw the pills. “We see international traffickers fly in, check in to one of the top luxury hotels, make their deals and then leave,” says an Amsterdam criminal investigator (Blickman *et al.*, 2003). Pills are sometimes produced and delivered ‘on request’. “This can take place at remarkable speed. Traffickers book a night in the Hilton and order pills in the evening which are subsequently produced and ready to be picked up the next morning after breakfast.”³¹ This pattern is not found only at the wholesale level. A police officer gave the example of a US citizen who tried to buy just 7.000 pills.

The characteristics of organised crime in the Netherlands

Organised crime in the Netherlands is mainly composed of frequently overlapping networks and is characterised by its entrepreneurial features, rather than by hierarchical or territorial bound structures. Given the nature of the illicit commodities and their price structure, it is hardly surprising that most of the trafficking implies cross-border trading movements. The exception may be the homegrown cannabis and stimulants, though a substantial part of these products find their outlet abroad as well (Van Duyne *et al.*, 1990, Van Duyne, 1995; Fijnaut *et al.*, 1996; Klerks, 2000; Kleemans *et al.*, 2002). The traditional perception of organised crime had already been questioned based on field research into the local drug market in Amsterdam in the early 1990s (Korf & Verbraeck, 1993) and the first research projects on crime-entrepreneurs in the Netherlands (Van Duyne *et al.*, 1990; Van Duyne, 1995). Cannabis and cocaine importing organisations and laboratories for amphetamines and ecstasy were not smooth running, long-term operations. Each import and production operation was a project in itself, which could function for some time (even years) within a set framework by the same people; in general they were temporary joint ventures.

As could be expected from previous research (Van Duyne *et al.*, 1990), a much more diverse picture emerged: one of extended fluid networks of a multitude of individuals, often formed into ‘cliques’ or groups, either connected by means of loose or close relationships or with the capacity to establish those kinds of relationships rather easily if necessary through ‘friend of friends’. Within those networks are ‘nodes’ and persons with more power than others. Many of these relationships are not very stable. Specific interests of groups and personalities of bosses can clash and lead to dissolving the cooperation or even violent conflicts. New ‘action-sets’ will arise to ‘do the job’ by means of shared investments or

³¹ Interview with a drug expert on the Rotterdam police force in Rotterdams Dagblad, 8 December 2000.

forming longer-term coalitions (Fijnaut *et al.*, 1996: 55-56). Criminal cooperation is often directed towards gaining reciprocal benefits or resolving mutual problems. Especially at the production level, where the supply of raw materials and production tools are a problem, groups pool resources and contacts to obtain precursors and formulas. Semi-manufactured products are also exchanged. This way 'buffers' are created to counter the uneven supply of precursors. The synthetic drug market is a 'free market', according to USD officials. Anyone can move in with the right contacts.

One case description shows the level of cooperation and exchange at the production and 'first hand' distribution (i.e. first buyer from producer) levels. The case involved a group operating in the southern part of the Netherlands. Five individuals in this group were involved in synthetic drug production. They closely collaborated with about six other Dutch criminal groups also involved in producing and trafficking synthetic drugs, but who were implicated in other criminal activities as well. Cooperation included supplying precursors, means of production and end products as well as exchanging staff and expertise. Various chemists worked for several groups. A chemistry professor taught one group to produce ecstasy while a lawyer provided another group with the formula for ecstasy he had found in court files. Some of the groups and individuals were large-scale suppliers of precursors and production equipment bought at ordinary chemical businesses, second-hand markets or through front stores in Eastern Europe. Deliveries were made from the southern provinces of Limburg and Brabant and the Amsterdam area. Some groups were also involved in setting up labs in Eastern Europe. One of the groups used a mobile lab in a steel container on a truck. Another group operated a very sophisticated laboratory built partly underground. Amphetamines were smuggled to Scandinavia, the UK, and Amsterdam markets. Ecstasy was mainly distributed to Amsterdam and the UK, but also Italy and Spain. When one group had a shortage, they bought from another, and batches of amphetamine were exchanged for ecstasy (Houben, 1996).

Historical advantages

These patterns of organised crime activities and the existence of a broad set of beneficial 'routine socio-economic activities' in the legitimate economy were some of the preconditions for the emergence of a very dynamic and flexible illicit industry in the Netherlands in the late 1980 when ecstasy became a popular drug and part of new youth culture. Two historical advantages proved to be very beneficial. First, prior to the emergence of ecstasy as a popular drug, local criminal groups in the southern provinces of Limburg and North-Brabant, on the other side of the border in Belgium, had established a primary role in

producing and trafficking amphetamines to Scandinavia (where amphetamines were very popular),³² the UK and Germany in the 1960s and 1970s. These southern producers traditionally had ties with large-scale hashish traffickers in the west of the country in the *Randstad*³³. These groups had managed to control a significant segment of international hashish trafficking during the 1980s (Fijnaut 1996: 19ff).

Consequently, expertise in production and trafficking were available. According to one USD official, the amphetamine producers were a rather small sector at the time (Husken & Vuijst, 2002). Law enforcement identified four major professional amphetamine laboratories in the 1980s: three in the south of the Netherlands and one in the west. The names of those 'amphetamine pioneers' recur in a series of ecstasy investigation. One of the sons of such an amphetamine pioneer also entered the ecstasy business. The southern amphetamine producers did not pioneer ecstasy production but learned quickly when ecstasy became popular (Husken & Vuijst, 2002).

Second, the Netherlands and Belgium were among the first countries where the new youth culture developed. Ecstasy came to the Netherlands in the 1980s through alternative circles and trend-setting globetrotters who had their first experiences in Goa or Ibiza and the subsequent 'summer of love' in the United Kingdom (Adelaars, 1991). The first dealers and producers were of the 'aficionado-type', people who used ecstasy themselves and sold to friends and acquaintances. The real expansion came in the late summer of 1988 when the first large scale house parties were organised in Amsterdam. People from this scene set up the first small laboratories in the Netherlands. There were virtually no links to the more traditional underworld. Some of the organisers of these house parties kept ecstasy distribution to them; either to launder their profits or ensure good quality ecstasy was available. Some of the house-scenes fell apart in those days because of bad quality pills (Korf & Verbraeck, 1993). Amsterdam also became one of the distribution centres for the rest of Europe. Pills were smuggled from Amsterdam to London and Ibiza, which was also supplied from Spain (Mareso *et al.*, 2004).

Until 1988 and 1989 most ecstasy tablets in trend setting Amsterdam were still imported. In 1989, ecstasy in pills and powder came from Spain. Some MDMA was imported from the US in powder and tableted in the Netherlands,

³² According to a Dutch detective this was furthered by coincidence: a Dutch criminal from Limburg spent some time in a Swedish prison and established contacts for an enduring outlet for amphetamine during the 1970s. After his relieve he became for two decades the prime exporter of that product from Limburg.

³³ The Netherlands is a densely populated country of towns. However, none of the main cities, such as the financial centre Amsterdam, the government centre of The Hague and the economic hub of Rotterdam, Europe's largest seaport, has more than a million residents. These key national centres are concentrated in the western part of the country no more than an hour apart by train or car. This metropolitan area is often referred to as one single metropolitan area, the *Randstad*.

and there was also a small supply of powder, capsules and badly fabricated, crumbly pills from small domestic laboratories. In the spring of 1989, most ecstasy pills were so-called ‘Stanleys’ manufactured on a large scale by the German chemical company *Imhausen* just before its prohibition. That year, the police raided a ‘stash house’ with 900.000 *Imhausen* pills. They apparently did not manage to seize them all since ‘Stanleys’ were sold up until the summer of 1990 (Adelaars, 1991; Korf & Verbraeck, 1993; Van Duyne, 1995). When ecstasy was put on the list of drugs with ‘unacceptable risks’ in the Dutch Opium Act in November 1988, observers at the time stated that ‘bonafide’ ecstasy producers, who were part of the rave culture at the time, increasingly left the market. Some of the initial dealers retreated from the open circuit of discotheques. The traditional amphetamine producers and experienced hash traffickers increasingly filled the gap.

The first professionally manufactured pills from illegal laboratories appeared on the Amsterdam market in the spring of 1990, according to observers at the time. From the summer of 1989 until the summer of 1990, real ecstasy was difficult to find. By the end of 1991, the supply of good quality pills was no longer a problem (Korf & Verbraeck, 1993).

In February 1992, a major ecstasy production and trafficking organisation was dismantled. Leaders of this group belonged to the established underworld of Dutch criminal organisations in Amsterdam and Rotterdam that had become major players in national and international hashish trafficking in the 1980s. The group owned laboratories, imported precursors from Belgium and ran export trafficking lines, mainly to the UK. It even ran a counter-surveillance operation to check on police activities. It had produced millions of pills within its ten months of operation and had an estimated business volume of € 135 million, according to forensic experts. Profits were estimated at € 33 million but in the end only some € 7 million were invested in the licit economy (Van Duyne, 1995, 1997; Fijnaut *et al.*, 1996). One of the key organisers was known as the ‘ecstasy professor’ because he had apparently revolutionised the production process. He had learned the tricks of the trade from the southern ‘amphetamine cooks’ (Husken & Vuijst, 2002). He used to organise hashish transports with the established hash entrepreneurs of the 1980s, a clear indication of the ‘traditional’ underworld involvement.

According to a police report, by the mid-1990s most producers were professionally in the business for the money (Houben, 1996). The bottleneck in the business was and still is the supply of hard-to-get precursors, in particular PMK. In July 1995 the law on ‘Prevention of Abuse of Chemicals’³⁴ came into force. The law tightened controls of the trade in materials under a licensing

³⁴ Wet voorkoming misbruik chemicaliën (WVMC). Even before the new law, precursor controls in the Netherlands were stricter than abroad because of the country’s history as an amphetamine producer. Chemical companies required end-user certificates and would report ‘suspicious transactions’ (Korf & Verbraeck, 1993: 175).

system. To obtain precursors, traditional amphetamine producers had the advantage of previous experience in obtaining the main precursor for amphetamine, BMK, which is also a controlled substance. Ecstasy producers either needed contacts with the chemical industry or with companies abroad where controls were less strict or with the black market. The result was that small independent producers were even more marginalized, and the business became monopolised by big ecstasy producers with ties to 'organised crime' that were able to procure the required chemicals illegally.³⁵ Another reason for the apparent dominance of large-scale producers may be that they are simply more competitive. They lead the market because they are able to produce higher quantities at a cheaper price. Small laboratories have no substantial part of the market because they cannot produce in bulk.

The production and distribution chain is sometimes divided according to certain stages of the process (acquisition of precursors, production of ecstasy powder, tableting, distribution, disposal of chemical waste by-products). Some of the groups involved in a particular stage do not necessarily know other parts of the organisation (Fijnaut, 1996; Houben, 1996; Kleemans *et al.* 1998). Synthesis often takes place at a different site than where the chemicals are processed, mixed or tableted. Nonetheless, there are still also small groups of two or three people who manage the whole production process and initial distribution stage. According to one mid-level dealer, large producers with ties to organised crime presently have a monopoly, providing 90% of the Dutch domestic market and exporting some 80-90% of their production. Original small producers who manufactured small amounts for their own networks have been pushed out of the market, mainly because intensified precursor controls reduced the availability of raw materials. One informant stated that in the old days a few 'hobbyists' might produce a few kilos of MDMA that were tableted in a few runs. Nowadays, big producers deliver pills from 100 kilos of MDMA in just one run. (Blickman *et al.*, 2003)

Most law enforcement officials agree there is a small, invisible group at the top that might finance and outsource synthetic drug operations. This group includes the 'old guard' of hashish entrepreneurs that is currently more involved in money laundering and real estate transactions. Groups that produce and distribute synthetic drugs depend on them for financial backing, the import of precursors and/or export of pills (Fijnaut *et al.*, 1996). According to law enforcement officials involved in setting up the USD, some ten 'top' criminals financed the production of synthetic drugs in the Netherlands in 1996. They put up the money (sometimes hundreds of thousand of euros) to set up laboratories and collect millions in profits. These top levels sometimes work together, pooling their resources, trafficking lines and contacts. Other financiers were located in Spain and the United Kingdom. Together they dominated the European market in synthetic drugs. One USD officer reluctantly guesstimated there were appro-

³⁵ Interview with mid-level dealer, September 2002.

ximately 60 to 65 groups in the Netherlands with a total of about 500 people involved in ecstasy production and distribution on different levels. Another police officer estimated that the top level of the ecstasy business was in the hands of 80 or 90 people. Police continually run into the same people during investigations. Nowadays, most are around 40 years old and find it difficult to get out. Experienced individuals are frequently dragged back in again (Blickman *et al.*, 2003).

