

How Bad Boys Turn Good: The Role of Law in Transforming Criminal Organizations Into Legitimate Entities by Making Rehabilitation An Economic Necessity

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“-You once told me: ‘In five years the Corleone family will be completely legitimate.’ That was seven years ago.

-I know. I’m trying, darling.”

—THE GODFATHER PART II¹

I. INTRODUCTION

The old adage: “crime does not pay” is incorrect. Crime pays and pays extremely well, but at some point lawful actions pay more.² Most people have asked: How does crime arise? What are its roots? Why do people become criminals? This article asks a different question: Why do criminals become law-abiding? And more specifically, why and when do criminal organizations metamorphose into legal businesses?

The lifespan of a criminal entity is like that of a butterfly. It begins life as a petty criminal larva, matures into an opaque organizational cocoon, and if the legal and economic weather is right, metamorphoses into a legitimate adult creature—assuming the justice mechanism does not eat it first.

Criminal organizations reach a point where it becomes more profitable to become a legitimate business organization than to continue to exist as a criminal entity. By understanding how and when this transformation happens, legal mechanisms can be structured to reduce crime, increase economic productivity, provide for integration of otherwise unavailable resources into the economy, and supply a criminal/

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1. Paramount Pictures (1974).

2. As G. Gordon Liddy said, “Obviously crime pays, or there’d be no crime.”

commercial law structure for developing nations. Concomitantly, policy should focus on providing strong incentives against commission of crimes, and at the same time promote conversion of illegal enterprises into legitimate ones.

In 1066 A.D., England was a relatively advanced society with one of the most sophisticated systems of governance in Western Europe including an established national tax system, and a developed system of courts and laws.³ When Norman invaders (Vikings who had settled in France) swept through English lands that year, they pillaged, plundered, and sought power to fill their needs.⁴ Yet after years of looting and destruction, the Norman raiders integrated into the structure and governance of the English civilization.⁵

By 1135, England had transformed from its pre-Norman days into a centralized monarchy with feudal obligations, a nationwide census, and a centralized accounting system, becoming one of the most efficient and respected nations on the European continent.⁶ Much like the Roman invasion of Greece centuries earlier, what began as a criminal onslaught against an advanced society actually transformed and integrated the invaders. More importantly, it advanced the society as a whole through the introduction of knowledge, power, and new resources.⁷ A similar trend occurs today in modern criminal organizations.

“Human behavior is economic behavior. The particulars may vary, but competition for limited resources remains a constant.” Need, as well as greed, lie at the foundation of our *modus operandi* and the rewards of a better and more efficient legal system still await those wise enough to recognize this deep thrumming of our common pulse.⁸ The law constrains the way we achieve our goals of maximizing economic profitability—breaking the law has a price, but getting away with it has its rewards. On the whole, criminal organizations are “eco-

3. MARJORIE CHIBNALL, *THE DEBATE ON THE NORMAN CONQUEST* (Manchester University Press 1999).

4. *THE KINGFISHER HISTORY ENCYCLOPEDIA* 132 (Miranda Smith ed., Kingfisher Publications 2004).

5. *Id.* at 131.

6. *United Kingdom: Henry I (1100-35)*, *ENCYCLOPEDIA BRITANNICA*, at <http://www.britannica.com/eb/article-44775/United-Kingdom> (last visited Mar. 11, 2007).

7. *See THE CAMBRIDGE HISTORY OF GREEK AND ROMAN POLITICAL THOUGHT* (Christopher Rowe & Malcom Schofield eds., Cambridge University Press 2000). The Romans were culturally barbarian, but strong militarily. The Greeks were very much the opposite. *See id.* Yet when Rome conquered Greece, it integrated the Greek culture and innovations into its own society, thereby lifting its civilization as a whole and advancing the rate of scientific and political progress for the newly formed Greco-Roman empire. *See id.*

8. SID MEIER'S *ALPHA CENTAURI* (Firaxis Games 1999).

onomically rational” entities that seek to maximize profitability and reduce costs—they are not in it for the kill, they are in it for the dough.⁹ The famous bank robber Willy Sutton explained this well when asked why he robbed banks: “because that’s where the money is.”¹⁰

Yet laws are often arbitrary; whichever moral majority is in control often attempts to pass through its version of morality.¹¹ To some, the Mafia is destroying the American way of life; to others, it is simply another avenue of private contract enforcement.¹² As the Prohibition experiment taught the United States, many laws are not necessarily moral simply because they are laws; in fact, laws often change with the winds of time.¹³ This is by no means an endorsement of moral relativism or crime. Rather, in order to conduct a full evaluation of the above-described phenomenon we must temporarily dispense with our moral revulsion at breaking “the law” and instead look at such conduct through an economic lens.

Economic rationality—conducting an action only if the expected benefits outweigh the expected costs—applies to criminals small and large. For example, if robbers wanted to prove how strong they were during robberies, they would pick on football players. Instead they rob little old grandmas because the associated costs and risks are much less.¹⁴ This calculation is even more precise in larger criminal organization as they are better able to predict the outcome of an action as well as the actions effects on future profits and survivability of

9. A criminal organization does what it does for the same reason that Wal-Mart or General Motors do what they do: because the organization’s skills can maximize its profits by operating within its particular industry. See DAVID D. FRIEDMAN, *LAW’S ORDER: WHAT ECONOMICS HAS TO DO WITH LAW AND WHY IT MATTERS* 8 (Princeton University Press 2000); see also Richard A. Posner, *Rational Choice, Behavioral Economics, and the Law*, 50 STAN. L. REV. 1551 (1998) (explaining rational choice theory as choosing the best means to the chooser’s ends. However, rationality does not imply omniscience. In fact, it would be irrational to spend all of one’s time acquiring information.). *Id.* at 1553. Additionally, this term is economic only and is not concerned with ethics or morality.

10. Federal Bureau of Investigation – FBI History – Famous Cases, at <http://www.fbi.gov/libref/historic/famcases/sutton/sutton.htm> (last visited Mar. 11, 2007).

11. See DIEGO GAMBETTA, *THE SICILIAN MAFIA: THE BUSINESS OF PRIVATE PROTECTION* 5 (Harvard University Press 1993) (1996) (quoting Sicilian scholar Santi Romano: “we all know how arbitrary, contingent, and variable are the criteria with which the state rules on the legality or illegality of some associations”).

12. See, e.g., Ian Angell, *Economic Crime: Beyond Good and Evil*, 4 J. FIN. REG. & COMPLIANCE, available at <http://www.sgrm.com/art25.htm> (arguing that organized crime has a sharper sense of community and citizenship than the politicians who prohibit them; “[w]hen a mafia family runs a neighborhood, little old ladies don’t get mugged on the street”).

13. See generally Stuart P. Green, *Why It’s a Crime to Tear the Tag Off a Mattress: Overcriminalization and the Moral Content of Regulatory Offenses*, 46 EMORY L.J. 1533 (1997).

14. DAVID D. FRIEDMAN, *PRICE THEORY: AN INTERMEDIATE TEXT* 134 (2d ed. South-Western Publishing Co. 1990).

the organization.¹⁵ This article will focus on the business structure of a mafia—a multi-faceted business organization that provides illicit goods and services—as an example of the furthest progression of a criminal entity on its way to becoming legal.¹⁶

This article will extrapolate from the legal and economic history of some of the major criminal organizations and the national and international attempts to control them. Accounting for the mafia's costs and profitability, as well as examining and applying commercial laws on historic and hypothetical grounds, will help determine where and when this metamorphosis occurs. The threshold at which this transformation will take place for various types of criminal businesses will differ depending on the laws, their enforcement, and the types of goods or services produced. Nonetheless, determining this range should enable legislatures, administrative agencies, and courts to craft optimal laws and regulations to deter crime and provide an incentive for criminal organizations to “rehabilitate.”¹⁷

Part II provides a general background to the business of crime, black markets, and criminal organizations. Part III analyzes the specific costs and benefits associated with an illegal enterprise that distinguish it from its legal corporate counterpart. Part IV examines the role and structure of law in facilitating this metamorphosis and Part V provides examples of such metamorphoses in three different countries. Part VI proposes policy and strategy through which the law should facilitate this transformation. Part VII concludes this article.

II. BACKGROUND

A. *The Business of Criminal Organizations is Business*

1. What is wrong with criminal businesses in the first place?

From an economic standpoint, crime is inefficient because it wastes resources through rent-seeking. Rent-seeking occurs when people spend resources transferring or preventing the transfer of wealth from

15. See e.g., HOWARD ABADINSKY, ORGANIZED CRIME 182 (Allyn and Bacon, Inc. 1981) (quoting U.S. DEPT. OF JUSTICE, REPORT OF THE NATIONAL CONFERENCE ON ORGANIZED CRIME 37-39 (U.S. Gov't Printing Office 1975)).

16. While some commentators restrict the definition of a mafia as an organization that only provides protection services, e.g., GAMBETTA, *supra* note 11, this is an artificial restriction. Mafias are generally involved in all kinds of illegal goods and services trade including drugs, protection, prostitution, loan-sharking, and numerous others. PETER REUTER, DISORGANIZED CRIME: THE ECONOMICS OF THE VISIBLE HAND 119-20 (The MIT Press 1986).

17. The analysis applied in this paper is for mafias and other criminal enterprises. However, it should also be possible to apply a similar, wider-scoped, analysis to criminal organizations such as terrorist groups; though this is outside the scope of this paper.

others to themselves.¹⁸ For example, if you know I have \$500 and you rob me, the robbery only transfers the wealth from me to you. But if I know that someone will try to rob me, I will invest resources to deter the robbery (i.e. I will buy guns, locks, and safes, for \$100). In response, you will expend additional resources (i.e. you will purchase bigger guns, lock picks, and facemasks for \$100). Thus, in this transfer of wealth there are resources lost with no net benefit produced.¹⁹ The resources shifted to locksmiths and gun manufacturers could have been used more productively.

Crime is bad for me; I have now lost \$500. Crime is bad for society; society has lost resources that could have been better employed elsewhere. But crime is good for the thief—he has gained \$500 and only spent \$100. If laws exist to prevent this crime (and are applied effectively and result in real penalties) then the thief will only do the crime if he estimates his costs to be smaller than the “profits.” In other words, if the thief predicts that there is a 41% chance that he could get caught and have to pay a \$1,000 fine and he is risk neutral, then his expected value for the costs in the crime is \$510 (\$410 fine and \$100 costs of robbery devices) and he will not steal the \$500 from me.²⁰ While individual thieves may not undertake this exact balancing every time, larger criminal business organizations will, because in determining which line of business to pursue they do not survive by the short term theft in the alley, but rather through long-term transactions.²¹

2. Black Markets

An illegal enterprise exists because its owners judge it more profitable for the enterprise to operate in black markets, trafficking prohibited goods or services than to engage in an alternate business.²² Such organizations act as “large-scale continuing firm[s] with the internal

18. See FRIEDMAN, *supra* note 9, at 33.

19. See *id.*; see also, e.g., Serguey Braguinsky, *Enforcement of Property Rights During the Russian Transition: Problems and Some Approaches to a New Liberal Solution*, 28 J. LEGAL STUD. 515, 517 (1999) (describing how crime leads to financial freeloading and dissipation of value produced in the resource extraction sector).

20. See generally FRIEDMAN, *supra* note 9 (emphasizing profit maximization in criminal organizations).

21. See, e.g., GAMBETTA, *supra* note 11, at 158 (arguing that forms of behavior traditionally associated with the Mafia, such as their rituals, symbols, and ceremonies, can all be explained by an economic theory of private protection as rational responses to customer demand; the mafia needs to convince potential customers of the quality of the products that they provide, i.e. protection, in order to gain legitimacy).

22. See Nora V. Demleitner, *Organized Crime and Prohibition: What Difference Does Legalization Make?*, 15 WHITTIER L. REV. 613, 614 (1994) (viewing organized crime as a rational response to the demand for illicit goods and/or services).

organization of a large enterprise, and with a conscious effort to control the market.”²³ These enterprises provide risk prevention (e.g. forcing competitors out of business), underground contractual enforcement mechanisms, black market commodities (e.g. illegal drugs, weapons, pharmaceuticals), and black market services (e.g. gambling, prostitution, murder).²⁴ Illegality does not eliminate the trade in the good or service. Legal rules are subservient to the law of the marketplace—where there is a high enough demand, a supply will exist.²⁵ Illicitness simply raises the costs of providing the good or service, arguably destroys some of the demand,²⁶ and raises the price compared to what it would have been in a legal, perfectly competitive market.²⁷

By forcing a market underground, society in effect grants a monopoly to the entity or entities willing to undertake the risk of being caught and prosecuted.²⁸ This monopoly is characterized by high, government-made barriers to entry, an often inelastic demand for the good, and a rapid response to demand fluctuations.²⁹ For example, when one town in the former Soviet Union allowed extra clothing to be allocated to people with recently deceased relatives, a market for counterfeit death certificates sprang up overnight.³⁰ Additionally, black market goods and services profit from avoiding royalties to the government—taxes—while suffering from high costs related to avoid-

23. *Id.* at 616 (quoting ANNEISE ANDERSON, *THE BUSINESS OF ORGANIZED CRIME: A COSA NOSTRA FAMILY* 10 (1979)).

24. *See, e.g.*, JAMES O. FINCKENAUER & YURI A. VORONIN, U.S. DEP'T OF JUSTICE, NAT'L INST. OF JUSTICE, *THE THREAT OF RUSSIAN ORGANIZED CRIME* 5, 7, 20 (2001), available at <http://www.ncjrs.gov/pdffiles1/nij/187085.pdf>.

25. *See* Steven Wisotsky, *Beyond the War on Drugs*, in *THE DRUG LEGALIZATION DEBATE* 103, 107 (James A. Inciardi ed., 1991).

26. Destruction of demand is arguable because, while illegality deters those people who would have committed the deed but for its illegal status, it also spurs on those who would not have cared to do it but now will because it is “the forbidden fruit.”

27. *See* Gary Becker et al., *The Economic Theory of Illegal Goods: The Case of Drugs* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 10976, 2004), available at <http://www.nber.org/papers/w10976> (relating demand for illegal goods to marginal profits, costs imposed on traffickers through enforcement and punishment, and costs imposed on users by the government). A perfect market is one characterized by a very large number of buyers and sellers of a homogeneous product where entry and exit from the industry is nearly costless and information is freely available to all market participants. *BARRON'S DICTIONARY OF ACCOUNTING TERMS* 337 (4th ed. 2005).

28. Demleitner, *supra* note 22, at 616-17. While some competition may exist in illicit markets, most entities in such markets use violence to force competitors out of business or divide and cartelize a territory. *See infra* LEVITT & DUBNER note 35 and accompanying text.

