

# CAPITALISM'S ACHILLES HEEL

*Dirty Money and How to  
Renew the Free-Market System*

RAYMOND W. BAKER



WILEY

John Wiley & Sons, Inc.



## *Additional praise for Capitalism's Achilles Heel*

“*Capitalism's Achilles Heel* is an incredibly thought-provoking book, written for the business executive, the economist, the philosopher, the politician, and the human rights activist, all in one. Author Raymond Baker clearly articulates the superiority of the capitalist system to raise standards of living and reduce global poverty. However, as he so aptly describes in very thorough research, it is not the criminal element that hurts the world's poor as much as it is the intelligent and the well-off in the myriad ways we find to take advantage of weak and often corrupt countries. Our ability to be notionally legal but ethically and morally bankrupt is destroying capitalism, and *Capitalism's Achilles Heel* provides concrete advice on how to turn the tide, starting with those in leadership in both business and government.”

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Vice President and one of the trio of whistle-blowers  
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“Raymond Baker pictures a world of vast corruption, much of it accepted as standard procedure. Gathering his own evidence, he makes a compelling case, and he argues persuasively that if we could rein in the corrupting influences, free markets would work much better and we'd all be better off, rich and poor alike. He believes in change within the system. A fascinating book, an enjoyable read, and a lot to think about. I have quite a list of business and banking friends to whom I'm sending copies.”

—John Whitehead, former Co-Chairman of Goldman Sachs,  
former Deputy Secretary of State, former Chairman of the  
Brookings Institution, Chairman of the Lower Manhattan  
Development Corporation

“An engrossing account of a huge global issue, offering extraordinary insights for the professional and a study of human nature for all. With riveting case studies drawn from the real world, Raymond Baker successfully addresses the opposing aspects of legality and illegality, honesty and dishonesty, and the line between good and evil in a capitalist world.”

—Ray Kendall, Q.P.M., former Secretary General of Interpol

“This book is a challenge to western governments. Financial stability, justice between rich and poor, and the progress of democracy all demand

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—Lord Daniel Brennan, Queens Counsel, former Chairman  
of the Bar of England and Wales

“This book, with its uncompromising documentation, is especially welcome. Shameless money laundering through the great international banks, tolerated by both international agencies and national banking supervisors, not only supports crime and terrorism but cripples both governmental and private efforts to give hope and opportunity to the wretched billions condemned to desperate poverty. Raymond Baker's remedies, including tight definitions of money laundering and publicity to multinational tax returns, would make a real difference if governments had the guts to impose them.”

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than 30 other books

“We have sophisticated and convincing models of how capitalist economies work. Raymond Baker shows how thoroughly these models miss the reality of globalized commerce and finance. *Capitalism's Achilles Heel* analyzes the pervasive corruption of governments, banks, and corporations in vivid detail and shows how it facilitates the international trade in women, drugs, and nuclear technologies and how it supports terrorism, crime, and the persistence of extreme poverty. This book is essential reading for those who want to understand what our world is really like, and why.”

—Thomas Pogge, Department of Philosophy,  
Columbia University

“This book will become a landmark on the road to better relations between rich and poor countries. For decades, analysts have failed to look at the obvious—the broad range of financial manipulations that contribute to impoverishing billions of people worldwide. Raymond Baker understands how it works, and he tells it like it is.”

—Jack Blum, Partner, Lobel, Novins & Lamont

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*To  
Deren and Amy, Gayle and Jim,  
their friends,  
and their generation.*

*The best reason for optimism.*





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# PROLOGUE

THE GREATEST economic arrangement ever devised needs an overhaul. *Capitalism's Achilles Heel* invites you to join in this process, join in a journey that winds its way across the global free-market system. It begins with little illicit transactions and leads on through massive illegalities used by criminals, terrorists, and multinational corporations. It proceeds into global income inequalities, worsened by the illegalities that have come to permeate international capitalism. It continues into philosophical underpinnings that appear to justify flaws in the system. And finally it concludes with what we need to do to renew capitalism and spread its enormous potential across the whole of humanity.

Before we begin this journey, let me set the stage by telling you how I began my journey. For the first 15 years of my international career I lived in Africa. What took me there in the first place? After finishing Harvard Business School and while teaching the upperclass course in management at the University of New Hampshire, I decided to get a taste of business overseas. Job applications went out to some 200 companies, and offers came back to go to Iran, Nigeria, and Brazil. I chose Nigeria because it was a newly independent country and the job had an immediate start date. In 1961, the first year of the Kennedy administration, Africa was “the new frontier,” beckoning businesspeople, Peace Corps volunteers, journalists, diplomats, and adventurers to postcolonial nations brimming with opportunity and excitement. It was a heady time to be going abroad.

Before taking up my position in Lagos, I was assigned as a representative

to a U.S. trade fair in Accra, Ghana. This brought me into contact with the Rockefeller Brothers Fund (RBF) and its local agent, Bob Fleming, a burly, articulate American who had lived in West Africa for several years. Bob was a former military police officer in the U.S. Army, and the story was that he had served as James Jones's model for the tough M.P. in the book *From Here to Eternity*, a character played by Ernest Borgnine in the movie. Bob was closing RBF's office in Accra and moving it to Lagos and wanted to get his Land Rover into Nigeria. Customs duty would have to be paid on the import of the used vehicle, about £300, a little less than \$1,000. I and two other Americans, Bill Pribbeno, a wheat farmer from Nebraska, and Lyman McKee, a dairy farmer from Minnesota, offered to drive the Land Rover to Lagos and pay the duty, provided we could take the route we wanted, encompassing a large swath of West Africa. Bob wisely inserted his personal driver Steven into our group, in part because he spoke a bit of most of the languages we would encounter along the way.