However, new individuals sometimes suddenly appear, young people in their mid-20s who in a short period of time succeed in creating new networks and alliances with dealers and production organisations. Thus the top level of the ecstasy industry seems to be very dynamic and flexible and composed of fairly loose coalitions involving established criminals in the *Randstad* and southern provinces of Brabant and Limburg. From time to time disputes result in lethal violence. Increased law enforcement against major ecstasy groups has had some success. But new groups quickly fill the gaps. Young adventurers step in where the older guard has been arrested or retired, but they do not have the same leadership capacities. The result is more tension in the milieu and violent liquidations, and probably also one of the reasons that production moves from the south to the western part of the country.³⁶ These characteristics at the upper level are a barrier for some to move up. Two mid-level dealers that were interviewed started as retailers and moved up to the mid-level (10.000 pills) but said they did not want to move up to the wholesale level since ‘organised crime’ is involved and the business would no longer be ‘relaxed’ because too much money is involved.³⁷ One mid-level dealer with some experience in the underworld through relatives said however the really ‘big guys’ are not problematic types, but the level just below (Blickman *et al.*, 2003).

Specific law enforcement actions

Paradoxically, Dutch police unwillingly promoted ecstasy production in the early mid-1990s. In an attempt to bring down criminal organisations involved in ecstasy production, some prosecutors and criminal intelligence officers allowed an undercover agent to infiltrate several organisations of ecstasy producers. This operation was part of a desperate attempt to crack down on drug trafficking networks after Dutch law enforcement authorities discovered in the mid 1980s that in the previous decade some rather large international hashish trafficking organisations had developed. At the time, these criminal organisations had also become involved in ecstasy production and trafficking. Initially, the cure proved

³⁶ BN/DeStem, 22 March 2003.

³⁷ Another dealer interviewed in the mid-1990s also said he did not want to know wholesale dealers and producers because he was afraid of the very rough environment of producers (Houben, 1996).

to be worse than the disease. Irregularities led to the biggest law enforcement crisis ever in the Netherlands. In their eagerness to get the ‘real’ kingpins, some prosecutors and detectives ignored the procedural code carried out controversial investigation techniques (involving criminal undercovers, large-scale uncontrolled drug deliveries, illegal phone taps, clandestine house searches, etc.).³⁸ The use of undercover agents to incite people into trafficking is not allowed by Dutch law. A way to evade this constraint was to resort to long-term infiltration by a criminal informant, allowing criminal organisations to traffic dozens of tonnes of cannabis, sometimes with active support of the detective team. This support in the traffic was deemed necessary for enabling the criminal undercover to obtain trust from the top echelon. In the end it became unclear who was leading the operations: the police or the criminals.

Several major ecstasy transports to the UK were allowed to pass. More controversial was that in the beginning 1990s, criminal intelligence officers allowed a criminal undercover – a fairly small-time criminal known as *The Snail*³⁹ – to infiltrate several organisations of ecstasy producers. First, he learned the tricks of the trade from one of the traditional southern amphetamine cooks. When that man was arrested, *The Snail* instructed others how to produce ecstasy, supplied precursors and laboratory equipment, even built laboratory himself (Husken 2000; Husken & Vuijst, 2002). The whole operation eventually backfired when the controversial investigation methods were denounced. Most organisations targeted by *The Snail* were initially dismantled but in subsequent court cases against some of the southern ‘ecstasy barons’ the controversial investigation methods were judged illegal and several of the ecstasy-gang leaders had to be released.⁴⁰ The actions of the undercover helped to spread expertise on ecstasy production among criminal groups. Some of the major ecstasy producers in Limburg are still at large and ecstasy production expanded almost to the point of market saturation.

Multiplier effect

In a report on organised crime in the Netherlands, the Scientific Research and Documentation Centre (WODC) of the Ministry of Justice suggests an explanation for the rise of the ecstasy business in the Netherlands, specifically at its origin in the southern provinces. The WODC researchers point to a phenomenon from sociological research on the ‘social structure of entrepreneurial activity’: i.e.

³⁸ According to observers, diplomatic and operational pressures from the US had led to the acceptance of these so-called pro-active policing methods in the Netherlands (Klerks, 2000).

³⁹ He got this nickname because he was slow to respond when propositions were made. He first had to consult his ‘runners’ at the Criminal Intelligence Division.

⁴⁰ De Limburger, 27 April 2001; 12 May 2001. Two of them recently were awarded € 45.000 in indemnity, see: De Limburger, 8 July 2003.

the importance of the existence of other, similar enterprises in the emergence of a new venture. In such an environment, new ventures develop because they have more chances of acquiring the necessary know-how, plus the essential social relations to expand and the basic confidence to start up an enterprise. Personal contacts and geographical proximity are essential (Kleemans *et al.*, 2002: 43).

In the early 1990s, the ecstasy market was still relatively new and open. Along with large-scale producers and wholesalers, a host of middle-size and small-scale amateur enterprises operated who were sometimes as dangerous to themselves as their direct environment: incidents such as exploding stills, leaked acid and ammonia emissions resulted in small environmental tragedies and the premature closure of laboratories which looked more like primitive, unhealthy sculleries than professional factories (Van Duyne, 1996). Apparently, ecstasy production proliferated. WODC researchers point to a phenomenon which they describe as the 'snowball effect': individuals involved with criminal coalitions eventually become more and more independent from other people (and resources such as money, expertise and contacts) and start up their own venture. When they do so they involve new individuals from their own social environment and the process repeats itself in constant process of 'cell partition'. (Kleemans *et al.*, 1998: 55).

Conclusions

The Netherlands' importance as major ecstasy producer is less than is generally assumed, or otherwise it is losing its predominant position. There is no basis for the DEA's claim that it is supplying 80% of the world market, and also not 80% of the US market. Source for supply of ecstasy are much more varied, and that diversity of sources is growing.

Statistics are still flawed, and suffer from a wrong line of approach. Instead of looking at the global ecstasy industry on a national basis it makes more sense to research the networks that are involved. No single nation or national organisation controls the industry. Organisations producing or trafficking ecstasy, sometimes composed of several nationalities, are links in cross-border multinational chains. National borders lose their importance as criminal networks involved in the ecstasy industry organise their supply internationally. While at a certain moment the Netherlands provided a set of beneficial conditions for the development of an illicit ecstasy industry, a different set of conditions could favour the development of production facilities and trafficking lines elsewhere. Without insight in the functioning of criminal networks involved in the illicit ecstasy industry it is not possible to understand the functioning of the market.

In contrast with traditional plant-based drugs, the illicit ecstasy industry is not bound to specific cultivation areas. Because the industry is very dynamic and

flexible, it will adapt quickly to law enforcement actions, changes in drug consumption fashions and the resulting market transformations. There are signs that networks of Chinese nationals in different countries worldwide are acquiring a position on the international ecstasy market, while in Eastern Europe conditions also seem to offer opportunities. Nevertheless, the potentially favourable sets of conditions are difficult to predict as they depend on several factors occurring at the right moment in time.

Looking at the criminal networks would also avoid the pinpointing of specific countries as the source of global supply, based on flawed statistics and presumptions that often are more the result of political bias about general drug control policies of a specific nation rather than on reliable data.

References

- Adelaars, A., *Ecstasy. De opkomst van een bewustzijnsveranderend middel*. Amsterdam, In de Knipscheer, 1991
- AIDR, *Australian Illicit Drug Report 2001 – 2002*. AIDR 2001–2002
- BKA, *Rauschgiftjahresbericht 2001 Bundesrepublik Deutschland*. Lagezentrale Rauschgift, Bundeskriminalamt (BKA), Wiesbaden, 2001
- Blickman, T., D. J. Korf, D. Siegel and D. Zaitch, Synthetic Drug Trafficking in Amsterdam. In: *Synthetic Drugs Trafficking in Three European Cities: Major Trends and the Involvement of Organised Crime*. Turin, Gruppo Abele, 2003
- Bruinsma, G.J.N, Misdaddevingen uit de nieuwe lidstaten van de EU. *Justitiële verkenningen*, vol. 30, no. 6, 36–50, 2004
- CDPC, *Report on the Organised Crime Situation in Council of Europe Member States 1998*. Committee of experts on criminal law and criminological aspects of organised crime (PC-CO), European Committee on Crime Problems (CDPC), Council of Europe, PC-CO (1999) 17, Strasbourg, December 1999
- DEA, *Ecstasy: Rolling Across Europe*. Office of International Intelligence, Drug Enforcement Administration (DEA), Arlington, August 2001(a)
- DEA, *Drug Trafficking in the United States*. Domestic Strategic Intelligence Unit (NDAS) of the Office of Domestic Intelligence, Drug Enforcement Administration (DEA), Arlington, September 2001(b)
- DEA, *Drug Intelligence Brief: Russian Organized Crime Groups*. Office of International Intelligence, Drug Enforcement Administration (DEA), Arlington, January 2002
- DEA, *Vietnam Country Brief*. Office of International Intelligence, Drug Enforcement Administration (DEA), Arlington, November 2003
- DEA, *China Country Brief 2003*. Office of Strategic Intelligence, Drug Enforcement Administration (DEA), Arlington, February 2004(a)
- DEA, *Australia Country Brief 2003*. Office of Strategic Intelligence, Drug Enforcement Administration (DEA), Arlington, April 2004(b)
- DEA and RCMP, *Chemical Diversion and Synthetic Drug Manufacture*. Joint report of the Office of International Intelligence, Drug Enforcement Administration (DEA) and Drug Analysis Section, Criminal Analysis Branch, Criminal Intelligence Directorate, Royal Canadian Mounted Police (RCMP), Arlington/Ottawa, January 2002
- DNRI, *Nationaal dreigingsbeeld zware of georganiseerde criminaliteit*. Dienst Nationale Recherche Informatie (DNRI), Zoetermeer, July 2004
- EMCDDA, *2002 Report on the drug situation in the candidate CEECs*. Lisbon, European Monitoring Centre for Drugs and Drug Addiction (EMCDDA), 2002
- Europol, *Serious Crime Overview Drugs 2004*. The Hague, Europol, 2004
- Farrell, G., Routine Activities and Drug Trafficking: The Case of the Netherlands. *International Journal of Drug Policy*, no. 9, 21–32, 1998