29. *See* Alan S. Greenspan, Chairman, Fed. Reserve Sys. Bd. of Governors, *Thoughts About the Transitioning Market Economies of Eastern Europe and the Former Soviet Union*, Address at the Kellstadt Graduate School of Business at DePaul University (1994), in 6 *DEPAUL BUS. L.J.* 1, 8 n.18 (1994).

30. *Id.*

ing discovery and prosecution.³¹ This results in hyper-inflated prices for the illicit good or service and provides the “entrepreneur” with a monopoly.³²

Yet even an underground business must still operate as close as possible to the guidelines of the law—the further it deviates, the higher its costs. Destruction and gang wars may look like fun in movies, but they are generally unprofitable and cause increased prosecutions.³³ In both legal and illegal markets, “[t]he best of all monopoly profits is a quiet life.”³⁴

Instead of attempting competition in the same area, criminal organizations split up territories establishing cartels and geographic monopolies.³⁵ For example, it may be easier to kill a rival-drug selling mafia than to engage in product competition (manufacturing higher quality and cheaper drugs), but if this will lead to government prosecutions, rival mafia wars, or increased police enforcement, it may be cheaper to instead cartelize the industry or divide up the territory between the various suppliers.³⁶ The more murders the mafia commits, the more police and judges it has to bribe, and the more witnesses it has to kill. For example, when a Chicago drug ring leader was asked by one of his subordinates why he could not just shoot and kill competitors, he explained: “you’ve got to belong to a serious organization—you can’t just tear [things] up. It’s bad for business.”³⁷ Thus a mafia behaves just like any other profit maximizing organization—seeking to minimize its costs and maximize its profits. However, unlike a legal organization, the mafia will use illegal means if the expected profits from those means are more than the expected profits from their legal counterparts.³⁸ As one Mafioso eloquently said in

31. See HERBERT L. PACKER, *THE LIMITS OF THE CRIMINAL SANCTION* 278-79 (Stanford University Press 1968); see also Demleitner, *supra* note 22, at 617.

32. Demleitner, *supra* note 22, at 617.

33. See Achim Wennmann, *The Political Economy of Transnational Crime and Its Implications for Armed Violence in Georgia*, 6 *INSIGHT TURKEY* 2, April-June 2004, at 108, available at http://www.cimera.org/sources/105_117.pdf.

34. J. R. Hicks, *Annual Survey of Economic Theory: The Theory of Monopoly*, 3 *ECONOMETRICA* 1, 8 (1935).

35. See, e.g., STEVEN D. LEVITT & STEPHEN J. DUBNER, *FREAKONOMICS* 107 (2005) (describing the absence of gang drug wars in California as a mafia dictated cost minimization technique).

36. See *id.*

37. *Id.* at 108.

38. In fact, even legal organizations perform similar cost benefit analysis. For example, when the realized benefits from pollution exceed the anticipated civil costs imposed by the EPA and the loss of public goodwill, a company will oftentimes choose to pollute and pay the fine (as a Pigouvian tax), rather than perform a proper disposal or cleanup. FRIEDMAN, *supra* note 9, at 29. See e.g., *Boomer v. Atlantic Cement Co.*, 257 N.E.2d 870 (N.Y. 1970) (where the court

Mario Puzo's *Godfather*, "I don't like violence . . . I'm a businessman; blood is a big expense."³⁹

B. *International Scope of Illegal Entities*

Historically, mafias have been national entities, controlling the trade in illegal markets within a country.⁴⁰ Over the past forty years the international markets in human, drug, and weapons trafficking have seen a globalization of the mafia and increased cooperation and negotiation between nationally based mafia structures.⁴¹ Some of the world's most influential mafias: the Russian (whose yearly turnover is \$200 billion);⁴² the Japanese (which is so intertwined with the state that prosecutions now seldom occur);⁴³ the Chinese (whose range of operations has expanded immensely);⁴⁴ and the Sicilian (the oldest mafia in existence)⁴⁵ have increased their presence in countries lacking the necessary laws and enforcement resources to raise the cost of illegal activities.⁴⁶ Conversely, the American mafias, such as the *Cosa Nostra*, while still in existence, have had their influence and operations greatly curtailed⁴⁷ and are negligible by comparison.⁴⁸

Yet, while most countries recognize that mafias utilize an organizational structure similar to that of a corporation, few countries deploy the full arsenal of economic means to raise the enterprise's costs and lower its benefits.⁴⁹ To understand where such weaponry would be

allowed a \$45 million cement plant to pollute the air and reimburse private parties downwind rather than shut the plant down).

39. Paramount Pictures (1972).

40. FELIA ALLUM & RENATE SIEBERT, *ORGANIZED CRIME AND THE CHALLENGE TO DEMOCRACY* 56 (Routledge 2003).

41. *Id.*

42. Larry D. Newman, *RICO and the Russian Mafia: Toward a New Principle Under International Law*, 9 *IND. INT'L & COMP. L. REV.* 225, 227 (1998).

43. Curtis J. Milhaupt & Mark D. West, *The Dark Side of Private Ordering*, 67 *U. CHI. L. REV.* 41, 72 (2000).

44. See generally Yiu-Kong Chu, *International Triad Movements: The Threat of Chinese Organized Crime*, 291 *CONFLICT STUD.* (1996).

45. James B. Jacobs & Lauryn P. Gouldin, *Cosa Nostra: The Final Chapter?* 25 *CRIME & JUST.* 129, 139 (1999); see also Sara Jankiewicz, *Glasnost and the Growth of Global Organized Crime*, 18 *HOUS. J. INT'L L.* 215, 218 (1995).

46. Joseph E. Ritch, *They'll Make an Offer You Can't Refuse: A Comparative Analysis of Int'l Organized Crime*, 9 *TULSA J. COMP. & INT'L L.* 569, 599 (2002).

47. Brian Goodwin, *Civil Versus Criminal RICO and the "Eradication" of La Cosa Nostra* 28 *NEW ENG. J. ON CRIM. & CIV. CONFINEMENT* 279, 280 (2002).

48. JAMES O. FINCKENAUER & ELIN J. WARING, *RUSSIAN MAFIA IN AMERICA: IMMIGRATION, CULTURE, AND CRIME* 275-77 (Northeastern University Press 1998).

49. "The major difference between the diagram of an organized crime family and the chart of a major corporation is that the head of the enterprise—the Boss—does not have a box over him labeled "stockholder." Many of the other boxes are paralleled in the underworld. Ralph Salerno and John S. Tompkins, *The Crime Confederation*. 84-5 (1969). (The author of that state-

most useful, the next section will analyze exactly where the mafia's costs and revenues lie.

III. ANALYSIS OF MAFIA COSTS AND REVENUES

A. Introduction

Effective punishment raises the costs of the good or service, but also increases profits to efficient sellers who are skilled in secrecy and can avoid detection.⁵⁰ Yet, as marginal costs of production and expansion reach equilibrium with the marginal benefits received from another marginal sale or territory expansion, the mafia finds itself naturally limited to a certain size. For example, if expansion necessitates bribing a higher official, whose protection yields less than the profits that can be realized from the expanded output or territory, the organization will forego expansion.⁵¹

At this threshold point, expansion in that line of business is no longer economically profitable. This limitation on size will depend on the legal atmosphere, the degree of enforcement of the laws, and the economic rate of return in legal markets. As size limitations make reinvesting illicit profits into existing businesses unprofitable, excess capital will flow into other lines of business. Where legal channels present higher rate of returns than illegal ones, there will be a movement of the mafia toward legal enterprise.⁵² This economic "rehabilitation" occurs where established underground organizational structures can be converted to overworld edifices with minimum cost and maximum profit.

ment was a New York City police officer and a consultant to the Task Force on Organized Crime).

50. Becker, *supra* note 27, at 11. See also Milton Friedman, *An Open Letter to Bill Bennett*, WALL ST. J., Sep. 7, 1989, available at <http://www.fff.org/freedom/0490e.asp>, which states:

You are not mistaken in believing that drugs are a scourge that is devastating our society. . . . [T]he problem is demand . . . that must operate through repressed and illegal channels. Illegality creates obscene profits that finance the murderous tactics of the drug lords; illegality leads to the corruption of law enforcement officials; illegality monopolizes the efforts of honest law forces so that they are starved for resources to fight the simpler crimes of robbery, theft and assault. Drugs are a tragedy for addicts. But criminalizing their use converts that tragedy into a disaster for society, for users and non-users alike. Our experience with the prohibition of drugs is a replay of our experience with the prohibition of alcoholic beverages.

51. See e.g., SUSAN ROSE-ACKERMAN, *CORRUPTION AND GOVERNMENT* 83 (Cambridge University Press 1999) (describing a bribery model where high level officials decide to allow illegal activities only if the bribe is high enough to account for their risk).

52. See e.g., Vadim Volkov, *Security and Rule-Enforcement in Russian Business: The Role of the "Mafia" and the State*, 1999 PONARS POL'Y MEMO 79, available at http://www.csis.org/media/csis/pubs/pm_0079.pdf (describing the shift of some of the biggest Russian mafias into legal national corporations).

This section will analyze the costs and benefits of a mafia organization. Part B will analyze the general costs associated with such an illicit entity and develop a general formula for the profit structure of a criminal organization. Part C will analyze the bribery costs to which illegal businesses are subject. Part D will address laundering costs while part E will analyze the agency costs (e.g., costs incurred due to different goals of management and workers within the organization) and the costs of monitoring information flow within the secret organization. Part F will analyze the costs that the mafia incurs because of legal prosecution of its employees and management, and address other costs facing the illegal enterprise.

B. *General Costs*

An enterprise's costs are both fixed and variable. Fixed costs for an illicit business include, for example, capital invested into facilities such as cocaine fields and warehouses, transportation vehicles such as planes and trucks, and lodgings such as prostitution bordellos and gambling houses.⁵³ The variable costs include production costs such as growing the cocaine, or training low-level thugs to provide extorted protection of the businesses; distribution costs such as the importation and distribution of narcotics or the daily patrols of thugs around the neighborhood; secrecy costs such as bribes, enforcement of a code of silence, inability to structure the organization at optimal bureaucratic levels and grow past a certain size to prevent detection; and punishment costs such as laundering fees and jail times.

The main cost that illegal organizations incur, which the legal ones do not, is secrecy. The illicit nature of the enterprise balances on the razor's edge of concealment. For example, until the 1950s little if any information was available on the inside workings of the U.S. mafia, and informants often turned up dead.⁵⁴ In fact, while secrecy costs exist in legal organizations in the form of trade secrets and proprietary information,⁵⁵ the main difference between the two is that legal organizations hide their information from private market competitors, whereas the mafia hides theirs from public sector's enforcers. Thus, secrecy is the primary cost that distinguishes an illicit enterprise from its legal counterpart and its presence primarily affects the transforma-

53. Cf. LEVITT & DUBNER, *supra* note 35, at 101 (describing the costs incurred by a drug gang: wholesale cost of drugs, licensing fees, mercenary fighter costs, and weapons costs).

54. Jacobs & Gouldin, *supra* note 45, 131.

55. GAMBETTA, *supra* note 11, at 39.

tion threshold.⁵⁶ Secrecy costs can be divided into four main parts: bribery costs, laundering costs, agency costs, and other costs.

C. *Bribery Costs*

When buying and selling are regulated, the first things to be bought and sold are the regulators.⁵⁷ Secure operation of an illegal business is ensured by bribes to officials at various levels, including the police, judges, and politicians.⁵⁸ Not only can bribes be used to obtain immunity from prosecution, they can also be used to assure monopoly power in the illegal market by convincing officials to raid competitors. An effective bribe, therefore, leaves the bribing organization free to operate with impunity.⁵⁹ In other words, an illicit organization outsources part of its secrecy responsibility to officials within the public sector.

A bribe is a bilateral transaction in which the two participants exchange secrecy for money, yet most economic and legal literature deals with bribes solely from the point of view of the bribe giver (the briber).⁶⁰ While the briber's incentives must be considered, an "economically rational" government official (the bribee)⁶¹ should only accept a bribe if the expected revenue (the bribe) exceeds the expected costs. The expected costs are the probability of detection multiplied by the discounted cash flow of that position's income, minus the expected income after detection, plus the probability of detection multiplied by the expected fine (money and/or jail time) that will be imposed on the government official if he is detected.⁶² Therefore let:

56. See e.g., BECKER, *supra* note 27, at 8 (arguing that expenditures on avoidance include an increase in direct costs from operating an illegal enterprise).

57. P.J. O'ROURKE. *PARLIAMENT OF WHORES: A LONE HUMORIST ATTEMPTS TO EXPLAIN THE ENTIRE U.S. GOVERNMENT* 210 (Grove Press 2003).

58. See ACKERMAN, *supra* note 51, at 23.

59. *Id.*

60. See e.g., Peter Pashigian, *On The Control of Crime and Bribery*, 4 J. LEGAL STUD. 1, 311 (1975). See also ACKERMAN *supra* note 51, at 9-23 (outlining some of these analyses from the point of view of a criminal giving a bribe to prevent paying a fine, obtaining a government contract award, or a criminal paying an official and then blackmailing that official).

61. Once again, "economically rational" only assumes that the government official is acting in his direct financial interests unconstrained by morals or ethics.

62. The model outlined here assumes that if the official is caught, he nevertheless gets to keep the bribe. Thus, his expected revenue is always the amount of the bribe. If the punishment involved giving back the bribe (and the exact amount was detectable) then the bribe would have to be multiplied by the probability of non-detection. For an example of the difficulty of forcing a payback of the bribe see e.g., *United States v. Sapoznik*, 161 F.3d 1117, 1118 (7th. Cir. 1998). There, Judge Richard Posner estimated that a corrupt police chief received \$500 a month for four years to help cover up illegal gambling. However, instead of having to pay back the \$24,000 bribe (\$500x12x4) he was ordered to pay back a restitution of 1/4 of his four year salary. The damages that he had to pay were the difference in value between the salary of an honest police

p = probability of detection [p ranges from 0 to 1]

B = bribe amount

I_0 = government official's expected discounted income if he does not take the bribe

I_F = government official's expected discounted income after detection, if he takes the bribe, and after fine has been paid

F = fine the government official expects, if detected

$$(1) \quad B = p^* I_0 - p^* I_F + p^* F$$

A profit-seeking government individual will demand a bribe:⁶³

$$(2) \quad B = p^* (I_0 - I_F + F)$$

However, the bribe cannot exceed the mafia's expected profit ($E\pi$) from the venture, so that offering the bribe is still profitable to the mafia organization. Therefore the total bribe amount is constrained on both sides as:⁶⁴

$$(3) \quad E\pi \geq B \geq p^* (I_0 - I_F + F)$$

As the amount and size of the illegal activity increases, more than one official will need to be bribed. In fact, as the size and frequency of the crime increases, officials at different levels will be brought in and compensated for their assistance. However, at each governmental level the amount of power, participation, and assistance that the government employee wields is approximately equal to other employees within that occupational level.⁶⁵ For example, two city building inspectors for two different city districts wield similar powers and duties. Moreover, since government salaries and promotional rates are largely fixed, the expected incomes before and after detection will be approximately constant across each occupational level.⁶⁶ Consequently, since the amount and ability of the official's assistance at each occupational level will be approximately the same, the bribe that

chief versus that of a corrupt police chief (apparently the value of a corrupt police chief is $\frac{3}{4}$ that of an honest one). *Id.* at 1121-22. In essence the chief kept the bribe and paid restitution damages to the city.

