The Lie that Prosecuting Bank Fraud Will Destabilize the Economy Is What Is REALLY Destroying the Economy

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Failing to Prosecute White Collar Crime Guarantees a Weak and Unstable Economy … and Future Financial Crashes

The Departments of Justice and Treasury are pretending that criminally prosecuting criminal banksters will destabilize the economy.

The *exact opposite* is true.

Failing to prosecute criminal fraud has been *destabilizing* the economy since at least 2007 … and will cause *huge crashes* in the future.

After all, the *main* driver of economic growth is a strong rule of law.

Nobel prize winning economist Joseph Stiglitz says that we have to prosecute fraud or else the economy won't recover:

> The legal system is supposed to be the codification of our norms and beliefs, things that we need to make our system work. If the legal system is seen as exploitative, then confidence in our whole system starts eroding. And that's really the problem that's going on.
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> I think we ought to go do what we did in the S&L [crisis] and actually put many of these guys in prison. Absolutely. These are not just white-collar crimes or little accidents. There were victims. That's the point. There were victims all over the world.
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> Economists focus on the whole notion of incentives. People have an incentive sometimes to behave badly, because they can make more money if they can cheat. If our economic system is going to work then we have to make sure that what they gain when they cheat is offset by a system of penalties.

Nobel prize winning economist George Akerlof has demonstrated that failure to punish white collar criminals – and instead bailing them out- creates incentives for more economic crimes and further destruction of the economy in the future.

Indeed, professor of law and economics (and chief S&L prosecutor) William Black notes that we've known of this dynamic for "hundreds of years". And see this, this, this and this.

(Review of the data on accounting fraud confirms that fraud goes up as criminal prosecutions go down.)

The Director of the Securities and Exchange Commission's enforcement division told Congress:

> Recovery from the fallout of the financial crisis requires important efforts on various fronts, and vigorous enforcement is an essential component, as aggressive and even-handed enforcement will meet the public's fair

> expectation that those whose violations of the law caused severe loss and hardship will be held accountable. And vigorous law enforcement efforts will help vindicate the principles that are fundamental to the fair and proper functioning of our markets: that no one should have an unjust advantage in our markets; that investors have a right to disclosure that complies with the federal securities laws; and that there is a level playing field for all investors.

Paul Zak (Professor of Economics and Department Chair, as well as the founding Director of the Center for Neuroeconomics Studies at Claremont Graduate University, Professor of Neurology at Loma Linda University Medical Center, and a senior researcher at UCLA) and Stephen Knack (a Lead Economist in the World Bank's Research Department and Public Sector Governance Department) wrote a paper called Trust and Growth, showing that enforcing the rule of law – i.e. prosecuting white collar fraud – is necessary for a healthy economy.

One of the leading business schools in America – the Wharton School of Business – published an essay by a psychologist on the causes and solutions to the economic crisis. Wharton points out that restoring trust is the key to recovery, and that trust cannot be restored until wrongdoers are held accountable:

> According to David M. Sachs, a training and supervision analyst at the Psychoanalytic Center of Philadelphia, the crisis today is not one of confidence, but one of trust. "Abusive financial practices were unchecked by personal moral controls that prohibit individual criminal behavior, as in the case of [Bernard] Madoff, and by complex financial manipulations, as in the case of AIG." The public, expecting to be protected from such abuse, has suffered a trauma of loss similar to that after 9/11. "Normal expectations of what is safe and dependable were abruptly shattered," Sachs noted. "As is typical of post-traumatic states, planning for the future could not be based on old assumptions about what is safe and what is dangerous. A radical reversal of how to be gratified occurred."
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> People now feel more gratified saving money than spending it, Sachs suggested. They have trouble trusting promises from the government because they feel the government has let them down.
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> He framed his argument with a fictional patient named Betty Q. Public, a librarian with two teenage children and a husband, John, who had recently lost his job. "She felt betrayed because she and her husband had invested conservatively and were double-crossed by dishonest, greedy businessmen, and now she distrusted the government that had failed to protect them from corporate dishonesty. Not only that, but she had little trust in things turning around soon enough to enable her and her husband to accomplish their previous goals.
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> "By no means a sophisticated economist, she knew … that some people had become fantastically wealthy by misusing other people's money — hers included," Sachs said. "In short, John and Betty had done everything right and were being punished, while the dishonest people were going unpunished."
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> Helping an individual recover from a traumatic experience provides a useful analogy for understanding how to help the economy recover from its own traumatic experience, Sachs pointed out. The public will need to "hold the perpetrators of the economic disaster responsible and take what actions they can to prevent them from harming the economy again." In addition, the public will have to see proof that government and business leaders can behave

> responsibly before they will trust them again, he argued.

Note that Sachs urges "hold[ing] the perpetrators of the economic disaster responsible." In other words, just "looking forward" and promising to do things differently isn't enough.

Robert Shiller – one of the top housing experts in the United States – says that the mortgage fraud is a lot like the fraud which occurred during the Great Depression. As Fortune notes:

> Shiller said the danger of foreclosuregate — the scandal in which it has come to light that the biggest banks have routinely mishandled homeownership documents, putting the legality of foreclosures and related sales in doubt — is a replay of the 1930s, when Americans lost faith that institutions such as business and government were dealing fairly.

Indeed, it is beyond dispute that bank fraud was one of the main causes of the Great Depression.

Economist James K. Galbraith wrote in the introduction to his father, John Kenneth Galbraith's, definitive study of the Great Depression, The Great Crash, 1929:

> The main relevance of The Great Crash, 1929 to the great crisis of 2008 is surely here. In both cases, the government knew what it should do. Both times, it declined to do it. In the summer of 1929 a few stern words from on high, a rise in the discount rate, a tough investigation into the pyramid schemes of the day, and the house of cards on Wall Street would have tumbled before its fall destroyed the whole economy.
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> In 2004, the FBI warned publicly of "an epidemic of mortgage fraud." But the government did nothing, and less than nothing, delivering instead low interest rates, deregulation and clear signals that laws would not be enforced. The signals were not subtle: on one occasion the director of the Office of Thrift Supervision came to a conference with copies of the Federal Register and a chainsaw. There followed every manner of scheme to fleece the unsuspecting ….
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> This was fraud, perpetrated in the first instance by the government on the population, and by the rich on the poor.
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> The government that permits this to happen is complicit in a vast crime.

Galbraith also says:

> There will have to be full-scale investigation and cleaning up of the residue of that, before you can have, I think, a return of confidence in the financial sector. And that's a process which needs to get underway.

Galbraith recently said that "at the root of the crisis we find the largest financial swindle in world history", where "counterfeit" mortgages were "laundered" by the banks.

As he has repeatedly noted, the economy will not recover until the perpetrators of the frauds which caused our current economic crisis are held accountable, so that trust can be restored. See this, this and this.

No wonder Galbraith has said economists should move into the background, and "criminologists to the forefront."

The bottom line is that the government has it exactly backwards. By failing to prosecute criminal fraud, the government is *destabilizing* the economy … and *ensuring* future crashes.

Postscript: Unfortunately, the government made it official policy *not* to prosecute fraud, even though criminal fraud is the *main business model* adopted by the giant banks.

Indeed, the government has done everything it can to cover up fraud, and has been actively *encouraging* criminal fraud and attacking those trying to blow the whistle.

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