- Fossen, C.M., *Risk analysis. developments 1998 to the present*. Presentation at the International Synthetic Drug Enforcement Conference (SYNDEC) on International Cooperation, Scheveningen, 8-9 October, 2003
- Fijnaut, C., F. Bovenkerk, G. Bruinsma and H. van de Bunt, *Eindrapport georganiseerde criminaliteit in Nederland*. Enquête Opsporingsmethoden, Bijlagen VII, Kamerstuk 24072 no. 16, Tweede Kamer, vergaderjaar 1995-1996, The Hague, SDU, 1996
- Fijnaut, C., *Georganiseerde criminaliteit in Nederland: De rol van autochtone criminele groepen*. Enquête Opsporingsmethoden, Bijlagen VIII, Deelonderzoek I, Kamerstuk 24072 no. 17, Tweede Kamer, vergaderjaar 1995-1996, The Hague, SDU, 1996
- Fijnaut, C. and F. Bovenkerk, *Georganiseerde criminaliteit in Nederland: Een analyse van de situatie in Amsterdam*. Enquête Opsporingsmethoden, Bijlagen XI, Deelonderzoek IV, Kamerstuk 24072 no. 20, Tweede Kamer, vergaderjaar 1995-1996, The Hague, SDU, 1996
- Graafland, P., *International co-operation in investigation*. Presentation at the International Synthetic Drug Enforcement Conference (SYNDEC) on International Cooperation, Scheveningen, 8-9 October, 2003
- Houben, H., *Een eerste verkenning: Fenomeenonderzoek Synthetische Drugs*. Den Bosch, Interregionaal Rechercheteam Zuid-Nederland, 1996
- Huisman, W., M. Huikeshoven and H. van der Bunt, *Marktplaats Amsterdam*. The Hague, Boom, 2003
- Husken, M., *Deals met justitie. De inside story van infiltranten en kroongetuigen*. Amsterdam, Meulenhoff, 2000
- Husken, M. and F. Vuijst, *XTC smokkel*. Amsterdam, Meulenhoff, 2002
- INCSR 2002, *International Narcotics Control Strategy Report 2002*. Bureau for International Narcotics and Law Enforcement Affairs, United States Department of State, Washington DC, INLEA, 2003
- INCSR 2003, *International Narcotics Control Strategy Report 2003*. Bureau for International Narcotics and Law Enforcement Affairs, United States Department of State, Washington DC, INLEA, 2003
- Kleemans, E., E. van den Berg and H. van de Bunt, *Georganiseerde criminaliteit in Nederland. Rapportage op basis van de WODC-monitor*. Onderzoek en beleid no. 173, The Hague, Ministerie van Justitie, Wetenschappelijk Onderzoek- en Documentatiecentrum (WODC), 1998
- Kleemans, E., M. Brienen, H. van de Bunt, *Georganiseerde criminaliteit in Nederland. Tweede rapportage op basis van de WODC-monitor*. Onderzoek en beleid no. 198. The Hague, Ministerie van Justitie, Wetenschappelijk Onderzoek- en Documentatiecentrum (WODC), 2002
- Klerks, P. *Groot in de hasj. Theorie en praktijk van de georganiseerde criminaliteit*. Antwerp, Kluwer Rechtswetenschappen, 2000
- Korf, D. and H. Verbraeck, *Dealers en Dienders*. Amsterdam, Criminologisch Instituut Bonger (Universiteit van Amsterdam), 1993

- Korf, D., T. Nabben and A. Benschop, *Antenne 2000, Trends in alcohol, tabak, drugs en gokken bij jonge Amsterdammers*. Amsterdam, Rozenberg Publishers, 2001
- Korf, D., T. Nabben and A. Benschop, *Antenne 2001, Trends in alcohol, tabak, drugs en gokken bij jonge Amsterdammers*. Amsterdam, Rozenberg Publishers, 2002
- Ministerie van Justitie, *Samenspannen tegen XTC*. The Hague, Ministerie van Justitie, May 2001
- Mareso, M., M. Massari, P. Monzini and M. Veglio, The Synthetic Drug Market in Turin. In: *Synthetic rugs Trafficking in Three European Cities: Major Trends and the Involvement of Organised Crime*. Turin, Gruppo Abele, 2003
- NCIS, *UK Threat Assessment 2002. The Threat from Serious and Organised Crime*. National Criminal Intelligence Service, London, NCIS, 2002
- NCIS, *UK Threat Assessment 2003. The Threat from Serious and Organised Crime*. National Criminal Intelligence Service, London, NCIS, 2003
- NDIC, *Joint Assessment of MDMA Trafficking Trends*. National Drug Intelligence Center, Johnstown PA, July 2000
- NDIC, *National Drug Threat Assessment 2003*. National Drug Intelligence Center, January 2003
- NDIC, *National Drug Threat Assessment 2004*. National Drug Intelligence Center, April 2004
- Paoli, L., *Illegal Drug Trade in Russia*. Freiburg, Max Planck Institute for Foreign and International Criminal Law, 2000
- RCMP 2002, *Drug Situation in Canada 2002*. Criminal Intelligence Directorate, Royal Canadian Mounted Police (RCMP), Ottawa, July 2003
- RCMP 2003 (2004), *Drug Situation in Canada 2003*. Criminal Intelligence Directorate, Royal Canadian Mounted Police (RCMP), Ottawa, July 2004
- UNODC, *Global Illicit Drug Trends 2003*. United Nations Office on Drugs and Crime (UNODC), New York, United Nations, 2003(a)
- UNODC, *Ecstasy and Amphetamines Global Survey 2003*. United Nations Office on Drugs and Crime (UNODC), New York, United Nations, 2003(b)
- UNODC, *World Drug Report 2004*. United Nations Office on Drugs and Crime (UNODC), New York, United Nations, 2004(a)
- UNODC, *Amphetamine-Type Stimulants in East Asia and the Pacific*. United Nations Office on Drugs and Crime (UNODC), Regional Centre for East Asia and the Pacific, Bangkok, April 2004(b)
- USD, *Jaarverslag 1999*. Eindhoven, Unit Synthetische Drugs, June 2000
- USD, *Jaarverslag 2000*. Eindhoven, Unit Synthetische Drugs, June 2001
- USD, *Jaarverslag 2001*. Helmond, Unit Synthetische Drugs, May 2002
- USD, *Jaarverslag 2002*. Helmond, Unit Synthetische Drugs, June 2003
- Van Duyne, P.C., R.F. Kouwenberg en G. Romein, *Misdaadondernemingen; ondernemende misdadigers in Nederland*. Gouda Quint, Arnhem, 1990
- Van Duyne, P.C., *Het spook en de dreiging van de georganiseerde misdaad*. The Hague, SDU, 1995

- Van Duyne, P.C., The Phantom and Threat of Organised Crime. *Crime. Law and Social Change*, no. 24, 341-377, 1996
- Van der Heiden, T., *Routine Activities and Drug Trafficking via the Netherlands*. Presentation at the 2nd World Conference on the Investigation of Crime, Durban (South Africa), December 2001
- Van der Heijden, A.W.M., *De Nederlandse drugsmarkt*. Dienst Nationale Recherche Informatie (DNRI), Zoetermeer, November 2003
- Witteveen, M., *Juridische positie van XTC en strafrechtelijke handhaving*. Presentation at the conference 'XTC. Trends in Use and Illicit Trade', Centre for Information and Research on Organised Crime (CIROC), Amsterdam, VU University, 23 October, 2001
- Zaitch, D., *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands*. The Hague, Kluwer Law International, 2002(a)
- Zaitch, D., From Cali to Rotterdam: Perceptions of Colombian Cocaine Traffickers on the Dutch Port. *Crime. Law and Social Change*, no. 38, 239-266, 2002(b)

Drugs and organised crime in Bulgaria

Tihomir Bezlov¹

Introduction

Although Bulgaria is situated on the heroin route to Western Europe, prior to the collapse of the Soviet Bloc in 1990, no Bulgarians used heroin,² or participated in drug trafficking, or were involved in organised crime. However, the end of the communist regime marked the beginning of a heroin epidemic and the emergence of the first organised criminal structures. At first, emerging Bulgarian organised crime took no interest in the domestic drug market due to its small size.³ Interest mainly focused on the huge opportunities involved in smuggling consumer goods,⁴ in protection and insurance racketeering (especially in relation to automobiles and commercial outlets) and in the manufacture of pirate CDs (CSD, 2002; CSD, 2004).

By the mid 1990s Bulgarian organised crime was controlled almost exclusively by two big ‘insurance companies’ that had nationwide reach and had infiltrated all the major institutions of government (CSD, 2004).⁵ As money laundering was in its infancy (petrol stations were a favourite then), initial ‘investments’ went into typical criminal areas – drugs, gambling and prostitution. These criminal activities had to be run under tight control and required discipline and central command. As a result, the limited number of large crime groups were organised as hierarchical structures – with a small number of bosses at the top taking all the major decisions – resembling the model described by Cressey (1969). The centralised structures typical of legal corporate insurance businesses became the blueprint for the criminal organisations’ businesses. These differ from the floating criminal-network relationships frequently found by Western researchers (Reuter and Haaga, 1989; Morselli, 2001).

¹ Tihomir Bezlov is Senior Analyst at the Center for the Study of Democracy, Sofia, Bulgaria.

² Drug addicts were mainly people who used opiates designed for medical purposes, and according to interviews carried out before 1990 very few had even seen heroin. It has been suggested that the credit for this is to be given principally to the efforts of the communist special services (see for more detail CSD, 2003).

³ According to data of the Ministry of Health and the Ministry of Interior, the number of opiate users was between 1,300 and 1,500 in 1990.

⁴ Massive as the opportunities already were to exploit the lack of consumer goods in an ex-socialist country, the Yugoslav embargo increased them by several orders of magnitude.

⁵ ‘Insurance’ rackets were initially the preserve of private security companies. At the end of 1994, the government introduced a system of licenses. As most of the companies functioned illegally and could not be licensed, they moved into the insurance business. In this way they continued to blackmail businesses and citizens into buying their “services” – this time under the label of ‘insurance’, rather than ‘protection’.

The most lucrative line of development, however, became commercial involvement in the networks transporting and distributing heroin in Western Europe. At the same time the domestic drugs market had already become fairly sizeable and by the late 1990s the Bulgarian organised crime groups had it firmly under their control. Research provided evidence that in the large cities after 2001, the market for drugs except marijuana was almost completely monopolised by the organised crime groups (CSD, 2003). In these respects, during the period of our research, from 2001 to 2004, the characteristics of the Bulgarian drug market appear to have diverged from what studies have shown to be the characteristics of the US and West European markets (Block, 1979; Reuter 1983; Paoli, 2002; Van Duynne and Levi, 2005).

A territorial organisation developed. Big cities were divided into areas where retail dealers reported to a wholesaler, with any 'independent' dealer that might appear being promptly ousted. Corrupt police officers, prosecutors and judges often provided immunity for individuals involved in such drug trade networks. The classic sign that the drugs market was being monopolised was the fact that prices in Bulgaria continued to grow while the quality of the drugs worsened. Elsewhere in Europe the price of drugs, with the exception of marijuana, tended to go down. Thus, unlike other illegal activities, such as the smuggling of consumer goods, the organisation of prostitution or the theft of automobiles, where in the late 1990s organised crime developed network types of organisation, the drugs market continued to develop as a typical hierarchy.

This chapter aims to provide a schematic review of the participation of Bulgarian organised crime groups in the domestic drugs market and in drug trafficking within Bulgaria. Regrettably, Bulgaria still lacks a tradition in organised crime research, and this means that reliable data are scarce. The surveys used here are the first of their kind in the country. Therefore, the scheme outlined is in many respects incomplete and should even be interpreted as a set of hypotheses for further research.

Method of research

The present analysis draws on four studies conducted between 2002 and 2004. The first is the *Drug supply survey* (2002-2003). Fieldwork was carried out in the period from June 2002 to November 2003 by the Center for the Study of Democracy. The method used consisted of in-depth interviews. The basic informant groups were:

- representatives of citizen organisations and doctors working with drug addicts (30 interviews);
- long-term heroin users, low- and middle-level dealers, police and special services officers (50 interviews).

In addition to in-depth interviews, specialised analyses were obtained from law enforcement officers, journalist investigations and media reports (CSD, 2003).

The second study is the *Transport, Smuggling and Organized Crime Survey* (2004) (CSD, 2004 b) the fieldwork for which was conducted in the period between September 2003 and September 2004 at four separate border-crossing points: Kulata, Kapitan Andreevo, the Port of Varna and Sofia Airport. The data was gathered by means of semi-structured interviews with law enforcement officials and transport professionals. Interviews were conducted with a total of 700 officers including current and former officials of the Bulgarian Customs Agency (BCA), the National Service for Combating Organised Crime (NSCOC), the National Border Police Service (NBPS) and the Navy (which has responsibilities in the area of sea port security). Interviews were also conducted with transportation company owners, truck drivers and traders.