63. For simplicity, the amount of power that a government official reaps from his position is not included in this equation, but it could be quantified and added to the expected discounted income.

64. This formula is applicable to any enterprise operating within a realm where secrecy or assistance is required from the government officials to secure the profits of a venture—for example, where a business attempts to influence a government official in awarding a contract.

65. See ACKERMAN, *supra* note 51, at 27.

66. At the federal level the government sets out discrete levels which define the official's level of income—the General Schedule (GS) levels. A GS Schedule can be found at <http://www.opm.gov/oca/06tables/indexGS.asp>. A similar trend can be found at each state's level. See U.S. Census Bureau, Governments Division, at <http://www.census.gov/govs/www/index.html>. See also ACKERMAN, *supra* note 51, at 80 (describing civil service salary structures in foreign countries).

the official at each level will demand will also be approximately the same (with higher-levels receiving higher bribes).⁶⁷

Moreover, for bribees, the probability of being detected will depend on the occupational level: different occupational levels have different levels of public exposure and internal scrutiny, while the amount of an official's participation generally remains equal across the level. Therefore each variable becomes dependent only on the occupational level at which the bribe is taking place. Similarly, the expected profit from a given venture depends on the level of officials that must be involved to facilitate success; each higher level brings with it higher protection but also higher costs.

x = factor assigned to government official's occupational level—acting as a variable in the bribery function

$$(4) \quad E\pi(x) \geq B(x) \geq p(x) * (I_0(x) - I_F(x) + F(x))$$

Because the bribe's upper limit is the expected profit from the venture, the total bribe must be equal to or less than the sum of the individual bribes across each government occupational level required for hiding the crime. Assuming the compensation for each official at a particular level is roughly the same, the individual bribe amounts must be multiplied by the number of officials being bribed at each discrete level. Similarly, the occupational level dictates the number of officials that need to be bribed at that level. For example, a criminal organization may need to bribe a whole day-shift of customs agents in order to pass its drugs through a border, but the same organization could alternatively bribe one mayor to turn a town's blind eye and effectively reach the same result. Depending on the scope of the illicit operation, the bribe must only go so far up the levels—in a local drug sale only a single neighborhood cop may need to be bribed, but for a prostitution ring, the sheriff and the alderman may have to be oiled up.

If:

H = the highest occupational level that will need to be bribed to ensure the secrecy of the transaction; and

n = the number of government officials in each occupational level that need to be bribed, the equation becomes:

$$(5) \quad E\pi(x) \geq \sum_{x=1}^{x=H} n(x) B(x) \geq \sum_{x=1}^{x=H} n(x) [p(x) * (I_0(x) - I_F(x) + F(x))]$$

67. For simplicity, age differences of the officials at each level can be disregarded in equating their expected discounted incomes. Age differences may account for same level officials demanding different bribes because their expected loss from getting fired or jailed is different depending on how much they have left to live/work.

Thus, each discrete level “x” will receive a certain amount of the total bribe (B) multiplied by the number of officials (n) participating in the illegal activity at each level. The total profit (Tπ) that the mafia reaps from the venture is the expected profit Eπ(x) minus the total bribe TB(x):

$$(6) T\pi(x) = E\pi(x) - TB(x)$$

As the participants’ occupational levels rise, the organization must allocate higher bribe amounts to each participant at the level, with higher occupational levels having fewer officials. This pyramid allocation structure demonstrates the increasing investment needed to bribe high level officials, and leads to a natural ceiling on the size of specific illegal transactions, unless other secrecy tactics can be made more efficient.

Theoretically, secrecy tactics are a substitute for bribery. If the organization can conduct its activities more covertly, then fewer bribes will have to be expended. However, the mafia already operates at extremely high levels of secrecy and it is doubtful that further investment into secrecy tactics can yield profitable results.⁶⁸

Thus, the ceiling for expansion should be where the marginal bribe is equal to zero, i.e. where the derivative of the total profit function is equal to zero. Here, further business expansion yields no profits. Therefore:

$$(7) \frac{d}{dx} T\pi(x) = \frac{d}{dx} E\pi(x) - \frac{d}{dx} TB(x) = 0$$

$$(8) 0 = \frac{d}{dx} E\pi(x) - \frac{d}{dx} \sum_{(x=1 \rightarrow x=H)} n(x) B(x)$$

$$(9) 0 = \frac{d}{dx} E\pi(x) - \frac{d}{dx} \sum_{(x=1 \rightarrow x=H)} n(x) [p(x)^* (I_0(x) - I_F(x) + F(x))]$$

At this equilibrium point the derivatives of the expected profit will equal the sums of the bribes and will be equal to or greater than the sum of the individual expected costs upon detection summed over the individual levels and officials within each level.

68. See e.g., GAMBETTA, *supra* note 11, at 35-6 (describing the mafia’s extremely high secrecy levels and how new recruits are taught to “distrust even [their] parents”).

$$(10) \frac{d}{dx} E\pi(x) = \frac{d}{dx} (x=1 \rightarrow x=H) \Sigma n(x) * B(x) = \frac{d}{dx} (x=1 \rightarrow x=H) \Sigma n(x) [p(x) * (I_0(x) - I_F(x) + F(x))]^{69}$$

Consequently, as the mafia expands its operations and its size, it must employ one or all of the following methods to prevent information flow and maintain profitability: bribe more high level officials to ensure non-detection, increase the level of information monitoring (i.e. increase the detection and punishment rate of informants or other information leaks), and/or use higher skilled labor (the relevant skill being secrecy). However, the pool of such skilled labor is limited and is usually already employed for other ventures.⁷⁰

Additionally, while increasing efforts to monitor and “plug” information leaks may prevent some information flow, it also costs more, draws extra attention to the venture itself, and serves as a disincentive to labor. Not only do murders and disappearances attract outside attention, but “employees” will demand greater compensation when facing a higher risk of being killed by their own mafia employer.⁷¹

Thus, regardless of other secrecy options, continued expansion mandates increasing bribery payments.⁷² At equilibrium, therefore, expansion of illegal ventures will cease to be profitable because the expected profits will equal the bribe necessary to prevent detection. As can be seen from above calculations, the bribe necessity serves as an increasing black market tax which rises with the amount of goods or services sold, and thereby limits expansion.

D. *Laundering Costs*

1. Introduction

Because the mafia strives to maximize the return on accrued funds and capital, it will begin to transform itself into a legal entity when legal returns on capital become higher. This can happen in one of two ways. First, the mafia can continue to operate its naturally limited black market enterprise and, in parallel, invest the profits into legal

69. This formula would also be valid for non-criminal organizations and corporations that use bribes to secure contracts or avoid penalties in domestic or foreign markets. *Cf.* ACKERMAN, *supra* note 51, at 27 (suggesting that legal entities may use bribes to get favorable government contracts).

70. *See* GAMBETTA, *supra* note 11, at 62.

71. *E.g.*, if the mafia shifts its internal punishment system to punish employees for disclosing information “knowingly,” rather than “negligently,” or make the employees “absolutely liable” for any information disclosure, the probability of mafia punishment increases. A higher risk of organizational punishment must be compensated by a higher salary. *See e.g.*, LEVITT & DUBNER *supra* note 35 at 106-07 (describing a gang drug dealer’s analysis of risk vs. compensation).

72. Higher level government officials will require higher bribes as their risk of detection and potential loss of income will be higher. ACKERMAN, *supra* note 51, at 30.

ventures, thereby operating in both spheres and using the legal ventures as a money laundering machine.⁷³ Alternatively, it can invest its black market profits into legal ventures with higher returns than its black market operations and exit the black market altogether.⁷⁴ The path chosen, largely depends on existing law and its enforcement, which dictates the expected punishment facing the organization if its legal venture is found to be backed by an illegal enterprise.⁷⁵

Just like a corporation may sell off its less profitable divisions to concentrate and expand its most profitable ones,⁷⁶ so too a mafia can completely exit the constrained black market to focus on more profitable legal operations. In essence, the mafia exchanges a low cost start up enterprise with high natural growth limitations to a high start-up cost/higher rate of return enterprise with less restrictive constraints for expansion. A criminal that extorts money using a gun has expended little and expects a relatively low return. Sometimes he buys a gun for \$100 and he burgles \$500; sometimes he gets sent to jail. An organization that builds and runs a casino invests large capital into the enterprise, but expects high returns. It invests \$50 million and in return gets \$500 million, plus the added bonus of staying out of jail or getting killed.⁷⁷ Thus, the mafia can serve as an initial vehicle that allows an expedited acquisition of large amounts of capital needed for a legal, future, high-return investment.

The alternative to completely exiting the illegal industry is for the mafia to continue to function as an illegal enterprise and simultaneously funnel profits into legal ventures.⁷⁸ Money laundering instruments and institutions provide this channel, facilitating the continued

73. Lan Cao, *International Money Laundering: from Latin America to Asia, Who Pays?* 22 BERKELEY J. INT'L L. 59, 67-68 (2004); Michael Levi, *Money Laundering and Its Regulation*, 582 ANNALS 181 (2002).

74. See *infra* Part IV.

75. See e.g., Levi, *supra* note 73, at 182-3 (describing how differences in law and enforcement environments lead to different incentives for criminal organizations). See also Cao, *supra* note 73, at 76.

76. See e.g., Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, And Increased Risks*, 2002 U. ILL. L. REV. 215, 400-01 (2002).

77. Cf. SooCheong Jang & Larry Yu., *Analysis of Return on Hotel Investment: A Comparison of Commercial Hotel Companies and Casino Hotel Companies*, 26 J. HOSPITALITY & TOURISM RES. 38-53 (2002).

78. Laundered investments have been found in numerous industries including banks, insurance companies, casinos, shell corporations, trusts, and various money service businesses. Dept. of the Treasury, U.S. Money Laundering Threat Assessment (Dec. 2005), at <http://www.ustreas.gov/offices/enforcement/pdf/mlta.pdf>.

operation of illegal enterprise.⁷⁹ In fact, the money laundering business is itself a specialty business within the greater sphere of the criminal world.⁸⁰ Criminal profits are not truly profits until they are “cleaned.” Dirty money cannot be spent or invested without arousing too much suspicion as to their origin.⁸¹

A mafia can either launder the money itself or outsource this aspect to other professional criminal organizations.⁸² In fact, even to transform the mafia into a legitimate organization the money must first be laundered into legal channels.⁸³ To funnel money into the legal sector requires a conversion into utilizable financial resources that appear legitimate.⁸⁴ Thus, money laundering institutions present an incentive for the mafia to keep its hands in the pockets of both worlds at the same time: “if the opportunity to pretend that one’s wealth is legitimate . . . can be . . . denied then motivation for continued crime . . . is considerably reduced.”⁸⁵

Once the laundering process is complete the source of money can become untraceable and indistinguishable from legal sources.⁸⁶ It is estimated that between \$590 billion and \$1.5 trillion of illegally obtained funds are annually laundered worldwide (two to five percent of the world’s GDP).⁸⁷

2. Legislation

In the United States, the centerpiece legislation which imposes laundering costs is the Bank Secrecy Act (BSA),⁸⁸ recently supple-

79. See Teresa E. Adams, *Tacking on Money Laundering Charges*, 17 GA. ST. U. L. REV. 531, 552 (2000) quoting H.R. REP. NO. 99-746, at 17 (1986) (“There are problems especially for the large drug trafficking network which has to put volumes of cash generated from street sales of drugs into something more negotiable than boxes of ten, twenty and fifty dollar bills. Typically a drug trafficker needs to exchange small bill for large ones. . . . To accomplish these ends the drug dealer has to have access to banks and other financial institutions.”).

80. *Id.* at 552.

81. Michael McGuinn, *Money Laundering*, 43 AM. CRIM. L. REV. 739 (2006).

82. See Adams, *supra* note 79, at 553 (describing the comments of Assistant U.S. Attorney of Miami who argues that the entities conducting money laundering activities are a special niche in the criminal world that assist organized crime in washing their money).

83. See e.g., Volkov, *supra* note 52 (describing how criminal groups transferred their money into a large oil company and the group’s leader is now the vice president of the large holding company and has political aspirations).

84. Levi, *supra* note 73, at 182.

85. *Id.*

86. *Id.* at 183.

87. International Monetary Fund & The World Bank, Reference Guide to Anti-Money Laundering and Combating the Financing Terrorism, Second Edition and Supplement on Special Recommendation IX (Jan. 20, 2007), at http://siteresources.worldbank.org/EXTAML/Resources/396511-1146581427871/Reference_Guide_AMLCFT_2ndSupplement.pdf

88. 31 U.S.C. §§ 5311-5330 (2007); 12 U.S.C. §§ 1818(s), 1829(b), 1951-1959 (2007).

mented with sections of the PATRIOT Act.⁸⁹ The BSA imposes currency reporting requirements for domestic financial institutions and “know your customer guidelines,” which require officers to develop certain internal policies, procedures, and controls.⁹⁰ The bank is required to develop a program that must include the following four components: (1) a system of internal controls to assure ongoing BSA compliance; (2) independent testing of the designated financial institution’s compliance; (3) designation of an individual responsible for coordinating and monitoring day-to-day compliance; and (4) training for appropriate personnel.⁹¹

Designated financial institutions (DFI) are also required to file Suspicious Activity Reports (SARs) on any instances of known or suspected illegal or suspicious activity.⁹² To ensure that it can identify suspicious activity, the DFI must have in place a due diligence program under which the organization can assess the risks and gather sufficient information to determine whether a customer account or transaction warrants the filing of an SAR.⁹³

In addition, Section 313 of the USA PATRIOT Act and its implementing regulations address shell banks (banks created by illegal entities for the sole purpose of funneling money).⁹⁴ These regulations prohibit covered U.S. banks and broker-dealers from establishing, maintaining, administering, or managing a correspondent account for a foreign shell bank.⁹⁵

Additionally, RICO makes it unlawful for a person to use an enterprise to launder money generated by a pattern of racketeering activity.⁹⁶ This is the classic mafia investment case envisioned by Congress where organized criminals gain control of an uncorrupted business by

89. 31 U.S.C. §§ 5301-77 (2007) (particularly §§ 5318-19).