The third study is the *Drug Use Survey* (2003) based on the results of an investigation carried out by Vitosha Research. Fieldwork took place in December 2002 and January 2003. Data was gathered by means of the European Monitoring Centre for Drugs and Drug Addiction (EMCDDA) questionnaire administered through standardised face-to-face interviews. The survey included two independent sub-samples (derived from a two-stage national random cluster sample). The first sample is representative of the population above 15 years of age (N = 823). The second is representative of the group aged 15 to 30 (N = 1098).

The fourth investigation is the *Injection Drug User Survey* (2003),⁶ for which fieldwork was conducted in the period July to October 2003. Data was gathered using standardised face-to-face interviews. The sample included 501 injection drug users in four cities – Sofia, Plovdiv, Bourgas and Pleven. Respondents were selected by means of quota sampling designed to take account of the size of the city concerned.

Results

Main findings

The Domestic Drug Market

The best way to analyse the structure and mechanisms by which the organised crime groups operate, is to obtain a proper understanding of how the various drugs markets function.

⁶ The survey took place as part of the project, “From Pilot to Professional”, funded by the EU PHARE programme, and was carried out by four Bulgarian non-governmental organisations working in the areas of harm reduction. These included the NGOs “Initiative for Health” – Sofia, “A Shot of Love” – Bourgas, “Panacea” – Plovdiv, and “Pleven 21 Century Foundation”, in cooperation with the Addiction Research Institute, Rotterdam – IVO, Rotterdam.

The domestic drugs market is divided into three sub-markets, namely, the markets for 'grass' or marijuana, for amphetamines, and for heroin. The nature and the scarcity of the product, consumption and demand patterns, together with other circumstances have a varying influence on supply mechanisms. Due to the high price of cocaine, its use in the country is limited.

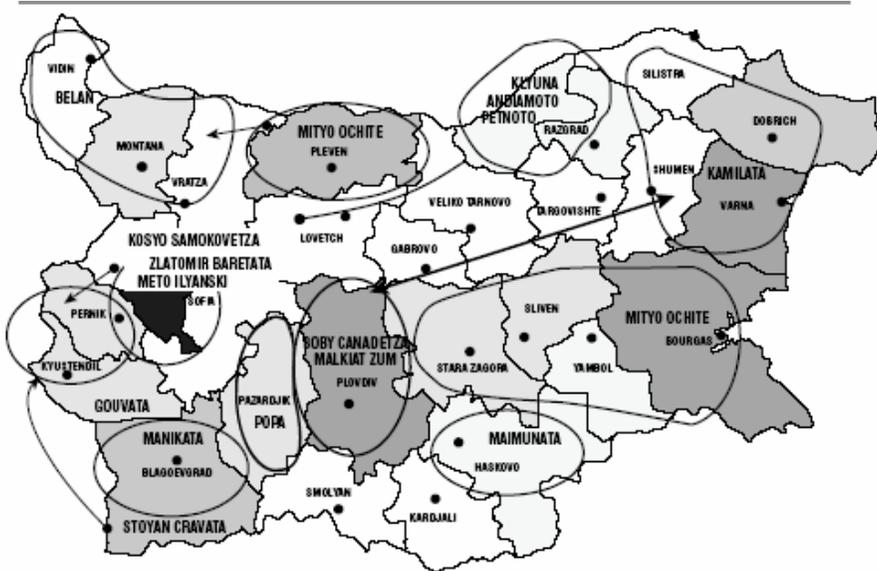
Cannabis

Unlike in Western Europe, the drugs epidemic that started in Bulgaria in the early 1990s was focussed on heroin. For this reason, until a decade ago the use of cannabis was rare. Now, however, as in the rest of Europe (EMCDDA, 2004; UNODC 2004), users of 'grass' outnumber the users of any other illicit drug (CSD, 2003). The market for cannabis continues to be relatively open, with a significant share of acquaintance-based trade on all levels from manufacturing to retail sales. The reason for this is that the climate in Bulgaria allows cannabis to be grown anywhere, hence providing a continuous supply while keeping prices relatively low. In recent years, however, organised crime groups have shown a noticeable interest in gaining control of this market. On the one hand, heroin dealers, already under the control of organised groups, want to add cannabis to the range of drugs they offer; on the other hand, small independent dealers, until recently working among acquaintances only, are now being forced to accept the 'protection' of , and the conditions imposed by the traditional networks for the distribution of heroin and amphetamines.

Heroin

The primary drugs market in Bulgaria, however, in terms of its value and significance for organised crime, is without doubt heroin. Surveys (CSD, 2003) have revealed that the country has been carved up into areas shared between three to four large criminal groupings around which some seven or eight smaller groups gravitate (see figure 1).

Figure 1. Controllers of the drugs market in Blugaria, 2002 – 2003: the geographical division of control between individuals



Source: CSD and National Service for Combating Organized Crime

The principle of territorial division is best illustrated by referring to the example of the country's capital city – Sofia. Sofia's heroin consumption equals that of the rest of the country, while its population is only 14% of that of Bulgaria as a whole.⁷ The city has been divided into several areas (incidentally overlapping with police districts which should prompt inquiries into possible protection by police officers), each area having a boss.⁸ Many similarities can be found with recognised patterns of heroin distribution – such as those described by Preble and Casey (1969) for the city of New York. In the case of Sofia five relatively stable distribution levels are distinguishable. At the lowest level are the heroin users who also deal.⁹ For Sofia their number is estimated to be between 5 and 7 thousand and for the whole country, including Sofia, between 15 and 25 thousand.¹⁰ Each dealer has a certain area and 'reports' to the 'holder' of the area. Selling even just outside the area, supplying drugs obtained from external

⁷ National Statistical Institute, 2001 Census.

⁸ In fact, not having 'contacts' in the relevant district means losing the area to competition. The typical fee payable to the police chief in charge of anti-drug operations in a police district amounts to some 15 to 20 leva (8 to €10) per dealer per week (for more detail see CSD, 2003).

⁹ Almost 10% of the people who have used drugs for more than 10 years say they have assisted the dealers or have been dealers themselves.

¹⁰ Data from the Drug Injection Survey show that drug users in the capital consume on average about 50 to 80% more than drug users in other parts of the country.

sources, or working for another area chief, is punishable, starting with a fine, and ending with a beating or even mutilation. The next level is formed by the street dealers, each providing drugs to 25 to 30 drug users. The third level consists of the suppliers, who secure the drugs for the dealers. In 2002–2003 each supplier provided stock for between three and ten dealers.

The fourth level consists of the bosses of the Sofia region – in 2003 they amounted to 6 or 7. An important characteristic of the fourth tier is that it includes a variety of players, such as the so-called ‘black’ lawyers (working for drug bosses) and the hit squads. The ‘black’ lawyers typically have professional experience with the agencies of the Ministry of Interior, or as investigators, prosecutors, judges. The lawyers’ usual task is to secure protection for the criminal operations at all levels of law enforcement – from police districts where clients have been detained, through investigators, detectives, prosecutors and judges.

Especially important for the operation of the hierarchy and the area division are the hit squads.¹¹ These are groups of three to four people, one or two of them possibly being the boss’ personal bodyguards. If a dealer breaks the rules he is typically scared off by a hit squad of two or three people. When ‘more serious measures’ need to be taken, a larger hit squad of up to ten individuals is assembled, gathering ‘staff’ from three to four areas.¹² As such assignments occur only episodically, the hit squads often perform other jobs required by the rules of organised crime – they collect overdue loans, punish pimps, racketeer shop owners, etc.

The fifth level consists of the 2 to 3 big bosses¹³ who negotiate the areas, secure the imports and control considerable shares not only of the black economy in Bulgaria, but also of grey, and even white (legal) markets. In some of its analytical works on organised crime in Bulgaria (2002–2004), CSD distinguished between different ‘shades of grey’ in order to draw the attention of both law enforcement institutions and policy makers to the fact that organised crime uses various forms of legality in its business operations. The metaphor has also been used by law enforcement officials to describe the adaptability of Bulgarian organised crime. It is best exemplified by the distribution of activities at its two top-most levels.

¹¹ The big hit squads of the 1994–1997 period, consisting of some 20 to 30 individuals have become too expensive and cumbersome to maintain. They have been replaced by a group of three to four: “a car load of people”.

¹² Punishments can be graded in terms of three levels: 1) fines – whose size, ranging from several hundred to several thousand leva, depends on the severity of the offence; 2) various degrees of beating – though the breaking of bones and heavy injuries are avoided; 3) mutilation – which ranges from the breaking of fingers to the breaking of one or both elbows, knees, etc. (that is, bones and joints that heal only with difficulty).

¹³ This has been inferred from interviews with dealers and with police and special services officers that took place in 2003. The subsequent drugs-market war that took place in late 2003 and early 2004 largely confirmed the existing hierarchy and the roles of most key figures.

At the fourth tier the most typical form of participation in grey businesses is through area chiefs' ownership of pawn shops, exchange bureaus and restaurants. Some of their activities are unlawful, others fully legal. Usually only a small portion of the turnover is officially reported. During the period from the end of 2003 until early 2005, a series of murders and abductions related to the top-most tier of bosses in Sofia revealed many details about the ways in which their business had been organised. Grey business operations included involvement in networks for the import of Chinese and Turkish consumer goods, where most import taxes were avoided. Legal business activities included investments in tourism, real estate, construction, parking lots, garbage collection, shopping malls, transportation, etc.

Such a structure can be said to have developed gradually and to have taken its final shape around 2001. Necessary for its operation are various models of negotiation to divide territories between criminal groupings. Just as necessary is a division of labour – the area bosses have their wholesalers, carriers, hit squads, black lawyers, etc. Elsewhere, depending on city size, there are one or two fewer levels, and smaller towns often become virtually the property of neighbouring large cities. The findings of the CSD survey of the country's heroin market indicate that this is a model very different from that found in Western Europe, at least to judge from Letizia Paoli's surveys of the Frankfurt and Milan markets (Paoli, 2002).

Amphetamines

The third domestic sub-market is the market for amphetamines. The manufacture of amphetamines has a long history going back to the Communist period when Bulgarian state-owned enterprises exported most of their amphetamine production to the Middle East. After becoming a party to major international agreements banning this production, Bulgaria stopped it in the middle of the 1980s. Following the closure of such factories, individuals who had gained experience and established contacts while working there, became involved in illegal laboratories. Due to its low quality most of the production was exported again, mostly to the Middle East. By the end of the 1990s, however, the low price and large volume of production attracted the attention of Bulgarian organised crime groups, who saw the amphetamine trade as an opportunity for additional income alongside that deriving from heroin. A considerable part of the domestic distribution of amphetamines today makes use of the networks associated with the heroin market.

Police detentions in the summer of 2003 provided evidence that the organisers of the amphetamine market were using existing domestic production capacity,¹⁴ thereby making obsolete imports through the expensive and risky

¹⁴ Although some smuggled BMK has been captured, there is reason to believe that considerable quantities are also produced in the country. There have been no seizures of ecstasy or PMK so far.

international supply routes of the heroin market. What is innovative is that in the criminal groups involved strive to maximize the number of laboratories participating in production. The structure resembles an hour glass. At the widest (uppermost) part of the inverted triangle are hundreds of *labourers* who receive cheap equipment, precursors and accurate instructions. The technology is as simple as the alcohol distillation technology massively used by the average Bulgarian. Many laboratories work only intermittently, thus achieving two simultaneous effects. Firstly, simple technology minimises errors. Secondly, the risk is minimised: if workshops are discovered they can easily be sacrificed as they are cheap and losing some of them does not bring the whole enterprise down. Below come the *couriers* shipping the precursors, sub-products and the amphetamine output. The penultimate level is occupied by the *organisers of the import of precursors*, the chemical engineers. The final level, the narrow part of the hour glass, is occupied by the bosses. The distribution part (the lower chamber of the hour glass) has the same pyramid structure as the one, described above, for heroin distribution. Despite the growth of the domestic market for amphetamines, 90 to 95% of what is produced continues to be exported. Unlike in Poland, where the synthetic drugs are of high quality and are mainly sold in Western Europe (Krajevski, 2001), Bulgarian produce goes East and is of very low quality and price (CSD, 2003).

Drug Trafficking

To complete the picture of drug-related organised crime the transit operations need to be described as well. Transit trafficking is typically associated with the traditional heroin route from Turkey to Western Europe. The 600 kg of cocaine seized by chance in the middle of the 1990s, the number of Bulgarian nationals who have been arrested transporting cocaine, and the 5 tons intercepted in Bolivia in 2003 (expected to pass through Bulgaria on their way to Western Europe) all provide mounting evidence that the experience gained in trafficking heroin is being utilised in the transport of cocaine to Europe. Interviews with police officers indicate that there are several dozen persons, recorded as former members of Bulgarian criminal groups experienced in the trafficking of heroin, who have been arrested in Western Europe and Latin America for trafficking cocaine. A number of people were detained after information was made available by the Bulgarian police services.¹⁵

¹⁵ A heroin-cocaine link is also reportedly traceable in the murder of Poli Pantev on the island of Aruba in February 2001, widely discussed in the media. Poli Pantev was one of the bosses of the former power insurance grouping, SIK, and held a considerable share of both the domestic heroin market and its transfer, while he was also linked to a shipment of Latin American cocaine destined for Europe which disappeared in Bulgaria (hence his assassination).

The clear trend towards growing Bulgarian participation in international trafficking networks is indicated by the nationality of arrested drug traffickers. In 2000, when some 2 tons of heroin were seized at Bulgarian borders, 17 Bulgarian citizens were detained, as compared to 40 Turks and around 30 Albanians (from both Albania and Macedonia). In 2003, the Bulgarian nationals numbered 41 as compared to 12 Turks and 10 Serbs. In 2004, the share of Bulgarian detainees set a new record as compared to other nationalities.¹⁶

An additional source of trafficking income for organised crime appears to be the export to Turkey of amphetamines and precursors. Since the mid-1990s, and especially in 2003–2004, Bulgarian criminal groups have actively participated in trafficking to the Middle East. According to a number of police sources, Turkish organised crime is interested in the exchange of heroin for amphetamines and precursors. Regrettably there has so far been insufficient data available to confirm this.

In the early 1990s, Bulgarian organised crime participated in international trafficking mainly by providing ‘mules’ and logistic support. Of late, the channels used for smuggling consumer goods – corrupt customs officers and border police – have been increasingly used for heroine as well. Two main schemes are used. The first is adopted when Turkish lorries containing drugs cross into Bulgaria and continue their journeys to other parts of Europe (which is risky as they could be stopped at other European borders); the second is adopted when the shipments are split up into smaller parts in Bulgaria and shipped by Bulgarian mules.

Around 1999–2000, Bulgarian criminals became active at all levels of the European heroin trade, including the supply of precursors, the organisation of depots for reloading shipments, the financing of illegal operations, etc. Evidence of this development is the large amounts of heroin and precursors seized inside the country. According to sources from the NSCOC and the customs service, Bulgarian criminals buy heroin or sell precursors in Turkey on their own, and in turn arrange shipments to Western Europe via their own channels. In the opinion of the Ministry of the Interior’s Chief Secretary General, Boyko Borissov, the reason for the recent large number of high-profile assassinations and murder attempts (of which there were over 60 between 2002 and 2004) is the growing activity of Bulgarian criminal bosses in the West European drugs market.

Analysis of police and drug-crimes data from the courts show that despite the significant number of detentions, the Bulgarian security services are only able to reach the lowest levels – ‘mules’ and operative organisers. Higher-level investigations and discoveries are usually only possible with the assistance of the US Drug Enforcement Administration.

According to the special services and police experts, organised crime groups have put special efforts into isolating the channels and the persons trafficking

¹⁶ Source: Bulgarian Customs Administration, letter to CSD dated 30.08.2004

drugs through Bulgaria to European destinations, from the structures and the persons involved in the domestic distribution of drugs. CSD's field research in many respects supports this observation. Hence, it could be said that transit trafficking on the one hand, and the Bulgarian drugs market on the other, function separately.

Organised crime networks

When describing Bulgaria's drugs-related organised crime, one must emphasise that it does not constitute a special case. Although it obeys its own rules and requires its own types of organisation, it is still part of the broader system of criminal relations, which ultimately operate as a network. However, comparing it with the other types of organised crime such as prostitution, the smuggling of goods, or the production of counterfeit money and documents, it proves to be well related to, and integrated in, other international criminal organisations.¹⁷ It involves large numbers people and has very complicated forms of organisation. It is related to almost all the other forms of organised crime found in the country – from the theft of automobiles and human trafficking, to the export of valuable archaeological objects and the control of prostitution abroad.

According to experts from the police and customs drugs-related crime groups mostly use existing channels for the smuggling of goods, which ensures the import of heroin for domestic use and for transit. In the last couple of years these channels have also been used for the export of amphetamines and precursors. These channels usually offer a full infrastructure: transport companies, storage bases, and corrupt law-enforcement officers. Analysis of the killings of people known for their involvement in drug crime, has showed that those killed were people who at an earlier stage had been actively involved in the smuggling of legal goods. The criminal biographies of people arrested for dealing in drugs in Western Europe show that they have also been involved in car theft, human trafficking, the illegal export of art, etc. In most cases they have used the already developed criminal infrastructure (CSD, 2004 b; CSD 2004 c).

Command or negotiate?

The fixed hierarchical structures with high-level towering bosses appear to have been of a temporary nature. When in 2003 the CSD carried out the first study of the drugs market in Bulgaria, a very different picture of the shape of criminal organisations emerged. Analysis of the links between drug distribution within

¹⁷ There has been a lot of speculation about the connections between Bulgarian drug bosses and international crime organisations ranging from the Serbian Zemunski clan to the Columbian North Valley Cartel.

the country, and international trafficking, as well as of the links with other sectors of the black economy, revealed inconsistencies between the traditional model of organised crime, sketched above, and the actual operation and behaviour of the criminal structures. Tracing the various criminal schemes in operation, from the export of arms, to the import of stolen cars, it turned out that big criminal organisations were on the wane.

It appears that in the past ten years, a number of factors have been at work to bring about a transformation in the structure of 'organised crime'. The advance of the rule of law and the increased effectiveness of law enforcement, albeit unevenly throughout the region, has increased transaction costs in the black economy in general and pushed many crime entrepreneurs towards greyer areas. In addition, the separate black markets in the country were insufficient to absorb the available human and financial criminal capital. As a result, Balkan crime groups became part of European networks dealing in drugs and prostitution, but also diversified their smuggling operations to include consumer goods. The liberalisation of trade combined with insufficiently effective border controls also contributed to this diversification.

Thus crime entrepreneurs found themselves in a new environment in which the old hierarchical structures were no longer as effective. Analysis of the smuggling of cigarettes and petrol products, and of the grey import of Chinese goods to the Balkans, for example, has shown that the presence of so many criminal offenders is only explicable in terms of their belonging to a network of numerous small relationships and 'nodes' (CSD, 2004 b). It gradually became clear that the model best depicting the current structure of organised crime was the network – a web of persons and organisations (Morselli, 2001; Reuter and Haaga, 1989). Operating as a network, rather than as a tightly disciplined clan taking orders from a small group at the top, has given crime entrepreneurs a number of advantages. It is more adapted to the requirements of international criminal trade, which demands the development of a flexible international and domestic wholesale and retail capacity. Political protection can be purchased ad hoc, which is important in the volatile political environments of the region as trusted persons can lose their power. And it has also allowed deeper penetration of the informal economy where access to a much broader range of services is needed – from political protection to administrative bribery. Functions like service bartering in the new economy of crime, previously taken care of by the Boss, is now performed at all levels and 'switches'. There is no longer any need for authorisation from above for a criminal operative to trade favours with the police or with bureaucrats.¹⁸

Another factor contributing to the transition has been a change in the recruitment basis of crime. Social and economic deprivation in the early 1990s

¹⁸ In contrast with the famous 'six degrees of separation' experiment, a good shadowy networker in Bulgaria has to be able to procure any service at a maximum of two 'hops' in the network. For network concepts see Travers and Milgram (1969) and Watts (2003).

supplied an abundance of *lumpencriminaliat* who saw in crime both glamour and opportunity at a time when crime seemed to pay. The growing effectiveness of the rule of law, rising income, even a nascent middle class, have narrowed this base. In this changed context crime is now increasingly in need of lawyers, accountants, IT experts and various other professionals to maintain a seamless continuum between its black, grey and legal operations.¹⁹

Thus, what we still inaptly term ‘organised crime’ is today in fact an intricate network of transactions and relations of a predatory nature. It brings together criminals, bureaucrats, judges and prosecutors, politicians and businesses operating in the informal economy (even sports clubs) in a web whose ultimate goal is to ‘redistribute’ by misappropriation national wealth outside the rule of law. The resulting forms of social interaction, which include patronage, bribery, intimidation, service bartering, etc., prove to be infinitely richer than the regulatory and policy frameworks, which tend to simplify this variety to a few clearly defined ‘organised crime’ violations of the law.

Anecdotal evidence of this change can be found in a quote, allegedly from a notorious Bulgarian criminal boss with a background in mathematics. He compared the operation of his organisation to the Internet. And indeed, analysis of his network sheds light on a particularly interesting intertwining of persons and companies. Several of the network’s organisations exist as perfectly legal commercial entities. The hundreds of staff members of the legal enterprises are obliged to register firms in their names, firms which are brought into play without them ever being informed. The bosses at the highest levels of this structure participate in dozens of commercial firms in various configurations involving as partners people of their rank, or of the middle level. These firms own other firms and thus a network is set up which can lose or sacrifice certain components, while the fabric as a whole remains intact. Whenever a part of the network is down, its functions are taken over by other components. There have been examples of arrests of scores of participants and their bosses involved in illegal imports, and yet despite this ‘success’, a couple of days later the import scheme has been fully restored.

In this context, the emergence of a significant grey zone between the black market of outright criminal operations, on the one hand, and the legal economy on the other, is also part of the indispensable mediation through which crime functions today. It is much easier for criminal networks to hide their activities amidst a large number of illegal – though not (overtly) criminal – transactions of the grey economy. Grey businesses are also much easier take-over targets for interested criminals as they operate at least partially outside the official set of rules and cannot call on the protection of the authorities. It is increasingly difficult, for example, to distinguish the cigarette smuggler and the fuel importer evading state revenue tax, from the investor in tourism and the criminal boss

¹⁹ Racketeering, for example, has been significantly reduced in Bulgaria as the generation of illegal profits has moved into more sophisticated areas.

holding the concession of a public beach. This allows criminals and shadowy businessmen to move between these economies. For example from the grey zone of the smuggling of Chinese consumer goods using established channels and corrupt customs officers, some criminals move into the black zone, where they use the same channels, but then for the transfer of heroin.

Conclusion

The emerging picture of the structure of organised crime in Bulgaria shows both hierarchical operations and networks. Although the drug bosses participate in many other grey and black operations organised as networks, within drug-dealing organisations the hierarchical structure has been preserved. Completion of the survey, *The Drug Market in Bulgaria*, coincided with the culmination of the drug-market war (from the autumn of 2003, to the spring of 2004). It was waged by two gang leaders who fought for control of the markets of the capital, Sofia, and those of some smaller cities. The rivals resorted to assassinations, which included the use of explosives against some senior gangsters, and the attempt to force street dealers to change sides. It was expected that this war might remove the senior figures and make the country's drug distribution more similar to that of Western Europe – with its many independent participants in an illegal but free market (Paoli, 2002; Van Duyne and Levi, 2005). Grounds for such expectations were the transitory nature of the large criminal structures of the 1990s. However, at the end of the drug-market war, the predictions were belied by the facts. Although some of the most influential drug bosses had been murdered, had disappeared, or had been arrested, the structures reproduced themselves within months. 'Beheaded' areas acquired new bosses, shattered hit squads in the capital city were replaced by others from the country. The crisis in the supply of heroin was overcome; the quality of street heroin came once again under 'regular control'. Cash flows were centralised even further.