90. 31 U.S.C. § 5314(h) (2007). The BSA requires banks to establish and maintain effective anti-money laundering programs, implement customer identification programs, and maintain transaction records. Banks also are obligated to report cash transactions exceeding \$10,000 as well as transactions that appear suspicious. *Id.*

91. Dept. of the Treasury, U.S. Money Laundering Threat Assessment, *supra* note 78.

92. *Id.* DFIs must implement a written customer identification program appropriate for their size, location, and type of business. *Id.* The procedures are supposed to enable a bank to form a reasonable belief that it knows the true identity of each customer. *Id.*

93. *Id.*

94. 31 U.S.C. § 5318 (2007).

95. 31 U.S.C. § 5318 (2007). In addition, U.S. banks and broker-dealers must take reasonable measures to ensure that any correspondent account that they establish, maintain, administer, or manage for a foreign bank is not being used by the foreign bank to provide banking services indirectly to a foreign shell bank. Dept. of the Treasury, U.S. Money Laundering Threat Assessment, *supra* note 78.

96. *Lightening Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1187-88 (3d Cir. 1993).

investing profits from gambling or other illegal activities.⁹⁷ Moreover, RICO makes it illegal to have control of or interest in an enterprise engaged in racketeering activity, to participate in such an enterprise, or to conspire to do any of these actions.⁹⁸

The BSA, PATRIOT ACT, and RICO statutes have been supplemented with vigorous enforcement by the Department of Treasury and heavy penalties for banks not following the Acts' procedures. In a recent action against AmSouth Bank, the bank consented to pay \$50 million to the United States government for failing to develop a proper BSA compliance program and for helping to funnel money for various politically exposed persons (Chilean dictator Augusto Pinochet was one of these).⁹⁹

3. Laundering Despite the Legislation

Despite these regulations, money laundering continues to prevail in the United States and throughout the world.¹⁰⁰ As the government imposes more restrictions on private monetary institutions, the money launderers have increasingly turned to informal avenues of money transfer systems that exclude banks altogether, and do not fall under the reach of the above statutes.¹⁰¹ Moreover, banks oppose invading the confidentiality of their clients, and many see these restrictions as unduly burdensome.¹⁰² Some banks have even made it a point to become the "no questions asked" dealers, and to locate offshore so as not to fall under the jurisdiction of U.S. laws.¹⁰³

4. *Summing Up the Costs*

Money laundering fees serve as a tax on illicit profits and like most costs they can be at least partially passed on to the consumer (both legal and illegal customers). Laundering is reported to be expensive to the criminal organization and its costs have risen since the 1980s with the establishment of new laws and special international task

97. *Id.*

98. *United States v. Turkette*, 452 U.S. 576, 577 (1981), *citing* 18 U.S.C. § 1962(c) (1976 ed. and Supp. III).

99. *In the Matter of AmSouth Bank*, AL Dept. of Banking 2004.

100. McGuinn, *supra* note 81, at 740.

101. *See Cao*, *supra* note 73, at 73-8 for a discussion of informal norms and avenues of money laundering.

102. Virginia Boyd, *Financial Privacy in the United States and the European Union: A Path to Transatlantic Regulatory Harmonization*, 24 *BERKELEY J. INT'L L.* 939, 943 (2006).

103. *See Michael Levi & Peter Reuter*, *Money Laundering*, 34 *CRIME & JUST.* 289, 351-54 (2006).

forces charged with watching transfers of large sums of money across the world.¹⁰⁴

During the 1980s, laundering costs ranged from 6-10% of the total profit of a given venture, and are reported to have been between 15-30% in the 1990s and 2000s.¹⁰⁵ Laundering fees depend largely upon the amounts needed to be transferred, and vary with government enforcement and prosecutorial capabilities, availability of laundering institutions, and expected punishments upon detection.¹⁰⁶ For example, on a \$2.25 billion annual profit by a drug cartel the estimated costs of money laundering are \$350 million or approximately 15.6% of the total profits.¹⁰⁷

These laundering fees can thus be accounted for by subtracting them from the pre-laundered gross profit to yield the final profit. The final laundered profit is then the expected profit less the bribery costs (BC) (as, for example, derived in section III(C)) and less the laundering costs (LC): (11) $F\pi = E\pi - BC - LC$

E. Agency and Information Monitoring Costs

An organization that cannot optimally adjust to its expanding size and operations suffers inefficiency and agency costs.¹⁰⁸ Like other business entities, the mafia is organized in a hierarchical structure to allow for the flow of information between its ranks, maintain command and control, and fulfill its profit maximization function.¹⁰⁹ Additionally, the mafia must stay under the radar of law enforcement—the benefits that a legal corporation reaps from its bureaucratic, open, and vertical structure are a detriment to the mafia. The mafia requires quick horizontal control and high secrecy; lots of people and lots of paperwork make for easy prosecutions.¹¹⁰ The mafia must therefore keep its size below a certain level, centralize its control while main-

104. See Levi, *supra* note 73, at 191. The International Monetary Fund lists the following costs for banks associated with laundering operations: loss of profitable business, investigation costs and fines, asset seizures, loan losses, declines in stock value, as well as others. Anti-Money Laundering, *supra* note 87, at II-4.

105. Morais, Andrea, *Money Laundering in Brazil*; see also Echeverry, Juan Carlos, *Colombia and the War on Drugs, How Short is the Short Run*, Documento CEDE 2004-13, Universidad de los Andes (2004), available at <http://ideas.repec.org/p/col/001050/002142.html>.

106. See *id.*

107. *Id.*

108. MICHAEL C. JENSEN, *A Theory of the Firm* 47 (Harvard University Press 2003).

109. Demleitner, *supra* note 22, at 618. E.g., the American-Italian mafia was modeled along the lines of a Fortune 500 company—the organizational chart of a crime family or syndicate mirrors the management structure of a corporation; see also Jankiewicz, *supra* note 45, at 221; see also SALERNO & TOMPKINS, *supra* note 49.

110. See GAMBETTA, *supra* note 11, at 35-6. See also FRIEDMAN, *supra* note 14.

taining a decentralized management structure, keep its upper decision making ranks buffered from the lower executing ranks,¹¹¹ and obtain obedience from its subordinates through a reward or a threat of force or death.¹¹²

The inefficiencies generally suffered by legal corporate entities are in large part opposite to those suffered by mafia organizations. In a legal corporation the most prevalent agency problems are (1) a corporate culture that substitutes friendliness and politeness for truth; (2) information flow problems due to large corporate size; (3) legal liability for board members which forces them to minimize downside risk for stock prices rather than maximize corporate value; (4) lack of equity holdings by management; and (5) oversized boards that are modeled after a political democracy.¹¹³

Conversely, the mafia incentive structure presents few if any of these issues. (1) The control culture concerns itself least with politeness.¹¹⁴ (2) The size of the organization is kept small to avoid detection.¹¹⁵ (3) "Shareholders" are unable to use the legal system to bring suits against management. (4) Management and administrators have large equity and profit sharing interests in the organizations.¹¹⁶ And (5) control of the organization is concentrated and authoritarian.¹¹⁷

Rather the mafia's major inefficiency lies in its less-than-optimal size.¹¹⁸ Many legitimate companies alleviate some of these problems through methodical, hierarchical structuring, vertical reporting, and business consulting. But because of secrecy concerns, these avenues are largely unavailable to the criminal organization.¹¹⁹ At once, the

111. Buffering is another cost minimization technique which works by isolating the managing ranks from the executing ranks. This makes prosecution difficult because the managing ranks can assert that they lacked knowledge of the crime, if detection occurs.

112. See GAMBETTA, *supra* note 11, at 35, 40, 43, 66.

113. Jensen, *supra* note 108, at 49-53.

114. See GAMBETTA, *supra* note 11, at 40, 68.

115. FRIEDMAN, *supra* note 14.

116. LEVITT & DUBNER, *supra* note 35, at 108-14; GAMBETTA, *supra* note 11, at 60-63.

117. *Id.*

118. See e.g., FRIEDMAN, *supra* note 14 (arguing that organized crime is analogous, not to a giant corporation, but to something more like a chamber of commerce or better business bureau for the criminal market). See also LEVITT & DUBNER, *supra* note 35, at 108 (arguing that a study of the Chicago drug gang and its national board of directors revealed that drug gangs within the greater structure of organized drug distribution function more like franchises than corporate entities. For example, there were only 3 levels of hierarchy (gang leader, people reporting directly to the gang leader, and street soldiers) between the board of directors and the lowest rank and file.)

119. Lawyers do perform some legal consulting duties. Jankiewicz, *supra* note 45, at 260 n.40 (describing a lawyer as a link between organized crime and legitimate business). Nevertheless, illicit businesses cannot acquire professional business, management, or strategy consulting advice from the marketplace.

mafia structure must be small enough to avoid authorities and minimize monitoring and bonding costs,¹²⁰ yet large enough to have specialization of tasks for its members, utilize economies of scale,¹²¹ and allow management control over subordinate activity.¹²² In other words, bosses must ensure that associates are acting in the best interests of the organization (monitoring costs) and that they will not switch to a rival mafia (bonding costs). Simultaneously, the organization must be large enough to operate at low cost (by utilizing economies of scale) and, at the same time, not get caught. “TPS reports” may make good accountability tools, but they make wonderful prosecutorial evidence as well.

Thus, the predominant set up of criminal organizations across the world is much like that of a franchise operation: small firms enjoying the specific trademarks and visibility of a larger structure, organized along territorial lines under a board of directors consisting of some or all of the individual firm leaders, within an effectively cartelized industry.¹²³ The smaller criminal organizations are awarded significant independence in their operations, but may have to pay licensing fees to the larger cartelized criminal organization.¹²⁴ These arrangements include Italian mafia families under the umbrella of the “Commission,”¹²⁵ Chicago territorial drug gangs paying licensing fees to a board of directors,¹²⁶ Japanese Yakuza gangs that report to the *oyabun* (boss),¹²⁷ and even the Russian mafia cells¹²⁸ (which currently

120. Bonding costs are incurred to assure that an employee stays with the mafia. For example, ensuring that a “boss” does not switch his employment to another mafia family. One way that mafias minimize such costs is by only allowing specific ethnic groups into their mafias to ensure loyalty to the organization. See, e.g., Diego Gambetta, *Mafia the Price of Mistrust*, in *TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS* 158-175 (Diego Gambetta ed., 2000), available at <http://www.sociology.ox.ac.uk/papers/gambetta158-175.pdf>.

121. Cf. Braguinsky, *supra* note 19, at 532-533 (emphasizing that the mafia is able to offer protection as a service because the organization is so large and effectively competes with the large state. Utilizing economies of scale, he advocates imposing a large centralized state backed organization that would provide protection service and could undercut criminal protection rackets because of cost advantages).

122. GAMBETTA, *supra* note 11, at 62.

123. Cf. FRIEDMAN, *supra* note 118.

124. *Id.*

125. See GAMBETTA, *supra* note 11, at 101.

126. LEVITT & DUBNER, *supra* note 35, at 99.

127. Milhaupt & West, *supra* note 43, at 66.

128. FEDERICO VARESE, *THE RUSSIAN MAFIA: PRIVATE PROTECTION IN A NEW MARKET ECONOMY* 170 (2001) (describing the organizational structure of the Russian mafia group as all too reminiscent of an Italian Mafia family). Groups called *brigades* are organized among territorial lines, the leader of the brigade is surrounded by six to eight people, not more, directly under his control (“otherwise the structure becomes too difficult to manage”), below them are the crew leaders and under them are the foot soldiers: *shestiorki*. *Id.* Each brigade comprises of 1,000 to 9,000 individuals, yet crews operate with a degree of independence within each brigade. *Id.* The

have much less enforcement and prosecution to worry about from the state than their Italian, Japanese, or American counterparts).

F. *Costs of Prosecution and Other Costs*

The obvious cost for the mafia, that most legal organizations do not incur, is that of government prosecution. If detection occurs, the government can levy heavy fines, seize property, and of course, send “employees,” “supervisors,” and “bosses” to jail. Since paperwork on how to run the organization is scarce and relationships with customers and suppliers are heavily trust-based and therefore leader-centric, a serious disruption in the organization can occur as a result of a successful prosecution.¹²⁹

Other costs exist for the mafia that may or may not exist for a legal organization. One is the cost of competition with other illegal entities. This includes, for example, the costs of security, property loss from competitor raids, and loss of labor through murders and force. Additionally, such competition causes inefficiencies in management resulting from the killings of top officials, prevention of hostile takeovers by competing entities, forced sharing of profits, and territorial disputes with other illegal entities in the cartelized industry.¹³⁰

Another cost is increased risk compensation. For example, salaries of mafia employees have to be higher to account for employee legal opportunity costs and to reimburse for the increased risk.¹³¹ Mafias are also unable to obtain legitimate capital. Thus even where the mafia organization can obtain investment capital, the returns must be higher than the market rate to account for the increased levels of risk

brigade’s leadership is controlled by the Supreme Council which is headed by the 12 leaders of the strongest crews. *Id.* at 171. Disputes between the brigades are arbitrated by respected crime lords known as *vori v zakone*. *Id.* at 170-2. The head of the Russian Interior Ministry Department for Combating Organized Crime and Terrorism, Nikolay Ovchinnikov, stated that approximately 100 criminal fraternities, with a core membership of 3,500-4,000, are currently operating in Russia. *Ministry Spokesman Presents Report on Organized Crime in Russia*. BBC WORLD-WIDE MONITORING, February 15, 2005.

129. See Jacobs & Gouldin *supra* note 45, at 157-9.

130. Gambetta, *supra* note 120, at 158.

131. See Milhaupt & West, *supra* note 43, at 62 (incomes of Japanese lower level mafiosos in 1993, ranged between \$30,000-\$100,000. For comparison, the average yearly contract earnings of all employees for the same year was \$33,504 - the average dentist earned approximately \$65,000, while janitors earned \$30,000). *Id.* See also LEVITT & DUBNER, *supra* note 35, at 104 (noting that the salary of a drug dealer must be higher or at least seem higher to account for the higher risk of getting killed or going to jail). Levitt argues that while an entering gang drug dealer makes less than \$2/hour—significantly less than an entry level McDonalds employee—he is compensated by tremendously higher profits if he can advance up the level of the organization. If not promoted to higher ranks the drug dealer quits the illegal business altogether within a few years. *Id.*

and detection as well as the decreased supply of capital.¹³² Finally, the mafia also incurs transactional costs such as security protection, weapons, warehouses, safe houses, and false fronts.¹³³ On the other hand, somewhat like their legal counterparts, criminal businesses expend resources to secure the goodwill of the community in which they operate.¹³⁴

The next section integrates and analyzes the above-described costs and revenues to determine the effect the law plays in the threshold transformation.