It is unlikely that these developments can be explained by a single factor alone. Probably one of the most important factors has been the weakness of government, and incompleteness in the reform of Bulgaria's institutions of law enforcement. Another factor probably relates to the continuing influence of the large 'insurance' racket firms from the mid-1990s, known by their abbreviations, VIS and SIK. Although long gone, they had been so powerful and included such a large number of criminals, that they have formed a kind loyalty fault line in the underworld and today most gangsters still associate themselves with them. Various specifics of heroin supply and distribution have no doubt had an organisational impact. And last but not least, ironic as it may seem, imitation of the Italian-American Mafia model has also had its influence upon criminals as well.

In transition countries, and especially in Bulgaria, organised crime figures have evolved in parallel with the process of social transformation, and their

organisations have spontaneously been shaped to meet different objectives: becoming power centres, seizing parts of 'their' markets and gaining recognition in the wider organised-crime community. Image and public/political attitude was not an issue at all in the beginning; it has started to emerge as an issue only recently. Being elements of the transition, and not having a stable society to embed into, organised crime figures in Bulgaria have, because of the considerable resources they have accumulated, spontaneously become power players, or at least important factors in the social, economic and political transition. An important aspect in this respect is that a substantial number of former security service officers have entered the milieu of organised crime.

It is interesting to observe the high level of replacement of leading figures. 'Old' bosses tend to enter, or to establish legitimate businesses and to develop positive self-images. Is this the 'gentrification' of organised crime-entrepreneurs? Not necessarily and not fully. The negative images of the networks they come from are still effective in terms of their capacity to arouse fear, and in terms of what they imply about connections etc. – for which reasons new crime entrepreneurs find it attractive to take the places of the 'old' bosses. At the same time the 'modern forms' (networks) have not fully succeeded in replacing the hierarchical structures, which control territories by using violence. In addition, the old bosses who acquire legitimate property cannot afford or do not want to leave the hierarchical structures to new marginal leaders. As one of the 'distinguished' grey leaders, known for his love of chess put it: "... narco business is like the central parts of the chess board: if you neglect it you lose the game". To avoid that they continue to operate in two worlds: organised crime-entrepreneurs are hard to gentrify.

References

- Bezlov T. and C. Barendregt, *Injecting drug users in Bulgaria: Profile and Risk*. Sofia, Initiative for Health Foundation, 2004
- Block, A.A., The snowman cometh: Coke in progressive New York. *Criminology*, vol. 17, May Issue, 75-99, 1979
- Cressey, D.R., *Theft of Nations: The structure and organisation of organised crime in America*. New York, Harper & Row, 1969
- Center for the Study of Democracy, *Corruption and trafficking: monitoring and prevention*, Center for the Study of Democracy (CSD), 2000, available at <http://www.csd.bg/artShow.php?id=12890>
- Center for the Study of Democracy, *Corruption, trafficking and institutional reform*. Center for the Study of Democracy (CSD), 2002, available at <http://www.csd.bg/fileSrc.php?id=10665>
- Center for the Study of Democracy, *The drug market in Bulgaria*. Center for the Study of Democracy (CSD), 2003, available at <http://www.csd.bg/fileSrc.php?id=181>
- Center for the Study of Democracy, *Partners in crime: the risks of symbiosis between the security sector and organized crime in Southeast Europe*. Center for the Study of Democracy (CSD), 2004(a), available at <http://www.csd.bg/fileSrc.php?id=525>
- Center for the Study of Democracy, *Transportation, smuggling and organized crime*. Center for the Study of Democracy (CSD), available at <http://www.csd.bg/artShow.php?id=4236>, 2004(b)
- Center for the Study of Democracy, *Weapons and scrutiny: implementation arm export controls and combating small arms proliferation in Bulgaria*. Center for the Study of Democracy (CSD), 2004(c)
- Duyne, P.C. van and M. Levi, *Drugs and money, Managing the drug trade and crime-money in Europe*. London, Routledge, 2005
- EMCDDA, *Annual Report 2004*, European Monitoring Centre for Drugs and Drug Addiction (EMCDDA), 2004, available at <http://annualreport.emcdda.eu.int>
- Krajevski, K., Drug Trafficking in Poland. In: P.C. van Duyne, V. Ruggiero, M. Scheinost, and W. Valkenburg (eds.), *Cross-border crime in a changing Europe*. Nova Science Publishers Inc, New York, 2001
- Letizia P. *The 'Invisible Hand of the Market': Illegal Drug Trade in Germany, Italy, and Russia*. Venice, 12th Annual Conference of the European Society of Social Drug Research, 2001
- Morselli, C., (2001) 'Structuring Mr. Nice': entrepreneurial opportunities and brokerage positioning in the cannabis trade. *Crime, Law & Social Change*, no. 3, 203-244, 2001
- Preble, A. E. and Casey J. J., Taking Care of Business-The Heroin User's Life on the Street. *International Journal of the Addictions*, vol. 4, March Issue, 1969
- Reuter, P., *Disorganized crime: the economics of the visible hand*. Cambridge MA, MIT, 1983

- Reuter P. and J. Haaga, *The organization of high-level drug markets: an exploratory study*. N-2830-NIJ, xix, 74, The RAND Corporation, 1989
- Travers, J., and S. Milgram, An experimental study of the small world problem. *Sociometry*, no. 4, 425-443, 1969, available at http://www.unodc.org/unodc/en/world_drug_report.html
- UNODC, *World Drug Report*. United Nations Office on Drug and Crime (UNODC), 2004
- D.J. Watts, *Six degrees, The science of a connected age*. New York, W.W. Norton & Company, 2003

Trafficking in women in Bosnia and Herzegovina

Almir Maljevic

Introduction: the fertile ground for crime entrepreneurs

Before anything is said about trafficking in human beings in Bosnia and Herzegovina, attention should be paid to certain features of the country that have had an enormous impact on the development and spread of crime in general. Bosnia and Herzegovina regained its independence in 1992 after the dissolution of the former Federal Socialist Republic of Yugoslavia. Unfortunately, the dissolution was followed by chaos, crises, and wars, which came to a head in the territory of Bosnia and Herzegovina. In addition to the almost unbelievable human losses, and the socio-economic damage that Bosnia and Herzegovina and its citizens suffered as consequences of the conflict, the 1992-1995 war also resulted in changes that created fertile ground for the development and spread of criminal organisations that challenged the state's capacity to combat crime in general.

Apart from trying to set up functional institutions of government, and to establish the rule of law, Bosnia and Herzegovina has also been going through a transition process – not only in the sense of a change from authoritarianism to democracy, but also in the sense of a change from a stringently controlled, to a free market economy. The disappearance of the absolute control over every feature of people's lives (including the economy and crime) that was exercised between the War and the early 1990s, allowed new forms of crime to emerge, driven primarily by the desire for illegal profit.

Moreover, in accordance with the terms of the Dayton Peace Agreement,² Bosnia and Herzegovina was divided into two entities,³ – each with extremely extensive powers and a high level of autonomy – and one district.⁴ Though the powers of the central state extend to security issues – including the fight against criminal organisations, which have surfaced wherever opportunities have been

1 Almir Maljevic is Academic and Research Assistant at the Faculty of Criminal Justice Sciences of the University of Sarajevo, Bosnia and Herzegovina.

2 The Dayton Peace Agreement, which brought the war to an end, was signed on 14 December 1995. At the same time, in order to preserve Bosnia and Herzegovina as one country it contained very vague provisions defining very complex, completely decentralised, administrative structures

3 These are the Federation of Bosnia and Herzegovina – which is administratively and territorially divided into ten cantons with extensive powers, high levels of autonomy, and their own assemblies and governments – and the Republic of Srpska.

4 The Brčko District of Bosnia and Herzegovina

favourable – the co-existence of two powerful entities has meant that the central state's control has always been weak. This problematic situation appears even worse if one considers that no fewer than 180 ministries are responsible for governing Bosnia and Herzegovina – thus providing fertile ground for all types of corruption, including corruption of the police and the judiciary.

In addition, until recently there was no state-wide agency of law-enforcement. This changed in 2000 when the State Border Service,⁵ the very first state-wide law-enforcement agency, was formed. It established comprehensive control over the country's borders at the very end of 2002. This means that, due to the tensions that persisted in the aftermath of the 1992-1995 war, the institutions of government failed, until 2002, to establish any serious form of police or judicial cooperation, or to exercise adequate control over the country's borders. Another state-wide police force was established in 2004: the State Agency for Investigation and Protection (SIPA).⁶

In accordance with the country's constitution, prior to March 2003, legislative powers, including those relating to criminal matters, belonged almost entirely to the entities.⁷ Given the differing political structures and philosophies of the two entities, this state of affairs resulted in the emergence of two different approaches to a number of issues. This was true even during the early stages of criminal law reform and especially when it came to the implementation of standards prescribed by international conventions ratified by the state of Bosnia and Herzegovina.⁸ As a consequence, the two entities had systems of criminal law that were incompatible, not only as far as the definition of certain criminal offences was concerned, but also in terms of criminal procedure, thus rendering judicial cooperation difficult.

The lack of unified political leadership, of harmonised criminal legislation, of state-wide law-enforcement agencies and of judicial and police cooperation: all this was of considerable assistance to crime entrepreneurs, who were able to develop and to extend their activities easily throughout the country and the whole region.

⁵ The Law on the State Border Service, *Official Gazette of Bosnia and Herzegovina*, no. 19/2001

⁶ The Law on the State Agency for Investigation and Protection, *Official Gazette of Bosnia and Herzegovina*, No. 27/2004. Among other things, trafficking in human beings falls within its jurisdiction.

⁷ The Office of the High Representative promulgated the Criminal Code of Bosnia and Herzegovina in January 2003. It has been published in the *Official gazette of Bosnia and Herzegovina*, No. 3/03 and it took effect on March 1st 2003

⁸ From the very beginning the Republic of Srpska refused to acknowledge Bosnian and Herzegovinian legislation and implemented laws defined and applied in the neighbouring Serbia and Monte Negro. At the same time the Federation of Bosnia and Herzegovina strove to bring its criminal legislation into line with various international conventions, regional and bilateral agreements.

Organised crime in Bosnia and Herzegovina

Due to the fact that very little serious research is available on the number of criminal organisations in Bosnia and Herzegovina, it would be highly speculative to say anything about their nature or extent.⁹ Nevertheless, some research projects focusing on criminal activities that can be related to organised crime should be mentioned. Criminal activities that have been the subject of research projects in Bosnia and Herzegovina are corruption and trafficking in human beings.¹⁰ Of course, this does not mean that other forms of organised crime, such as illicit drug trafficking, money laundering, computer-related crime (Budimlić, 2003), child pornography, illicit trafficking of firearms (see Hajdinjak, 2002), cigarette smuggling (also Hajdinjak, 2002), or the smuggling of migrants, do not exist.¹¹ On the contrary, such offences have been recorded in abundance, but research into them has yet to be carried out. Hence there are no valid scientific indicators that can be presented here.¹²

The only organised criminal activity to have been the subject of systematic research so far, is the trafficking of human beings, or, more precisely, the trafficking of women. This chapter will present some of the core findings from this research.

Although this chapter focuses on human trafficking in Bosnia and Herzegovina, it goes without saying that this criminal activity extends to the whole region and beyond. Therefore, there is a need briefly to describe the wider Balkan-region context – within which the trafficking of humans in Bosnia and Herzegovina is just one instance. Owing to a number of local, regional and global factors (Nikolić-Ristanović, 2004, and 1998; Lewis, 1998; CSD, 2003), in recent decades the Balkans have become a centre for illegal trafficking in all kinds of substances from drugs (so called ‘Balkan route’, Wegner, 2004) and arms to cigarettes (Hajdinjak, 2002), but also for trafficking in humans (Ćopić,

⁹ Most of the available research has been carried out by individuals interested in the field on the one hand (the results of such research being limited as a result of scarce financial resources) and by non-governmental organisations on the other.