IV. WHAT ROLE DOES THE LAW PLAY IN FACILITATING THE THRESHOLD AT WHICH THE MAFIA WILL ATTEMPT TO TRANSFORM INTO A LEGAL BUSINESS?

Enforcement of the law is performed through two different avenues, by the interested victim and by the disinterested actors of the state. While it is generally inefficient to have private entities enforce criminal laws,¹³⁵ private entities with specialized knowledge of the crime serving as witnesses are extremely efficient in fostering prosecution.¹³⁶ The law as a whole provides criminal and civil punishment to parties involved in the criminal organization as well as incentives for injured parties to bring suit.¹³⁷

When the mafia organization faces the law and its enforcers, it may react in a number of ways. First, it can attempt to circumvent the law by altering its practices. Thus, when the law prohibits importation of cocaine, the mafia can invest in research and development of new drugs that are not yet prohibited by law such as “crack” or “ecstasy,” or invest in sidestepping importation barriers by growing or making the drug in the country itself. American mafias, for instance, took this

132. See Gambetta *supra* note 11, at 230 (describing the Sicilian mafia’s inability to obtain capital especially in “smuggling where large sums are required to buy the goods and pay for ships, motorboats, and crews. . . . Investors are reluctant to entrust their money to risky business. Since confidence in criminals is low, the mere promise of exorbitant returns is hardly sufficient incentive.”).

133. See ABADINSKY *supra* note 15, at 120-180 (describing many of the businesses that the Mafia is involved in and the costs that it incurs).

134. See LEVITT & DUBNER, *supra* note 35, at 98 (describing how a drug gang purchases community goodwill by providing money and support for families of the community and that of murdered members). See also Milhaupt & West, *supra* note 43, at 65 (describing how Japanese crime firms engaged in public relations when the deadly earthquake struck Kobe in 1995 - it was a mafia firm, not the government, that was first to bring food and water relief to devastated neighborhoods).

135. See FRIEDMAN, *supra* note 9, at 309-18 (discussing other countries and historic periods where private individuals enforced criminal laws).

136. Pamela Bucy, *Private Justice*, 76 S. CAL. L. REV. 1, 12 (2002).

137. See generally *id.*

route with popular sex drugs named “poppers.” When legislators outlawed a specific chemical composition, the producers reformulated the drug so it had the same net effect, but fell outside the specific legislation.¹³⁸

Alternatively, the mafia can break the law directly but prevent its enforcement through monetary incentives to the enforcers—bribes. As previously mentioned, bribes to legislators, judiciaries, and police officials are a common and time-proven way to maintain market presence and deter prosecution.¹³⁹

A third option is to set up the organization in countries with a favorable environment for such criminal activity. Utilizing this tactic, from the 1970s through the late 1980s various drug cartels operated almost freely from Nicaragua, Cuba, Panama, and Columbia, where the legal environment was filled with sympathetic and well-bribed politicians.¹⁴⁰ The drug prosecutors in the United States were able to catch drug mules and distributors, but were unable to reach the upper levels of the cartels themselves.¹⁴¹

Finally, with the advent of a new law the mafia can decide that it would be more profitable to invest its resources, influence, and structure into legal ventures. This was the case when, following Prohibition in the United States, criminal enterprises exited the recently legalized alcohol industry and invested their capital into the legal sphere.¹⁴²

A. *United States: RICO*

1. RICO's Background

Congress has passed a number of acts attempting to deal with criminal organizations,¹⁴³ yet none has been as successful as RICO at attacking the “criminal enterprise” itself.¹⁴⁴ Until the 1970s, organized crime had a significant presence in the United States.¹⁴⁵ Criminal

138. Paul Varnell, *Poppers Less Than Meets the Eye*, Windy City Times, Mar. 30, 1989; see also Simon Sheppard, *Speaking of Poppers What are They?*, at <http://www.gay.com/health/sexuality/article.html?sernum=770>.

139. See ACKERMAN, *supra* note 51, at 76; see also *infra* Part III(C).

140. GUY GUGLIOTTA & JEFF LEEN, *Kings of Cocaine: Inside the Medellin Cartel* (1989).

141. *Id.*

142. See *infra* Part V(A).

143. For an excellent summary of many of the crime fighting tools in the United States' arsenal see Craig M. Bradley, *Criminal Law and Procedure: Anti-Racketeering Legislation in America*, 54 AM. J. COMP. L. 671 (2006). These laws include the Hobbs Act, the Controlled Substances Act, various provisions of the Internal Revenue Code, The Bank Secrecy Act, The Money Laundering Control Act, and the PATRIOT Act. Goodwin *supra* note 47, at 292-93.

144. Goodwin, *supra* note 47, at 293.

145. *Id.* at 289.

charges were hard to press, especially when some witnesses turned up dead, while others, fearing reprisal, refused to testify.¹⁴⁶ The mafia heavily enforced its code of secrecy—the *Omerta*—across the ranks, resulting in a lack of information about the organization.¹⁴⁷ In fact, the most common way of convicting mafia criminals was through the use of deportation regulations, traditional murder and conspiracy laws, and fraud statutes.¹⁴⁸ This amounted to “culling the herd” by targeting the weak, low-level members and allowing more efficient gangsters to take their place, while the organization persisted.¹⁴⁹ Even when higher level officials were convicted, the organization would be wounded, but would nevertheless still live on. Just like a legitimate enterprise, the mafia survives because of its business organization and product, rather than a life or death dependence on management, shareholders, or boards of directors.¹⁵⁰

2. RICO's Features

Fearing the rapid growth of crime, Congress, in 1970, passed the Racketeering In Corrupt Organizations Act as Title IX of the Omnibus Organized Crime Control Act.¹⁵¹ The trademark features of the Act were that it reached beyond the person committing the illegal action to the enterprise and the key bosses involved that activity. The prosecutor had to show that the enterprise had committed a pattern of specific racketeering activity (two or more predicate acts).¹⁵² The investigation would be carried out by a special racketeering investigator, and funds seized in racketeering trials would be put into a separate fund for future RICO prosecutions and investigations.¹⁵³ In addition, RICO contained the first criminal forfeiture statute in American his-

146. Jacobs & Gouldin, *supra* note 45, at 131.

147. *See* Goodwin, *supra* note 47, at 290.

148. *See* ABADINSKY, *supra* note 15, at 182.

149. Goodwin, *supra* note 47, at 292.

150. Demleitner, *supra* note 22, at 617 (1994) (arguing that organized crime, just like legitimate enterprises, survives as an institution independent of management, majority shareholders, or board of directors. Consequently the distinctive feature of organized crime is “not its players but rather the illegal nature of the product and/or service.”) *Id.*

151. *See* Organized CRIME Control Act of 1970 (OCCA), Pub. L. No. 91-452, §901, 84 Stat. 941 (1970) (codified at 18 U.S.C. § 1961-68). (Congressional Statement of Findings and Purpose).

152. The government must prove 1) the commission of two or more racketeering acts, 2) a pattern, 3) an enterprise, 4) an effect on interstate commerce, and 5) that the accused act is prohibited. 18 U.S.C. § 1961 (2007). The two predicate acts must occur within a ten year period. However, there is no requirement that the defendant be convicted of such activities, nor are prosecutors prohibited from using prior convictions as predicate acts. Goodwin, *supra* note 47, at 293-94.

153. 18 U.S.C. § 1961 (2007).

tory allowing the seizure of property—particularly money—obtained from a pattern of racketeering activity.¹⁵⁴

With the advent of RICO and diligent prosecution, organized crime in the United States diminished rapidly in the 1970s and 80s, and in the 90s its demise was further aided by prosecution of the New York and Chicago mafias.¹⁵⁵ In fact, successful prosecutions of the heads of La Cosa Nostra families (called Dons or Godfathers) have triggered reference to the “twilight of the Godfathers.”¹⁵⁶ Entire organizations have been dismantled, and mafia influence over many legitimate industries has been eliminated.¹⁵⁷ It has been stated that some mafia families have disappeared entirely, and others have dwindled to as little as ten to fifty percent of their size thirty years ago.¹⁵⁸

Through these features of the Act, the United States attempted to raise the costs of illegal activity by holding each member of a criminal enterprise responsible for all of its acts and reducing the profits that could be reaped. In a large sense RICO’s “draconian punishments” forced higher monitoring and secrecy costs onto the mafia and forced many established illicit enterprises to exit the industry.¹⁵⁹ Secrecy has become so crucial to surviving enterprises that in the United States, unlike many other countries, murders of state authorities have been rare—largely out of fear of the backlash that would result.¹⁶⁰ In several mafia families, killing a state authority is strictly forbidden—even conspiring to commit such a murder is punishable by death.¹⁶¹ Since even one security breach can now cause serious damage to the whole enterprise (rather than one person or one division) there is no room for leaks or mistakes.¹⁶²

154. 18 U.S.C. § 1963 (2007).

155. Ed Magnuson, *Hitting the Mafia*, TIME, June 24, 2001; see, e.g., *United States v. GOTTI*, 771 F. Supp. 552, 566 (E.D.N.Y. 1991), *aff’d*, *United States v. Locascio*, 6 F.3d 924 (2d Cir. 1993); see also *United States v. Rainone*, 32 F.3d 1203, U.S. 32 F.3d 1203, 1209 (1994); see also Jacobs & Gouldin, *supra* note 45, at 132; see also Goodwin, *supra* note 47, at 303-04.

156. Goodwin, *supra* note 47, at 281.

157. *Id.* at 280-02.

158. *Id.* at 280.

159. Craig W. Palm, *RICO Forfeiture and the Eighth Amendment: When is Everything Too Much?*, 53 U. PITT. L. REV. 1, 5 (1991).

160. GAMBETTA, *supra* note 11, at 9.

161. *Id.* One mobster, Dutch Schultz, was reportedly killed by his peers out of fear that he would carry out a plan to kill New York City prosecutor Thomas Dewey. See Robert M. Pitler, *Independent State Research and Seizure Constitutionalism: The New York State Court of Appeals’ Quest For Principled Decisionmaking*, 62 BROOKLYN L. REV. 1, 73 n.262 (1996).

162. For example punishments imposed on John Gotti, the ‘Don’ of the Chicago-based mafia organization, were both internal and external. John Gotti, nicknamed the “Dapper Don” for his show-off attitude and “Teflon Don” for his ability to evade federal charges, had fireworks set for him when he was acquitted in his first large-scale prosecution. Goodwin, *supra* note 47, at 303. Yet, many members of his organization and fellow mafia organizations became extremely un-

B. *Other Countries' Laws*

Following the United States' success with combating organized crime, other countries have established a mixture of laws that parallel and emulate the RICO statute.

1. Russian Federation

In post-Communist Russia, there was and continues to be a lack of enterprise-based law. The mafia is thought to be intertwined with the top levels of government, and its annual revenue in 1998 was estimated at \$200 billion, the highest of any crime group in the world.¹⁶³ The first Russian Federation law was a carryover from the Communist era when the government denied the existence of organized crime and racketeering,¹⁶⁴ even though anywhere from ten to forty percent of Soviet GDP stemmed from underground sources.¹⁶⁵ Legislative infrastructure that could combat organized crime, such as banking laws, insurance laws, securities regulation, a RICO statute, laws against money laundering and a witness protection program, had not been adopted.¹⁶⁶ Conspiracy and criminal laws attacked individual fraud and criminal acts but did not extend to the whole enterprise.¹⁶⁷

In 1994, when organized crime was thought to control as much as forty percent of all of the Russian Gross Domestic Product and threatened the stability of the society and government,¹⁶⁸ then President Yeltsin issued a decree to combat organized crime.¹⁶⁹ This decree allowed for the deportation of undocumented aliens from the capital, enabled the government to interrogate suspected persons prior to instituting criminal proceedings against them and to use the evidence gathered, in later proceedings; and inspecting an individual's,

happy with his tactics of putting organized crime in the spotlight. *Id.* When he and the organization he controlled were brought down by the FBI in 1993, his own mafia employees attempted to take his life. *Id.*

163. Newman, *supra* note 42, at 227.

164. Daniel McGrory, *Symposium: Economic, Legal, and Political Dilemmas of Privatization in Russia: Civilizing the Russian Underground Economy: Requirements and Prospects for Establishing a Civil Economy in Russia*, 5 *TRANSNAT'L L. & CONTEMP. PROBS.* 65, 89 (1995).

165. *Id.* at 71.

166. Louise Shelley, *Development of the Democratic Institutions & The Rule of Law in the Former Soviet Union: Article: Post-Soviet Organized Crime and the Rule of Law*, 28 *J. MARSHALL L. REV.* 827, 835 (1995).

167. Mike Cormaney, *Prosecuting International Crimes: An Inside View: RICO In Russia: Effective Control Of Organized Crime Or Another Empty Promise?*, 7 *TRANSNAT'L L. & CONTEMP. PROBS.* 261, 294 (1998).

168. Eugene Solomonov, *US Russian Mutual Legal assistance Treaty: Is There a Way to Control Russian Organized Crime?*, 23 *FORDHAM INT'L L.J.* 165, 175 (1999); *see also* Milhaupt & West, *supra* note 43, at 41.

169. Solomonov, *supra* note 168, at 237.

or his or her relatives', or co-residents' records of financial activities and transactions, without the obstacles of banking and commercial confidentiality requirements.¹⁷⁰ Additionally, anyone suspected of being a part of a criminal organization could be denied bail or detained for up to thirty days without formal charges.¹⁷¹ Moreover, government officials could inspect buildings and premises of enterprises, institutions, and organizations suspected of criminal activities.¹⁷²

In 1996, the Russian State Duma (Congress) adopted the first post-Soviet Russian Criminal Code which contained provisions to punish leadership, creation, or participation of a stable armed group for the purpose of assaulting individuals or organizations,¹⁷³ as well as special provisions for individuals using their official government positions to participate in such groups.¹⁷⁴ Additionally, the Criminal Code created penalty provisions for organized criminal organizations participating in grave or especially grave crimes.¹⁷⁵

Yet the code failed to provide a vehicle through which to deal with "large and diverse organizations" because it did not attack the "criminal enterprise."¹⁷⁶ Instead of focusing on the man behind the curtain—the organization behind the crimes—it targeted the individuals committing crimes. As a result, prosecutors were unable to hold a member liable for crimes of other members of the organization unless they shared a specific common goal and agreement. This presented a large problem for the immense, multi-faceted business of the Russian mafia.¹⁷⁷ Moreover, for all of its specifically outlined powers, enforcement of the law remained low. For example it was reported by news agencies that 100,000 people belonging to 9,000 organized criminal groups were under surveillance by Russian law enforcement authorities but could not be arrested due to the lack of sufficient evidence necessary for their indictment.¹⁷⁸

170. *Id.* at 188-90.

171. *Id.* at 188.

172. *Id.*

173. *Id.* at 192 (citing Ugolovniy Kodeks Rossiyskoy Federatsii, No. 63-FZ of June 13, 1996, as amended on June 25, 1998, *Sobr. Zakonod. RF*, 1996, No. 25, Item 2954. For an English translation of the Criminal Code of the Russian Federation, see *CRIMINAL CODE OF THE RUSSIAN FEDERATION* (William E. Butler trans., Simmonds & Hill 2d ed. 1998).

174. Solomonov, *supra* note 168, at 192.

175. *Id.* at 193.

176. Newman, *supra* note 42, at 238.

177. *Id.*

178. Solomonov, *supra* note 168, at 197-8 (citing Tanya Frisby, *The Rise of Organized Crime in RUSSIA: Its Roots and Social Significance*, 50 *Europe-Asia Studies* 27, 40 (1998)).

Murders of high level government officials were common and fears of government reprisals ran low.¹⁷⁹ In 1997, then President Yeltsin struck down an attempted witness protection law leaving witnesses with little hope of being protected.¹⁸⁰ Moreover, the mafia heavily enforced its own code of secrecy and victims did not sell out their friends to the law because, as some victims put it, “they are more afraid of the police than they are of the mafia.”¹⁸¹ Bribery and information leaks at government levels were widespread. In 1994, after the murder of several high ranking officials, then President Boris Yeltsin instituted a one-time top secret operation to round up suspected mafia leaders—Operation Hurricane.¹⁸² But, on the day of the operation most of the suspected mafiosos were found to have recently left the country on vacation—the “hurricane” left virtually no damage.¹⁸³ And yet, as the mafia grew in size and influence during this apparent lawlessness, it began, almost on its own, to convert to the legitimate sector as will be explained in section V(B).

2. Italy and the Cosa Nostra

Prior to the mid-1990s, the Italian mafia—the Cosa Nostra—exerted immense influence in Italy’s legal, economic, and political spheres.¹⁸⁴ Institutional acceptance, political influence, and a lack of government prosecution allowed the Cosa Nostra to flourish.¹⁸⁵ Until 1982, much like in early 90s Russia, Italy’s laws against the mafia focused on preventing individual crimes.¹⁸⁶ Only in 1982 did Italy begin to deal with organized crime. From 1982 to 1992, 114 laws regarding organized crime were passed.¹⁸⁷ The general trend was to fight organized crime on the basis of the presence of three elements: the associa-

179. Newman, *supra* note 42, at 252.

180. Solomonov, *supra* note 168, at 197-8.

181. Federico Varese, *The Russian Mafia: Private Protection in a New Market Economy* 42 (2005).

182. Jeff Trimble, *Enemies of the People Once Again?*, U.S. NEWS & WORLD REPORT WORLD REPORT ON RUSSIA, July 18, 1994, at 39; *see also* Jonas Bernstein, *Yeltsin’s Crackdown On Organized Crime Hits Only Little Guys*, THE WASH. TIMES, June 25, 1994, at A7.

183. *See* Jonas Bernstein, *Yeltsin’s Crackdown On Organized Crime Hits Only Little Guys*, THE WASH. TIMES, Moscow, June 25, 1994, at A7.

184. Benjamin Scotti, *RICO vs. 416-bis: A Comparison of U.S. and Italian Anti-Organized Crime Legislation*, 25 LOY. L.A. INT’L & COMP. L. REV. 143, 155 (2002). According to a chief prosecutor at a salient mafia trial, the MAFIA IS “the only organization in the world that could exercise its power over a legal state.” *Id.*

185. *Id.* at 155-6.

186. *Id.* at 156-7.

187. Umberto Santino, *Law Enforcement in Italy and Europe Against Mafia and Organized Crime*, in CRIME AND LAW ENFORCEMENT IN THE GLOBAL VILLAGE 151 (William F. McDonald ed., 1997), available at <http://www.centroimpastato.it/publ/online/mcdonald.htm>.

tive bond (the power of intimidation that stems from being associated with the organization), the organized structure, and the criminal program (various enumerated crimes that the mafia commits).¹⁸⁸ In addition, the law in Italy now allows for *pentiti* or leniency for those criminals that repent and turn state evidence.¹⁸⁹ Also, Article 240 of the Italian Penal Code has a forfeiture provision providing for “confiscation of any proceeds of any crime.”¹⁹⁰

However, the majority of Italy’s mafia fighting tools are still concentrated on conspiracy-based actions. For example an often used law—Article 416 of the Criminal Code—punishes conspiracy between individuals that are part of mafia style organizations, or that promote or manage such associations, or that use intimidation.¹⁹¹ This has led to many of the problems associated with pre-RICO U.S. crime tools: inability to pursue the entire criminal organization on the basis of the organization’s goals and context, inability to implicate high-ranking leaders due to established buffers between layers of the group, and inability to charge sufficient members of an organization in order to incapacitate the organization as a whole.¹⁹² Section V(C) will show, however, how the Italian mafia also began converting to the legal sector during this time.

V. EXAMPLES OF MAFIA TO BUSINESS TRANSFORMATIONS

This section assesses the legal and economic atmospheres present when national mafias of the three countries described in Part IV (United States, Russia, and Italy) transformed to legal entities. By analyzing costs and benefits as derived in Part III, and applying the laws delineated in Part IV, this section takes a focused look at why the metamorphosis took place in the life of each country’s mafia. Finally, it derives several major principles which can be used to predict when criminal organizations will rehabilitate and avenues through which the government can aid and accelerate this conversion.

A. *Prohibition/Casinos*

The law is a two way street. Prohibition of a good or service creates criminal organizations and solicits underworld elements. Legalization

188. *Id.* See also ORGANIZED CRIME IN EUROPE: CONCEPTS, PATTERNS AND CONTROL POLICIES IN THE EUROPEAN UNION AND BEYOND (Cyrille Fijnaut and Letizia Paoli eds., 2004).

189. MARCO JACQUEMET, CREDIBILITY IN COURT: COMMUNICATIVE PRACTICES IN THE CAMORRA TRIALS, 53 (1996).

190. 1982 C.P. 240; see also Santino, *supra* note 187.

191. Scotti, *supra* note 184, at 160.

192. See *Id.* at 160-1.

on the other hand forces underworld elements out and brings in efficient operators who are not good at secrecy, but know how to run a business.¹⁹³ In the prohibited market, the illicit organization's relevant skills are not providing the good or service efficiently, but rather providing it secretly. For example, in 1909, Nevada passed a law making all gambling illegal; yet, rather than diminishing, the practice only became more discreet.¹⁹⁴ Instead of eliminating gambling, the new law attracted underworld gamblers skilled in the arts of cheating and bribing public officials.¹⁹⁵ Not only was public revenue from licensing lost, but games without any controls were developed and public officials became corrupted.¹⁹⁶

Likewise in 1919, the Eighteenth Amendment hurled the country into an era of Prohibition forcing liquor sales underground.¹⁹⁷ With the advent of this tremendous new black market, legal distilleries and businessmen were rapidly substituted by organizations skilled in secrecy and bribery.¹⁹⁸ But as soon as Prohibition ended in 1933, the organized criminal elements in charge of the alcohol market were quickly replaced by business organizations having no ties to the criminal world, as well as bootleggers who converted to the legal side.¹⁹⁹

The U.S. experiment with Prohibition allowed a quick conversion of mafia funds into legal ventures.²⁰⁰ Legalization of alcohol brought in competition by more efficient producers and forced the mafia to exit the alcohol industry altogether, as their secrecy skills were no longer needed.²⁰¹ In fact, a similar tactic was later used by the United States to drive out the Italian Mob from the waste management business—the government flooded the market with efficient producers that competed with the mafia on the basis of cost.²⁰² In sum, when the Prohibi-

193. BECKER, *supra* note 27, at 23. Suppliers of illegal goods generally differ from those who would produce them if they were legal. *See also infra* note 194.

194. JEROME SKOLNICK, *HOUSE OF CARDS: THE LEGALIZATION AND CONTROL OF CASINO GAMBLING* 106-07 (1978).

195. *Id.*

196. *Id.*

197. U.S. CONST. amend. XVIII.

198. Demleitner, *supra* note 22, at 622.

199. *Id.* *See also* Guillaume Fournier, *From Alcohol Prohibition to Regulation*, THE SENLIS COUNCIL (2002), at http://www.senliscouncil.net/documents/from_alcohol_prohibition_to_regulation; *see also* PBS Special: *Las Vegas an Unconventional History*, July 11, 2005, available at http://www.pbs.org/wgbh/amex/lasvegas/peopleevents/p_syndicate.html.

200. Demleitner, *supra* note 22, at 627.

201. *See* Becker *supra* note 27, at 23 (explaining that illegal producers have higher production costs than legal producers when the good or service is not prohibited by the law).

202. Jacobs & Gouldin, *supra* note 45, at 175-6. New York created a Trade Waste Commission which issued licenses to companies involved in construction projects. *Id.* Only those companies that had no ties to the criminal world were given licenses. *Id.* Additionally, the Commission set

tion ended, the crime syndicates found themselves precisely at the metamorphosis point: large amounts of capital, a vibrant legal market in gambling, lowered or almost non-existent legal barriers to entry for illegal capital, and higher returns in the legitimate sector than in the illicit sector.²⁰³

Las Vegas presented the perfect avenue for conversion. Casino gambling was a proven industry with sky-high returns that sought high investment capital, and lacked legislation and enforcement to prevent infusion of illicit funds.²⁰⁴ As one legislator in Vegas said in response to accusations of illicit capital in casinos, “Las Vegas is a place for fun, we don’t run detective agencies here.”²⁰⁵ It is estimated that between the end of Prohibition (the forced exit from the previously illegal alcohol industry) and 1957 (when tougher legislation and enforcement affecting gambling was enacted), hundreds of millions of mafia capital was put into building Las Vegas.²⁰⁶ This included \$6 million for the Flamingo Hotel, \$40 million in “permanent loans” by Jimmy Hoffa and the Teamsters Union pension fund, and various other investments spread among 17 hotel casinos.²⁰⁷ Thus, the high profits reaped from bootlegging allowed some mafia organizations to exit from illicit markets altogether and use the accumulated capital to inadvertently advance the public sector. As a result, the large influx of capital brought with it significant private and public economic benefits.²⁰⁸

B. *Russian Mafia Transitions into State and Business*

In the past fifteen years Russia has presented a paradigm of organized crime mutating into legal business. Criminal leadership appears to have been an avenue for rapid social advancement and many legal

maximum rates and regulated contract duration. *Id.* This allowed legal suppliers to enter the construction market and compete with the mafia dominated ones. *Id.* The success has been overwhelming driving crime-ridden companies from the market, allowing national waste-hauling companies to enter the market, and dropping waste hauling prices by 30-40%. *Id.*

203. See SKOLNICK, *supra* note 194, at 112. From 1931 to 1949 barriers to entry were negligible. For example, from 1931 to 1945 the granting of licenses was purely the responsibility of local and county officials who treated the matter as a tax gold mine. *Id.* at 114. From 1945 to 1949 the applicants did not need to apply for a license on the casino until two weeks before the casino was ready to open—to deny the license at that point, when the casino was nearly completed, investment was substantial, and loans had been committed, was tantamount to revoking it. *Id.* Not until 1955 did Nevada form a gaming commission to regulate investment of illicit funds. *Id.* at 115.

204. *Id.* at 112-15.

205. SKOLNICK, *supra* note 194, at 76.

206. *Id.* at 112-15.

207. *Id.*

208. *Id.*; see also WILLIAM N. THOMPSON, *LEGALIZED GAMBLING: A REFERENCE HANDBOOK*, (1994).

businesses are now based on funds acquired on the black market and led or controlled by formerly criminal elements.²⁰⁹

The collapse of Communism transferred national economic assets into private control, but failed initially to provide property rights and relevant institutions to secure these assets.²¹⁰ Organized crime had largely assumed the role of contract enforcement as well as concentrating the transferred economic assets in certain private hands.²¹¹ For example, in the mid 1990s approximately seventy percent of all contracts were enforced without any participation from state organs; the mafia had taken over this responsibility.²¹² In addition, highly educated and knowledgeable individuals paired with individuals educated in secrecy and use of force, and together set up illicit businesses.²¹³ The chaos after the collapse of the Soviet Union thus provided a fertile ground for mafia business:²¹⁴ a highly educated labor force, government officials with sizeable power seeking bribes and shares in illicit businesses, lack of property rights, an enormous market seeking the mafia's services, and justice and police mechanisms devoid of power.²¹⁵

Yet, during the later part of the 1990s, legal institutions and enforcement mechanisms were built and strengthened and economic assets became more dispersed.²¹⁶ Additionally, property rights were increased and secured.²¹⁷ This led to the costs of operating in the black markets and (more importantly) the rewards of operating in the

209. Volkov, *supra* note 52, at 4.

210. *Id.* at 1.

211. Because the speed with which property was being allocated was greater than that of institution-building, the emerging markets "spontaneously developed alternative mechanisms of protection and enforcement. These involved various private groups and agencies that managed organized force: criminal groups, private protection companies, informal groups of state security employees, and various semi-autonomous armed formations attached to the state "power" ministries." *See id.*

212. *Id.* at 2.

213. *See id.*; see also Shoshanah V. Asnis, *Controlling the Russian Mafia: Russian Legal Confusion and U.S. Jurisdictional Power-Play*, 11 CONN. J. INT'L L. 299, 308 (1996).

214. See Achim Wennmann, *The Political Economy of Transnational Crime and its Implications for Armed Violence in Georgia*, in Conference Proceeding 6, *The Illusions of Transition: Which Perspectives for Central Asia and the South Caucasus*, GRADUATE INSTITUTE OF INTERNATIONAL STUDIES (IUHEI), GENEVA, SWITZERLAND 105 (2004), available at, http://www.cimera.org/sources/105_117.pdf.

215. *See generally*, VARESE, *supra* note 128.

216. Jacques deLisle, *Lex Americana?: United States Legal Assistance American Legal Models and Legal Change in the Post-Communist World and Beyond*, 20 U. PA. J. INT'L ECON. L. 179, 185-7 (1999).