¹⁰ Research on corruption has been conducted primarily by Transparency International Bosnia and Herzegovina using the well-known Corruption Perceptions Index, but also using the Study on National Integrity Systems. Using the same methodology in all cases, this is used to examine various institutions that should be combating corruption at a national level, by looking at the legal framework regulating the work of such institutions and the practical implementation of that framework. Meanwhile, the Association of Criminologists of Bosnia and Herzegovina is conducting research into the police and corruption, and is preparing research projects on corruption in the education system and in the judiciary.

¹¹ Although it is well known that Bosnia and Herzegovina lies at the heart of the (so called) *Balkan route* used for the trafficking of illicit drugs from East to West, the problem of drugs coming to and going through the country has never been researched!

¹² Between January 2003 and June 2004, the State Prosecutor’s Office initiated 79 investigations into allegations concerning the smuggling of migrants and 60 investigations into allegations of money laundering.

2002). Humans, predominantly women and children seen as a commodity (Williams, 1999), are being sold in all geographical directions: this has led to the Balkan region becoming widely known not only as a source, but also as a transit and destination region (Albania, 2003; Bosnia and Herzegovina, 2003; Bulgaria, 2003; Croatia, 2003; The FYR Macedonia, 2003; Moldova, 2003; Serbia and Montenegro, 2003; Romania, 2003).

Trafficking in women in Bosnia and Herzegovina

In order to obtain more insight into the phenomenon of trafficking in women in Bosnia and Herzegovina, the US Embassy recently financed the research project, "Trafficking in women in Bosnia and Herzegovina". The project was conducted by the Faculty of Criminal Justice Sciences at the University of Sarajevo under the supervision of Prof. Dr. Vladimir Obradović, from April 2003 until the end of the year.

The findings of the project are based on empirical data obtained from 691 respondents who were the victims of trafficking in Bosnia and Herzegovina in the period from 1999 to 2003. The sample included all recorded victims of trafficking in Bosnia and Herzegovina and was divided into two sub-samples: the first (N= 457) was used for social analysis, the second (N=238) for social-psychological analysis. Quantitative analysis was supplemented by a qualitative approach based on analysis of oral life-stories provided by the victims themselves, a number of semi-structured interviews conducted with five convicted traffickers, six taxi-drivers (transport providers) and *dancers* in night clubs, but also through participant observation during raids, and analysis of available police and judicial documents.

Results

It is very difficult to say when the first cases of trafficking in women were recorded, as the activity was not defined as criminal in Bosnia and Herzegovina until 2003. Cases that could have been defined as trafficking in women, were prosecuted as prostitution or as cases of aiding and abetting prostitution. It is a plausible assumption that, although some isolated cases were registered earlier, trafficking really began to take off after the war began in the region. There is a strong belief that that its increase is to be explained, not only by the general causes described above but also by the growth in the number of foreign peace-keeping military forces in the country (Obradović, 2004; Nikolić-Ristanović, 2004). The increased numbers of foreign military personnel led primarily to an increase in the numbers of nightclubs and other establishments featuring *exotic dancers*. Due to the fact that most of these dancers were not residents of Bosnia and Herzegovina, it was assumed that the women concerned were victims of

trafficking, which, as born out by the very first anti-trafficking police action, 'Macro', in 1994, proved to be correct.

Origin and routing of the victims

In his research, Obradović found that 93% of victims of trafficking were residents of Moldavia, Romania and the Ukraine. The fact that victims of trafficking came predominantly from these three countries, makes it plausible to assume that Bosnia and Herzegovina serves as a *destination* country with very well established routes for trafficking in women for sexual exploitation of various kinds (Obradović, 2004). These routes are the following:

- the majority (89.8%) travels on the route Moldavia-Romania-Serbia-Bosnia and Herzegovina and only 10.2% are sent on the route Moldavia - Romania -Hungary-Serbia-Bosnia and Herzegovina;
- the main routes for victims from *Romania* go through Serbia directly to Bosnia and Herzegovina (used in 94.2% of all these cases) or go from Romania to Hungary to Croatia to Bosnia and Herzegovina (5.8%);
- victims from *Russia, Belarus* and *Ukraine* come to Bosnia and Herzegovina through Romania and Serbia (58.6%) or through Hungary and Croatia (41.4%).

Accordingly, it can be said that almost all routes to Bosnia and Herzegovina are via Serbia. Therefore it is justifiable to assume that one of the main organised criminal networks involved in human trafficking in South Eastern Europe is to be found in Belgrade.

Table 1. The national origins of victims of trafficking

	1999	2000	2001	2002	2003	Total N	%
Moldova	7	97	80	109	10	303	44
Romania	3	65	89	92	4	253	37
Ukraine	2	31	15	32	4	84	12
Russia	-	2	6	11	1	20	3
Byelorussia	-	1	4	1	-	6	1
Serbia and Montenegro	-	2	6	6	2	16	2
Bosnia and Herzegovina	-	-	-	3	2	5	1
Bulgaria	-	-	-	1	-	1	-
Hungary	-	1	-	-	-	1	-
Kazakhstan	2	-	-	-	-	2	-
Total	14	199	200	255	23	691	100

Recruitment

Considering human trafficking as an enterprise, the first question to be addressed concerns the ways in which the ‘commodity’ is obtained. The next table provides an overview of how the victims were ‘recruited’.

Although almost one third of victims are recruited by someone they know, the figures in table 2 show that the majority of victims are recruited by people who, due to their active involvement in organised trafficking, victims define as traffickers.

Another finding that confirms the involvement of criminal organisations in human trafficking, is that a total of 71.6% of all journeys from the country of origin to another country were organised by known or unknown traffickers and only 10.3% by friends or acquaintances. If we assume that friends and acquaintances are not part of a criminal organisation (which may be entirely wrong), then we can suggest that in at least 71.6% of cases, victims were the objects of organised trafficking. The fact is that trafficking in women requires means of getting them out of a country, (forged?) travel documents, means of transport, temporary housing for the victim, and her sale on arrival at the pre-arranged destination. It is plausible to assume that these requirements (Escaler, 1998) are met by various criminal organisations.¹³

Table 2. The ‘recruitment’ of victims

Recruited by	N	%
Acquaintances/friends, of whom:	148	32.3
Female friends	92	20.1
Male friends	56	12.2
Traffickers/unknown	255	55.7
Female trafficker	16	3.5
Male trafficker	104	22.7
Unknown female	64	14.0
Unknown male	71	15.5
No data	55	12.0
Total N= 458	458	100%

When it comes to means of recruitment, it was found that in 59.6% of the cases, traffickers used friends and acquaintances to provide prospective victims with information about seemingly attractive work abroad, and that they did this themselves in only 17.9% of cases. Another result worth highlighting is that 8.7% of victims found the information concerning work abroad from newspaper

¹³ Aronowitz (2001) points out that, according to Europol, there are several indicators that point towards a high degree of organisation in trafficking. These are: the fact that women of different nationalities are smuggled together; the fact that a large number of persons are transferred over great distances; the large amounts of money that change hands; the fact that when things go wrong, legal assistance is immediately available.

advertisements.¹⁴ One of reasons why this did not have consequences might be the fact that, for example, in Moldova in recent years, remittances from migrant labourers have become a very substantial part of the country’s income. Migrants send home approximately \$120 million each year, which is the equivalent of half the national income. Therefore, investigation of such advertisements seems an unlikely prospect (*Trafficking in Human Beings in South Eastern Europe, 2003*).

Reasons for leaving home

The victim’s journey is a long one, both in terms of time and distance. It is reasonable to ask why they do not try to escape and ask for help as soon as they became aware that something is suspicious or at least strange. There are several possible answers to this question. First, it is possible that they are treated well during the entire journey, appeased by deceiving and encouraging information about their future jobs or about good salaries. Second, some of the women are used to suffering at home at the hands of their husbands or partners; thus they may not perceive the violence or suffering to which they are subject while being transported as something that deviates unacceptably from what they are used to. According to IOM, more than 80% of Moldavian victims of trafficking had been subjected to domestic violence before their journeys began (*Trafficking in Human Beings in South Eastern Europe, 2003*). Third, it is possible that traffickers travel and cross transit-country borders by bribing police officials and border guards, so that victims have no chance to escape.¹⁵

Table 3. Why did victims leave home?

Reasons for leaving	N	%
To work and earn some money	221	92.9
Tourism	1	0.4
Forced to leave her home	1	0.4
To escape from parents	3	1.3
Other	12	5.0
Total N =238	238	100

As the figures in Table 3 show, when asked about their reasons for leaving home, almost 93% of the victims said they had wanted to work abroad in order to earn enough money to make a decent living.¹⁶

¹⁴ This deserves special mention because one would have expected at least these 8.7% of cases to have been easily traced, investigated and prosecuted.

¹⁵ During an interview, one of the convicted traffickers said that in order to cross a border without any difficulties, he usually paid €250 to a border guard.

¹⁶ 55.9% of the victims agreed to travel to the former Yugoslav countries, 37.4% to Western Europe and only 6.7% to Greece, Turkey or Israel.

Most victims (55.4%) were expecting (that is, they were promised) work as waitresses, shop assistants or something similar. A total of 23.6% were expecting to be employed in a factory, to work in a household or as baby sitters, while a total of 21% of victims assumed they would work as dancers (16.4%) in nightclubs or as sexual workers (4.6%). Although only 4.6% of the victims openly declared that they were aware of the possibility that they would get involved in some kind of sex-related work, one wonders how many more, if any more, of the victims were aware that there was a risk of becoming involved in work of this nature.

Table 4. Treatment of victims

Nature of treatment	N	%
Physical abuse	116	25.4
Sexual abuse	41	9.0
Threats/blackmail	82	17.9
Freedom of movement restricted	49	10.7
Good relationship/Treated well	125	27.4
No answer	44	9.6
Total: N = 457	457	100

Given that 79% of the victims ended up in a business that they did not want to become involved in, it is interesting to see how they perceived the way they were treated by their *owners* or their co-workers. It should be noted that 34.4% of victims were abused either physically¹⁷ or sexually.¹⁸ In other words, more than one third of the women were subjected to serious violence. Another 17.9% was subjected to mental abuse. 10.7% was not allowed to move freely. 9.6% did not want to provide an answer, probably due to the fact that they were under stress and afraid to do so. Thus one can suggest that a total of 72.6% of victims was exposed to inhumane living and *working* conditions. At the same time, surprisingly, almost 27% of the women perceived their relationships with their *owners* as good. This may mean that they really were treated well – or that they were afraid to tell the truth.¹⁹

Revenues

Another interesting finding is that women are frequently sold more than once in Bosnia and Herzegovina. More precisely, 46.3% of those who responded (55.6%

¹⁷ The most horrifying example of physical abuse recounted in the course of the research, was the case of an owner who shot a victim in the stomach nine times. She survived, though remains permanently disabled.

¹⁸ Sexual violence was usually perpetrated by violent and drunk clients, but also by *owners* whenever victims requested something (to visit their families, to see a doctor, to go shopping etc.).

¹⁹ There was one case, in which the victim stated in court that her *owner* treated her just like any father would treat his daughter!

did not want to say how often they had been sold) said they had been sold once; 30% had been sold twice, and 23.7% had been sold three or more times. This means that almost every fourth woman, after becoming a victim of international trafficking, was re-sold at least once on the internal market in Bosnia and Herzegovina.

As far as the prices they were sold for are concerned,²⁰ these varied from KM250-8000 (€127.9-4092).²¹ As most of victims were sold for prices between KM1500 (€767.3) (the first quartile) and KM3500 (€1790.3) (third quartile), they were sold for an average price of KM2643 (€1351.9). Since they had an average of four clients a day,²² each paying an average price of KM100 (€51.15), their buyer made good on his *investment* within four to nine days. One of the outcomes was that *owners* usually had 5 to 17 women (with an average of 7) in their bars or clubs. If we multiply this by the average number of clients and the average price, we can conclude that owners' profits lay between KM60,000 (€30,690) and KM204,000 (€104,347) a month (an average of KM84,000 (€42,967) a month).