217. *See, e.g.*, Brandon Bennett, *Secured Financing in Russia: Risks, Legal Incentives, and Policy Concerns*, 77 TEX. L. REV. 1443, 1445-47 (1999).

legal market to increase drastically.²¹⁸ As a result, organized criminal structures started to exit the crime industry and establish a solid presence in the legal sphere.²¹⁹

This has caused the criminal organizations to transform into legal business enterprises that play by formal rules, engage in capital investment and charity, and behave more risk-aversely than their criminal progenitors.²²⁰ For example, the most powerful criminal group in the St. Petersburg region, *Tambovskaya*, invested in the oil business and created a large holding—Petersburg Fuel Company.²²¹ The leader of the group became its vice president.²²² Most of the notorious criminal leaders who have managed to survive government prosecution and territorial wars have turned into respectable capitalists with political aspirations.²²³

As state and private security agencies improved contract enforcement and private rights, many notorious crime organizations moved from the black to the white market. The elite of the formerly powerful criminal groups accumulated substantial capital and sought compromise with official authorities who are badly in need of investments.²²⁴ The formula became: “we respect the law and invest money in the legal economy; you let us be.”²²⁵

C. *Sicilian Construction Industry*

In Italy where the term “mafia” originated, a similar trend was seen between in the mid-1980s and mid to late 90s. Prior to the 1980s, Italian criminal organizations had deeply infiltrated all facets of Italian infrastructure including, and especially, the construction and transport trade.²²⁶ In the 1940s, the mafia had helped the Americans with the invasion of Sicily and it had retained the status of a “protector of the people.”²²⁷ Fearful of the communist threat, many politicians and a sizeable share of the populace tacitly supported the mafia as a way to

218. Volkov, *supra* note 52, at 2.

219. *Id.*

220. *See id.*

221. *Id.*

222. *Id.*

223. *Id.* This included, e.g., the owner of Krasnoyarsk Aluminium Factory (former boxer A. Bykov), as well as the founding father of the *Solntsevskaya* criminal group (Moscow entrepreneur S. Mikhailov).

224. *Id.* at 4.

225. *Id.*

226. Federico Varese, *How Mafias Migrate: The Case of the 'Ndrangheta in Northern Italy*, 40 L. & SOC'Y REV. 411, 427-8 (2006).

227. MARTIN J. BULL & JAMES L. NEWELL, *ITALIAN POLITICS: ADJUSTMENT UNDER DURESS* 106 (Polity Press 2005).

prevent the Reds from infiltrating the country.²²⁸ After the war, the mafia conducted its business through a protection racket in the poor countryside, where state influence was minimal.²²⁹ However, after the 1960s the mafia relocated to cities to participate in and take over the construction boom which the nation was experiencing.²³⁰

The mafia's power was so complete that in the 1970s and early 1980s all business contracts relating to their areas of operations included a fifteen per cent fee for the "Mafia risk."²³¹ By estimates, the mafia had more wealth than Exxon—the largest American corporation at the time.²³² The mafia acquired many construction businesses and forced their way into many construction contracts. In Palermo (and many other cities), for example, one can notice a plethora of unattractive buildings, roads that lead nowhere and overlap on themselves, and a lack of green parks and efficient parking areas—the mafia built nearly half of that city.²³³

Until the early 1980s, the State's response had been minimal and pedagogical—commissions convened for years, analyzed a mass of information, but concluded little of anything and purposefully overlooked the roles of politicians in assisting the mafia's growth.²³⁴ In 1982, the impetus to deal with the mafia increased for several reasons. For one, General dalla Chisea who had been given the job of defeating the mafia but then denied the resources that he requested, was murdered after only four months in the fight.²³⁵ This provoked a massive civil protest which prompted the government to pass stricter conspiracy and criminal organization laws and increase police enforcement.²³⁶ Additionally, the government started a major anti-mafia campaign headed by the lead prosecutor Giovanna Falcone, leading to the so-called Maxi-trial in 1984 where 473 defendants, including almost the entire mafia's leadership were tried.²³⁷

By the late 1980s, the push to stop the mafia had dampened, the investigations had ceased and even though more than 300 guilty verdicts were passed in the Maxi-trial, many of the convicted were re-

228. *Id.*

229. *Id.*

230. Varese, *supra* note 226, at 417-8.

231. BULL & NEWELL, *supra* note 227, at 107.

232. *Id.*

233. Diego Gambetta & Peter Reuter, *Conspiracy Among the Many: The Mafia in Legitimate Industries*, in *THE ECONOMICS OF ORGANIZED CRIME* 166 (Gianluca Fiorentini & Sam Peltzman eds., 2004), available at <http://www.publicpolicy.umd.edu/faculty/reuter/gambetta.pdf>.

234. BULL & NEWELL, *supra* note 227, at 108.

235. *Id.*

236. *Id.*

237. *Id.*

leased on appeal and the trial had become discredited.²³⁸ Yet In 1989, the drive for reform had once again caught fire and the Judiciary headed by now Judge Falcone, began conducting intensive systematic investigations into the Sicilian mafias and bringing criminals to trials.²³⁹ Additionally, the collapse of communism and totalitarianism across the world destroyed the mafia's image as a protector and reduced support for their collaboration with government officials.²⁴⁰ Moreover, the Roman Catholic Church, which had tacitly supported the mafia, finally came out of the closet on the issue.²⁴¹ Furthermore, the increased internationalization of the world brought in much higher competition from the Russian Mafia, Colombian Cartels, Chinese Triads, and Japanese Yakuza, reducing the available profits.²⁴² Finally, the assassination of Judge Falcone in 1992, helped galvanize the country into fighting the mafia, forced the Italian government to send in the Army, and led to a number of political reforms including those making it harder for government officials to be bribed.²⁴³

What is interesting to track, for the purpose of this article, is that the movement of mafia enterprises into the legal realm followed almost in parallel with the increased prosecutions, reforms, and competition. Many small and large mafia families exited the organized crime racket altogether and established themselves as legitimate businessmen during the mid 1980s and then once again in the mid-1990s.²⁴⁴ Hundreds of millions of dollars acquired through illegal means were transferred over to the legal sphere with this metamorphosis.²⁴⁵

238. *Id.* at 108.

239. MARK GILBERT, *THE ITALIAN REVOLUTION: THE END OF POLITICS ITALIAN STYLE?* 39 (1995).

240. BULL & NEWELL, *supra* note 227, at 109.

241. Rod Usher, *Heat on the Mob*, TIME INT'L, June 3, 1996, available at <http://www.time.com/time/international/1996/960603/mafia.html>.

242. See CarrieLyn Donigan Guymon, *International Legal Mechanisms for Combating Transnational Organized Crime: The Need for a Multilateral Convention*, 18 BERKELEY J. INT'L L. 53, 56 (2000). While globalization provided opportunities for international mafia cooperation, it also put the mafias at odds with each other. See Cao, *supra* note 73, at 65-6.

243. Barry James, *Meanwhile: Over Sicily, the Mafia Casts a Grim, Persistent Shadow*, May 13, 1999, INT'L HERALD TRIB., available at <http://www.iht.com/articles/1999/05/13/edjames.2.t.php>.

244. See SEE NAPLES AND DIE: THE CAMORRA AND ORGANIZED CRIME 178 (2002) ("the very availability of large amounts of money which arrive continuously, favours the faster and faster conversion of a [mafioso] into a businessman"); see also e.g., TOM BEHAN, *THE CAMORA*, 51, 90, (1996); see also Santino, *supra* note 187.

245. For example, \$280 million alone were invested by the Nuvolleta gang during the 1980s into such varied sectors as agriculture, cleaning contracts, construction, and leisure industry, THE CAMORRA *supra* note 244 at 90-1.

VI. PROPOSAL: MAKING THE JUMP/DETERMINING THE THRESHOLD

Thus, when all is said and done, the criminal organization strives for the same thing as the legal business organization—maximum profitability—lower costs and higher profits. When a legal business becomes more profitable than an illegal one, the transformation occurs. This section will synthesize and build upon the previous five sections to propose and analyze specific solutions that increase the costs of a criminal organization, lower the revenues, and raise the incentives for a full transformation into a legitimate corporation.

The migration of criminal enterprises to the legal sphere, uncovers the economic range where the benefits of being a legal business enterprise outweigh the benefits of being a criminal organization. Putting aside legalization of the good or service,²⁴⁶ the analysis in the sections above evokes seven major factors that generate this transformation: (1) increased costs of illicit business; (2) decreased profits from illicit transactions; (3) co-existence in both legal and illegal spheres becomes unprofitable for the enterprise; (4) the enterprise accumulates the minimum amount of capital necessary to enable financing a legal venture; (5) strong protection of private property rights through legal channels; (6) a high legal market return on investment; and, perhaps most importantly; (7) the transformation of the economic enterprise can be accomplished with relative ease.

A. *Costs of Illegality and What the Law Should Do*

1. Introduction

Increasing the costs of the criminal enterprise is the first step in facilitating the transformation.²⁴⁷ The main area the law should strive

246. There have been many excellent economic and social works written on how legalization of some goods or services (e.g., drugs) could actually ameliorate the situation. See, e.g., Friedman, *supra* note 50; see also Becker, *supra* note 27 (arguing that fighting a war on drugs by legalizing drug use and taxing consumption may be more effective than continuing to prohibit the legal use of drugs). However, it does not appear that legalization will occur any time soon, so this article will set that issue aside.

247. There is a nice fictional illustration of this point in a science fiction story by Poul Anderson, summarized in FRIEDMAN, *supra* note 14. “There is a potentially profitable trade route connecting two groups of stars which runs through the territory of an empire (“Borthu”) which seizes passing starships, confiscates their cargo, and steals their crews. The trading corporations could, if they wanted to, get together, build warships, and defeat Borthu. Doing so, however, would cost more than all of the profits to be made on the trade route. They could also arm their trading ships—but the cost of building and manning an armed ship would exceed the profit the ship would make. They could win—but, being rational profit maximizers, they won’t. The problem is solved [by an economist] as follows: arm one ship in four, reducing the profit but not eliminating it. Warships carry larger crews than merchant ships. Three times out of four, Borthu

to increase is the secrecy costs. The other costs of a criminal enterprise are easier to determine and are generally the normal focus of legal punishment and enforcement: e.g., destroying drug labs (raising fixed costs); increasing the rate of prosecution of racketeering thugs (increasing production costs); imprisoning drug mules, which in turn raises their salary requirements (raising distribution costs).

The criminal business' secrecy costs, conversely, are by their very reactive nature hard to uncover. Criminal businesses outsource part of their secrecy to third parties who are more efficient at maintaining the veneer, i.e., government officials who can conceal the illicit act. This outsourcing market is not very competitive—often bribery negotiations occur in a bilateral monopoly and there are only a few officials that can get the job done.²⁴⁸ Therefore, the law should raise the costs for criminal organizations to identify and bribe these officials.

The law should also strive to decrease the profits that can be reaped from illegal business ventures. In addition to the strategies for decreasing demand (just say no campaigns) or for decreasing supply (destroying cocaine fields), the law should be focused on attacking the mafia's realized profit by increasing the costs of laundering the illegal profits. This section will address the various costs that the law should endeavor to raise for the mafia.

2. Increasing Detection Costs

First, increasing the possibility of detection can be accomplished by using police agents as informants within the government organization itself and/or utilizing "sting" tactics to send agents to government officials to offer bribes.²⁴⁹ These tactics would elevate the corruption detection rate and make it costlier for officials to accept bribes. The government could also pay higher salaries to government officials thereby increasing the expected losses in case of detection.²⁵⁰ Alter-

attacks a trading ship, capturing it and its four-man crew. One time out of four, the trading ship is armed; Borthu loses a warship and its twenty-man crew. Every four attacks cost Borthu, on net, eight crewmen. Piracy is no longer profitable, so it stops. The logic of the problem, and the solution, is nicely summed up in [the economist's] reply to one of his colleagues, who suggests that they should fight even if it costs more than the trade is worth to them. "Revenge and destruction are un-Christian thoughts. Also, they will not pay very well, since it is hard to sell anything to a corpse. The problem is to find some means within our resources to make it *unprofitable* for Borthu to raid us . . . [T]hey will then stop raiding and we can maybe later do business." FRIEDMAN, *supra* note 14 (citing POUL ANDERSON, *Margin of Profit, in UN-MAN AND OTHER NOVELLAS* (1972)).

248. ACKERMAN, *supra* note 51, at 123 (1999).

249. *Id.* at 56, 58.

250. *Id.* at 78-9. Cf. Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974) (advocating compensation of enforcers to

natively, bribery funds or properties could be seized in addition to fining the official for the transgression.²⁵¹ Another solution is to increase the risk of detection for officials by minimizing administrative discretion and eliminating arbitrary decision-making. An official who has to follow regulatory codes, and can be monitored through objective standards, has much less autonomy and can be of much less help concealing a mafia's transgression. Consequently, this goal can be accomplished through an adoption of an administrative procedure code.²⁵² Finally, rewards and amnesty should be offered to government officials who come forward with information on bribery within the government organization (raise the benefits of detection and defection on the bribery and decrease the expected income after detection).

3. Increasing Monitoring Costs

Second, the law should also be structured to increase monitoring costs within the criminal organization itself; this in turn leads to increased agency costs. As the United State's experience during the 1970s showed, introduction of incentives for individuals within criminal organizations to inform on their organizations can be a useful tool.²⁵³ Such incentives as the witness protection program, reduction of sentence for a confessing witness, and infiltration of federal agents within the organization can greatly raise the costs of running a criminal organization.²⁵⁴ Employees of the criminal enterprise may make the best and most efficient tools in forcing criminal enterprises to take

have three components: "an 'entrance fee' equal to the temptation of malfeasance, a salary premium in each year of employment approximately equal to the income yielded by the 'entrance fee' and pension with a capital value approximately equal also to the temptation of malfeasance). As it were, enforcers post a bond equal to the temptation of malfeasance, receive the income on the bond as long as they are employed, and have the bond returned if they behave themselves until retirement. *Id.* Put differently they forfeit their bond if they are fired for malfeasance.

251. *See supra* note 62 and surrounding text, for a description of how bribe amounts are currently not being seized.

252. *See e.g.*, Daniel Gregory, *Civilizing the Russian Underground Economy: Requirements and Prospects For Establishing a Civil Economy in Russia*, 5 *TRANSNAT'L L. & CONTEMP. PROBS.* 65, 88 (1995). Here, one must be careful, however, to balance the benefits from tighter regulation with the resulting increase in bureaucratic inefficiency; lest we need more bureaucracy to maintain the expanding bureaucracy.

253. Jacqueline E. Ross, *Impediments to Transnational Cooperation in Undercover Policing: A Comparative Study of the United States and Italy*, 52 *AM. J. COMP. L.* 569, 584 (2004).

254. *Id.* E.g., Donnie Brasco was a famous FBI agent who infiltrated the Sicilian mafia for six years, and pulled out just before he was going to be killed. Jacobs & Gouldin, *supra* note 45, at 132. The information he gathered was invaluable to the war on the Cosa Nostra in the United States. *Id.*

higher information precautionary measures, thereby raising the enterprise's costs.