Clients

As far as clients are concerned, although the media portrayal and therefore the general population's assumption is that clients in nightclubs and bars are predominantly foreigners (foreign military personnel in particular), one of the most surprising findings of the research is that this assumption appears to be false.

Table 5. Clients

Clients	N	%
Local men only	119	66.5
Local soldiers and police	21	11.7
"Internationals" and local clients	12	6.7
SFOR and local clients	0	0.0
All profiles	27	15.1
Total N = 179	179	100

As the figures in table 5 show, excluding the 24.8% (N=59) of victims who were not willing to answer the question, it appears plausible that international clients, either alone or in combination with other types of clients, do not represent more than 21.8% of clients, whereas local clients account for no less than 78% of cases. In other words, only one in five is likely to be an *international*

²⁰ 57.3% of victims had no idea of the price they were sold for but the rest stated the exact amounts. Their answers are based on the amounts they had to *make up to (earn back for)* their *owners* because that is how much he told them he had paid for them.

²¹ KM1.00 KM is equivalent to €1.955.

²² 'Only' 15.0% of women had more than four clients a day.

client. Therefore, it can be argued that the presence of international personnel in the country should not be seen as the primary cause of the increase in trafficking in women in Bosnia and Herzegovina.

Victimisation characteristics

The research also focused on common victim characteristics. In order to do so, a total of 81 variables (situational, status-related or behavioural factors) were analysed by means of uni- and bi-variate analysis, and appropriate techniques of multi-variate analysis (factor analysis, regression analysis, cluster analysis, discriminant analysis, path analysis and logistical regression analysis were applied). It was found that 23 of the variables produced 11 factors – which in their turn explained 74.1% of the variance. Given that the research involved the collection of data from all recorded victims of trafficking in Bosnia and Herzegovina; given that the victims came from different countries, and given that victims of the same nationalities as those found in our sample are usually found in other countries in Southeastern Europe, it is plausible to assume that the characteristics found in the sample of victims in Bosnia and Herzegovina can be regarded as representative of those for other victims of trafficking in Southeastern Europe. The following factors were found to have the most significant impact on trafficking in women in Bosnia and Herzegovina:

The first factor (accounting for 16.4% of the variance) is victimisation by *owners* or clients. This is strongly connected to limited freedom of movement, physical or sexual abuse, and the denial of access to medical services.

The second factor (accounting for 9.9% of the variance) is the level of education, which correlates with sexual abuse and (not) being paid for providing sexual services. More educated victims are more successful in obtaining payment and in avoiding sexual abuse.

The third factor (accounting for 7.5% of the variance) concerns family relationships, which correlates with the quality of relationships, the economic status of the family, integrity of the family and physical or mental abuse.

The fourth factor (accounting for 6.7% of the variance) is a (dis)functional family.

The fifth factor (accounting for 6.1% of the variance) is a/an (un)known recruiter. This correlates strongly with the level of education.

The sixth factor (accounting for 5.8% of the variance) differentiates between victims on the basis of (not having) knowledge of possible involvement in sex-related work. This correlates with the type of job that was promised or expected and the presence of physical or mental abuse in the family of origin. The seventh factor (accounting for 5.0% of the variance) is abuse experienced in the family and it includes sexual, physical and mental abuse.

Push and pull factors

The literature on trafficking in women (Aronowitz, 2001; De Ruyver and Niron, 2002) usually attempts to tackle the issue of so called *push* and *pull* factors that, depending on their impact on a situation and/or individuals, can facilitate the process of trafficking. The results of previous research carried out in the region have been described in the Stability Pact for South Eastern Europe Framework for Combating Trafficking in Human Beings.²³ The Stability Pact has identified the following *push* factors: unemployment, poverty, lack of education, gender discrimination and family violence; and the following *pull* factors: expectations of employment and a salary, for those involved in prostitution – high salaries, access to *western* material goods, improvements in social status and treatment, a glamorous life in Western Europe, demand for women for reproduction, demand for *exotic* prostitutes and a cheap labour force. In order to test the impact of *push* and *pull* factors related to trafficking in women in Bosnia and Herzegovina, multiple stepwise regression was carried out. The analysis showed that a family's economic situation (poverty), unemployment and lack of education, viewed alone, do not represent *push* factors that facilitate trafficking in women in Bosnia and Herzegovina. However, the analysis showed that their impact significantly changes once family relationships are taken into consideration. In other words, unemployment and poverty do represent *push* factors, but only when a victim has problematic family relationships (e.g. due to alcoholism, drug addiction or a criminal environment).

As far as *pull* factors are concerned, the following factors were found to have the strongest impact: the kind of a job promised (expected), the way in which the victim learnt about the job (and who provided the information), who organised the journey and, for those who were aware of possible involvement in sex-related work, the potential client profile (foreigners).

These *pull* factors may explain why 27.4% of the victims (see Table 3) claimed to have a good relationship with their *owners*. It seems that traffickers are becoming aware that their *businesses* are likely to be more effective if they use their current *employees* as recruiters. Thus, they treat them well, pay them on a regular basis, allow them to see a doctor, allow them to go shopping and eventually allow them to travel home, where they are given the task of recruiting another woman.²⁴ In other words, it seems that the *business* is undergoing change. A further shift can be observed in relation to the location of prostitution: from nightclubs and bars to apartments and hotels.²⁵ These shifts

²³ The full text of the document can be downloaded from http://www.osce.org/attf/attf_pa.pdf 27.02.2005.

²⁴ This was confirmed in an interview with one convicted trafficker. He stated: 'Today, there is a new practice. I send the old girl home. She calls after a few days saying she has two new girls. I send money for a train or a plane ticket and they travel to Romania or Hungary, where I pick them up'.

²⁵ This was confirmed during the interview with one of the convicted traffickers

towards more satisfactory working conditions may explain the decreased number of victims requesting assistance from the non-governmental sector.²⁶

Conclusion

Despite the fact that only a few of the available findings on trafficking in women in Bosnia and Herzegovina have been presented here, some valuable conclusions can be drawn. First of all, Bosnia and Herzegovina serves as the destination country for women from Moldova, Romania and the Ukraine, as well as for women from other countries in the region, who arrive primarily via Serbia.²⁷ Almost all women trafficked to Bosnia and Herzegovina are subjected to at least one form of abuse, including, but not limited to, sexual, physical or mental abuse. Their sexual exploitation provides their *owners* with enormous profits, which are apparently either invested in future trafficking or laundered and invested in legal activities (Adamoli *et al.*, 1998). Although it is widely assumed in Bosnia and Herzegovina that international personnel, employed by a variety of humanitarian, governmental or non-governmental organisations, military or police forces, are the most frequent clients in night clubs and bars, and are therefore responsible for most of the demand for prostitution and trafficking in women, this study found most clients to be local people.

Anti-trafficking activities in the country, including problem-oriented police work, investigations, prosecutions and trials, together with legal reforms, have brought several changes in trafficking patterns. There are indications that some victims are now being treated much better than they were previously. As a result, they feel less exploited, and have even begun to serve as recruiters for their current *owners*. This is a possible explanation for the decrease in requests for help from victims as well as the geographic shift into private premises. These observations do not necessarily mean that the level of trafficking in women has decreased in Bosnia and Herzegovina. It should still be understood as a serious problem: it is one that has merely changed its appearance.

²⁶ The police, NGOs and the IOM also report that women very often refuse the assistance that is offered to them (Trafficking in Human Beings in South Eastern Europe, 2003)

²⁷ It should not be argued that Bosnia and Herzegovina is not a source or transit country. On the contrary, it is defined as such in a number of studies (e.g. see Lehti and Aromaa, 2004). The research presented here, however, confirmed that it also serves as a destination country.

References

- Adamoli, S., A., Di Nicola, E., Savona and P. Zoffi, *Organized Crime Around the World*. Helsinki, Heuni, 1998
- Aronowitz, A., Smuggling and trafficking in human beings: the phenomenon, the markets that drive it and the organisations that promote it. *European journal on Criminal Policy and Research*, vol. 9, no. 3, 2001, 163-195
- Budimlić, M., *Kompjuterski kriminalitet između teorije i prakse* (Transl.: Computer crime between theory and practice). Sarajevo, Fakultet kriminalističkih nauka, 2003
- CSD, *Corruption. Contraband and organised crime in Southeast Europe*. Sofia, Center for the Study of Democracy (CSD), 2003
- Ćopić, S., *Trafficking in human beings in the Balkan's post-war societies: legal reforms and practical issues*. Paper presented at British Criminology Society Conference 'Crossing Border', Keele, July 2002
- Escaler, N., *Keynote address. Report of the US-EU Trafficking in women seminar*. L'Viv, 9-10 July, 1998
- Hajdinjak, M., *Smuggling in Southeast Europe: The Yugoslav wars and the development of regional criminal networks in the Balkans*. Sofia, Centre for the Study of Democracy (CSD), 2002
- Korvinus, A. G., *Trafficking in human beings: first report of the Dutch National Rapporteur*. Den Haag, Bureau NRM, 2002
- Korvinus, A. G., E.M.H. van Dijk, D.A.C. Koster and M. Smit, *Trafficking in Human Beings: supplementary figures. Second report of the Dutch National Rapporteur*. Den Haag, Bureau NRM, 2003
- Lehti, M. and K., Aromaa, *Trafficking in Women and Children in Europe*. In: Nevala, S. and K. Aromaa (eds.), *Organised crime, trafficking, drugs, Selected papers presented at the Annual Conference of the European Society of Criminology*. Helsinki, HEUNI, 2004
- Lewis, R., *Drugs, war and crime in the post-Soviet Balkans*, in V. Ruggiero, N. South and I. Taylor (eds.), *The New European Criminology: crime and order in Europe*. London/New York, Routledge, 1998
- Nikolić-Ristanović, V., *Illegal markets, human trade and transnational organised crime*. In: P.C. van Duyne, J. Matjaž, K. von Lampe and J.L. Newell (eds.), *Threats and phantoms of organised crime, corruption and terrorism*. Nijmegen, Wolf Legal Publishers, 2004
- Nikolić-Ristanović, V., *War and Crime in the Former Yugoslavia*, in V. Ruggiero, N. South and I. Taylor, *The New European Criminology: crime and order in Europe*. London/New York, Routledge, 1998
- Obradović, V., *Trgovina ženama u Bosni i Hercegovini* (Transl.: Trafficking in women in Bosnia and Herzegovina), Sarajevo, Fakultet kriminalističkih nauka & US Embassy Sarajevo, 2004

- Ruyver, B. De, and N. Siron, Trafficking in migrants from a EU – perspective. In: De Ruyver, B., et al. (ed.), *Strategies of the EU and the US in combating transnational organised Crime*. Maklu, 2002
- UNDP, Albania Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in Human beings in Southeast Europe*. UNDP, 2003
- UNDP, Bosnia and Herzegovina Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in Human beings in Southeast Europe*. UNDP, 2003
- UNDP, Bulgaria Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in Human beings in Southeast Europe*. UNDP, 2003
- UNDP, Croatia Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in Human beings in Southeast Europe*. UNDP, 2003
- UNDP, Moldova Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in Human beings in Southeast Europe*. UNDP, 2003
- UNDP, Romania Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in human beings in Southeast Europe*, UNDP, 2003
- UNDP, Serbia and Montenegro, including the UN Administered Province of Kosovo, Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in human beings in Southeast Europe*. UNDP, 2003
- UNDP, The Former Yugoslav Republic (FYR) of Macedonia Update on Situation and Responses to Trafficking in Human Beings. In: *Trafficking in Human beings in Southeast Europe*. UNDP, 2003
- UNDP, *Trafficking in Human Beings in South Eastern Europe*. Sarajevo, UNDP, 2003
- Wegner, W., et al, *Balkanski putevi droge i Bosna i Hercegovina*, Fakultet kriminalističkih nauka, Sarajevo, 2004
- Williams, P., Trafficking in women and children: a market perspective, *Transnational organised crime*, Special issue on illegal immigration and commercial sex - The new slave trade, vol. 3-4, 1999