In fact, the incentives for confession and "turning" can be raised by allowing the employees more than just a "get out of jail free card" for crushing the cabal. Providing amnesty and monetary incentives (such as a flat fee or a portion of the civil damages of the enterprise) can help to destabilize the enterprise by providing quick monetary gain to anyone willing to blow the whistle on the illegal activities of the enterprise. Such *qui tam* actions have been used successfully to weed out illegality in corporate law and have been theorized for application to anti-trust law.²⁵⁵ Employees who are in the criminal organization are in the most efficient position to gather information on the illegal enterprise and at the same time have much to lose if someone else confesses first. It is indeed strange that such an efficient method has rarely, if ever, been used to increase the costs of the criminal organizations.

4. Increasing Laundering Costs

Third, another increase in costs for the enterprise must come from increasing the laundering costs for criminal profits. Profits are not final until they are laundered. Yet the BSA and PATRIOT Act laws have misplaced the incentives for banks to turn in criminal elements that utilize banking channels.²⁵⁶ The misalignment is between the government, which seeks to prevent the laundering, and the financial institution, which directly profits from it. Thus, the resources the bank devotes to checking the origins of each transaction will be inversely proportional to the amount of financial transactions they will do. The less they have to monitor the transactions the more business they can conduct.

The above laws have attempted to deal with this misalignment by imposing criminal penalties on banks that participate in transferring illegal funds.²⁵⁷ Yet, this imposes what is in essence an ex-post fine (Pigouvian tax) on financial institutions that fail to catch the illegal entities that utilize their financial networks. Such externally imposed fines may not lead to social optimality. On the one hand, banks may (and do) over-invest resources in investigation even where such investigation is not necessary.²⁵⁸ On the other hand, banks may under-in-

255. Bucy, *supra* note 136, at 56-7, 62.

256. See BSA and Patriot Act in *supra* notes 88-90.

257. *Id.*

258. See *e.g.*, Dept. of the Treasury, U.S. Money Laundering Threat Assessment, *supra* note 78 (the number of SARs filed by depository institutions from 1996 through 2003 increased on

vest resources out of concern for their clients' privacy—higher promises of privacy will likely attract higher capital.²⁵⁹ Thus, the low standard of proof and the ex-post quality of the fine reduces predictability and may both over and under deter client monitoring by the bank.

This efficiency problem could be resolved by providing a financial incentive to banks to monitor for potentially illicit funds. A monetary reward or a *qui tam* action could be granted to financial institutions, by paying them a portion of the funds which are seized in a successful prosecution of money launderers. For example, allowing the bank to retain the amount that it would have made in profits from the transaction with illegal funds (or more than that to account for the risk of under-detection) would allow the bank to devote the optimal resources to catching criminal-based transactions. Increasing such incentives to banks and other informal banking institutions would make money laundering prevention more efficient, by motivating banks to invest the resources necessary to find the illicit elements.

B. *Pinpointing and Facilitating the Transformation*

Most importantly, a successful metamorphosis will take place when the management of an illegal business can be confident that reseeding its resources into the legal sector will be worthwhile and unpunished. Because the risk that the illegal nature of the funds will be uncovered always looms, criminal enterprises may be hesitant to transfer all of their resources into the legal sphere until they know that their investments will not be seized.

1. The Transformation Principles

Looking at the economics and history of criminal organizations, three incentive principles emerge that fertilize the transformation and can help predict when it will sprout.

First, when the nature of the switch from illegality to legality is minor and the risk of detection of the illegal funds in the legal business is low, the criminal enterprise will have a large incentive to transform. This was the case in Sicily when mafia-controlled construction companies simply stopped the illegal part of the business (e.g., racketeering,

average by more than 25% annually. FinCEN indicates much of this increase may be attributed to “defensive filing” by financial institutions, in which SARs are filed on nonsuspicious transactions out of concern about regulatory and criminal scrutiny. Such defensive filing dilutes the value of the information in the BSA database.)

259. See McGuinn, *supra* note 100, Cao, *supra* note 101, and surrounding text (discussing banks that orient themselves to safeguard their clients' privacy regardless of the BSA).

falsifying contracts, bribing contract issuers) but maintained the legal business of construction.²⁶⁰

Second, when law and enforcement mechanisms strengthen the security of property rights and at the same time increase detection of illicit activities, criminal organizations will have an incentive to shift to legal industries. This was the case in Russia—years after the collapse of the Soviet Union criminal laws were strengthened, property and commercial laws were fortified, administrative regulations to prevent bribery were issued, and the rate of insider informants increased.²⁶¹ Russian mafias exited the underground and transferred their wealth from criminal channels into lawful business and politics.²⁶²

Third, a criminal enterprise will transform when there is a change in laws that forces a well capitalized criminal industry to look for other means of investment, while legal industries are simultaneously also looking for investment without setting high standards of due diligence as to the source of the funds. This was the case during the 1930s and 40s when the American Prohibition had ended and the mafia pulled the funds created selling alcohol and reinvested them into casinos.²⁶³ An underlying factor of this principle is the entrance of efficient, legal businesses into the illicit organization's prior-to monopoly market. This was the case when alcohol became legal after the Prohibition and when the New York waste-management industry became competitive.²⁶⁴ When mafias have to compete with legal companies to sell their product they will look to transform into the legal sector.

2. The Amnesty Provision

Finally, and perhaps most importantly, the law can be structured so as to provide a one time amnesty provision (a safe harbor) for enterprises that wish to rehabilitate. This would be accomplished by a uniform, one-time pass, allowing the illicit organizations to invest their money and efforts into legal channels. They would only be permitted to do this if they can show that they have fully exited the illicit industry. Just as the law allows criminals to rehabilitate by taking on legal jobs and integrating into the legal sphere, so too, it can offer a chance for rehabilitation to a criminal business.²⁶⁵ The alternative is hoping

260. See *infra* Part V(C).

261. See *infra* Part V(B).

262. See *id.*

263. See *infra* Part V(A).

264. See *supra* Part V(A); see also *supra* note 202.

265. Of course criminals that are caught are first punished and are only then rehabilitated. The fact is, however, that the criminal organization has not been caught (otherwise it would not

to catch the enterprise in the next act, something that has clearly not worked before or the enterprise would have already been behind bars. Offering full economic-rehabilitation presents a chance to integrate the enterprise's resources into the public sphere, while preventing the enterprise from committing another illicit act.

Thus, society would extend the incentive of profitability in the legal sector to the enterprises, so long as the transformation from an illegal cabal to a legal business is full and complete. At the same time, the law would heavily punish, both, mafias and legal enterprises financed by laundered funds, seizing accumulated capital and property of such organizations.²⁶⁶ Additionally, the law would increase the rate of detection for criminal enterprises by extending monetary incentives and safe-harbors to insider-informants. The law must also be carefully structured to ensure that the amnesty does not serve as an incentive for advancing criminal businesses to work towards a legal business as a goal—entering the criminal tunnel to get to the lawful light at the end. It should, therefore, have provisions to offer the amnesty uniformly, only once, and for a limited time period. For example, everyone would have from January 1st to May 31st to convert. This should serve as a rehabilitation incentive for those multitudes of organizations teetering near the threshold of the “finish line,” but afraid to make the jump for fear of punishment. At the same time it would not serve as a new incentive for potential entrants to the race.

3. Issues of Concern

In essence, then, the law would provide a carefully structured one-time safe-harbor gauntlet-elimination: all but the most efficient criminally secret businesses are demolished, while the ones that cannot be caught (the ones that have made it through the gauntlet) are given a safe harbor if they become legitimate and their resources are integrated into the public sector. Since the timing of the amnesty is limited and random and is only presented once, it will not provide an incentive for budding criminal organizations to become the most efficient for next time—because there will not be a next time.

be in existence) and so no punishment is put forth. The rehabilitation offered is thus preemptive.

266. While all laws punish the wrongdoer to some extent, criminal laws dealing with organized crime should be increased in enforcement and punishment. In addition to the ultimate goal of eradicating crime, the augmented penalties can also be justified because the criminals are given a parallel rehabilitation alternative.

a. What Happens to the Vacuum Left Behind?

One issue to contemplate may be that the transformation of the most efficient illegal organizations into legal ones would leave a vacuum for providing the illegal goods or services, which someone else would fill. Like the mythical hydra, if the law chops off one head, another will grow back since “for every Mafioso arrested there are another 10 desperate men ready to take his place.”²⁶⁷ First, as explained above, the proposed law and enforcement changes would not increase new entrants into criminal activities; in fact the increased penalties would dissuade some of the men meandering in the shadows. Moreover, when a criminal organization undertakes the transition under the shield of the amnesty provision, it will (and should be forced to) reveal a plethora of information about its past criminal activities.

This will allow the law enforcement mechanism to learn about the structure of the underground product or service; which will in turn preclude similar mistakes when it takes the fight to the next criminal organization. Additionally, structured criminal organizations take a long time to build. They must be built slowly, carefully, and covertly.²⁶⁸ The created vacuum, if there is one, would hence stand vacant for some time—the men waiting in the shadows would have to build a brand new organization from the ground up, in the place of the transported one. Meanwhile the law would continue to be ameliorated to secure property rights, increase punishment, and build up a legal and enforcement infrastructure where the product or service was being illicitly provided.

Finally, and notably, the newly transitioned organizations would themselves act to prevent another head from re-growing where theirs sprang out. First, the newly infused wealth would create jobs thereby increasing the economic status of the region (as mentioned above, growth of criminal organizations is inversely proportional to a region’s economic success). Second, economic stability is important for a business’ growth; the newly formed lawful organizations would thus seek to enforce stability to grow their own business. For example, when Sicilian and Russian criminal enterprises transitioned into legal channels, they attempted to break up the corruption and bribes going on the illicit side of that business. Additionally, the newly legitimized leaders of these organizations often seek political offices. Because il-

267. Usher, *supra* note 241.

268. While some criminals can quickly respond to demand increases for an illicit good, organizations that must survive past the initial creation of the demand are much slower to develop and branch out.

licit organizations often compete for political and administrative control, the newly elected political leaders will attempt to eradicate these shadow organizations in order to secure their own power.²⁶⁹ Thus, the newly created environment resulting from the transformation of a mafia into legality should substantially diminish a reemergence of new criminal organizations in its stead.

b. Does a Precedent Occur That Encourages Future Crime?

Another issue that may arise is that even though the amnesty is supposed to be a onetime offer, it could still be taken as a precedent. If it were, it would extend the hope to potential criminals that in the future another amnesty would be granted. Then illegal activity might even be encouraged, the criminals hoping to transition into a legal enterprise later.

This concern can be eliminated by ensuring that the one-time provision of the amnesty is explicit and enforced. Furthermore, the amnesty granted at the present point is a carrot, which carries with it an elongated stick comprising harsher punishments, stricter detection, and better law enforcement mechanisms. Criminal organizations take a long time to build. In the process they can be discovered and destroyed, especially with the above suggested improvements in the law. The mere hope that in the distant future a criminal may be able to become a legal businessman is unlikely to significantly increase the drive or profitability of forming or joining an illicit organization today.

c. Is the Law's Moral Power Questioned?

Besides simply making an activity illegal, the law often carries with it a moral condemnation of improper behavior. Stealing is not only wrong because a statute says so, but also because society considers it morally illicit. Thus, an objection could be raised that by providing amnesty to criminals, society is, at least implicitly, condoning the mafia's illegal activities. As a result, offering criminal organizations a blank slate promotes disrespect for the law and undercuts the moral high-ground from which policy is supposed to be administered.

269. As a parallel, terrorist organizations that are legitimized within a nation will often pursue and eradicate other terrorist factions that were once their friends in order to secure their own power. Political and economic legitimacy and the goal of attaining more power and money force the once-illicit organization to align its goals with that of the law. So long as a strong and proper infrastructure exists that prevents the corruption of the government itself (e.g., the Constitution, democratic elections) the organization should not be able to seize power, but will instead ameliorate society.

However, offering people and organizations a blank slate does not condone the activities that they conducted beforehand. In fact, the law recognizes the maliciousness and illicit character of the mafia's offenses and provides heavy penalties and punishments for the actions (when the criminals are caught). Yet, simply because someone had a troubled past does not mean that they cannot convert and become a productive part of society. The amnesty provision rests on economic grounds, and its surrounding provisions express disdain for illicit behavior.

Additionally, one must consider the alternative. Sitting perched on the Great Wall, closing one's eyes, and pretending that the barbarians are not at the gates because we are a nation of laws will not save the city if the arsenal of weapons used is ineffective. Mafias prevail and flourish in various countries, they siphon and waste valuable societal resources, and they will likely continue to exist despite law enforcement's best efforts, unless something is done. Some civilized nations are simply unable to deal with their internal barbarians because they refuse to acknowledge their existence or continue to grasp on to the hope that eventually mafias will come over to the bright side because that is "the right thing to do." Yet the fact remains, criminal organizations within a nation have not been lassoed and continue to perpetuate.

Without an incentive to convert, even stronger punishments by themselves are unlikely to stamp out criminal organizations, especially because there is only so much that today's civilized nations will do before questions of civil liberties arise. Under this article's proposal, the government will continue to communicate a consistent moral scorn towards illegal action, while making an economic decision to prevent many more future violations. The phantom cost is letting some crimes remain unpunished; but one must remember that most of these crimes would never be punished at any rate—the government has no way of collecting enough evidence to prosecute them. Allowing barbarians through the gates so long as they leave their swords outside and enter wearing a business suit, recognizes the economic and legal reality and acts to change societal welfare for the better.

VII. CONCLUSION

Thus, the transformation of illegal organizations into legitimate enterprises is most likely to occur when either one or all of the following occurs: (1) the nature of the switch to legality is minor and the risk that illegal funds are detected is low; (2) property rights are secured; (3) detection of illegal activities intensifies; and (4) a legal change

brings in competition from legal or illegal entities in the mafia's industry and compels the well capitalized criminal industry to search for other means of investment.

The law can facilitate, encourage, and even induce such a transformation by (1) increasing the secrecy costs of illicit activity; (2) providing economic incentives to enforcers (e.g., police, banks, witnesses, insiders, government officials) to turn in the illicit organization; (3) constructing legislative instruments to combat organizational crime and money laundering; (4) noting sizeable accumulation of capital in the hands of illicit organizations indicating their readiness to transform; and most importantly (5) structuring a way to quickly and efficiently transfer this capital into legal ventures.

We do not need to kill and eliminate all illegal businesses and every individual within those enterprises. The costs to society would be too much. Rather we should make it unprofitable for the existing entities to remain illegal and convert their resources to the public sector. Expediting this metamorphosis can help worms transform from their dark underground cocoons into beautiful butterflies that pollinate legitimate fields.