We set off on our 10-day escapade on December 22, 1961, driving north out of Accra to Kumasi, the heart of the Ashanti region. Among the attractions of the city was the Kumasi Zoo, containing an impressive collection of West African wildlife. Walking through, we passed the cage of a gnarled old chimpanzee. As my traveling companions moved on, I lingered alone in front of this fellow's enclosure.

It reminded me of an incident out of my childhood, visiting an alligator farm. There, the tour guide related how caretakers would bring chicken, beef, rabbit, whatever, to the rail and grunt, "Uuuhhh, Uuuhhh." Knowing this was the signal for feeding time, the alligators would open their gaping maws and the bearers of rations would throw in the meat. While my parents went ahead I stayed behind and, with my most mature voice, looked at this big 18-footer and called out, "Uuuhhh, Uuuhhh." The gator opened its mouth, and, having prepared for my little bit of mischief, I threw a clod of dirt into its waiting jaws. Not altogether trusting the rail fence, I paused just long enough to see this monster sputter and thrash before tearing off to reach the safety of my family.

How would such utterances work on this primate now glaring at me through the cage bars? My voice had deepened, so no doubt my credibility would be enhanced. Facing each other in a one-on-one I bellowed the magic words, "Uuuhhh, Uuuhhh."

This was not a dumb ape. He put his paw behind his rear, discharged the contents of his bowels into his palm, and hurled the full load through the bars of the cage at his protagonist. No time to duck. SPLAT! My face, shirt, pants, and shoes are all hit with this brown, warm, icky, smelly mass.

Now, pause for a moment, taking in the whole scene. He's sitting there in his cage, I'm standing out here with you-know-what all over me, and I could swear to God this furry half-wit is laughing out loud.

Slinking off to rejoin my friends I get hit again with simultaneous queries, "WHAT HAPPENED TO YOU?"

"Don't ask."

We motored on north in our open-top Land Rover, through Tamale and Navarongo and crossed into Upper Volta, since renamed Burkina Faso, meaning "land of the upright men." Here in the Sahel, the base of the Sahara, the terrain, sprinkled with baobab trees, quickly turned more arid and much less populated, and our paved road gave way to a dirt track.

Needing a place to spend our third night out, we passed small villages of round mud huts often decorated with painted walls, sensing that we might frighten the occupants if we veered into their comfort zone, and suddenly lurched to a halt. Having driven some 50 miles from the border with our eyes peeled and as it was now past nightfall, we finally decided to chance it and stop at the next compound, go to the largest dwelling, and ask if we could spend the night sleeping in our Land Rover parked in front. Another five miles and something wondrous happened. We saw an electric light shining in the distance, out in the middle of nowhere. We worked our way in that direction, more lights, and we came upon a single-story, white bungalow with a tall, wrought iron fence around it. Pulling up to the front, we called out to announce our presence, and soon a uniformed steward came to the gate. Explaining that we were weary travelers, we asked if we could spend the night sleeping on the ground inside the fence. He disappeared for a moment and then returned to usher us into quite posh guest quarters at one side of the enclosed area—bedrooms, mosquito nets, toilets, showers, the works.

A bit later the steward appeared again and invited us to dinner, which we gladly accepted, still not having any idea what we'd stumbled onto. A table was set outside under the stars—white cloth, china, silverware, glasses. We washed up and put on decent clothes and appeared as instructed at 9:00 P.M.

In a few minutes out from the main house walks an absolutely beautiful blonde woman. We're wondering, is this a mirage or what? And a few minutes later out walks a second absolutely beautiful blonde woman. We sit down to a meal of soup, gazelle steak, potatoes, vegetables, and wine. After taking the measure of us, the ladies open up. The first relates that she is Parisian, married to an Italian contractor who owns a construction company in Ouagadougou, the capital. The second is her younger sister visiting from Paris. This is a weekend getaway house for the married couple, as the husband particularly likes to hunt lions. We feasted and drank until midnight, having chanced upon, according to our hosts, the one Shangri-La in 10,000 square miles.

The next day we bounced into Ouagadougou and traversed all 400 yards of paved roads of this premier metropolis of a new nation. No apparent hotels, so we asked a Catholic priest if we could sleep on the bench pews of his church; of course, he agreed.

A couple of days later we're in the middle of Upper Volta proceeding east on another corrugated track that jolted us up and down like rubber balls. I was sitting in the open rear on straw mats we brought as bedding, when I reached back to check my wallet and found it missing—driver's license, money, everything. Coming to a halt, we agreed to drive slowly back, stand up looking over the front and search for it, hopefully visible somewhere in the center of the road. This was a deserted stretch, so we might get lucky. We backtracked for about 30 miles, to no avail. In this distance, we passed only one person walking along the side of the road carrying a large straw basket on his head, covered with a cloth to protect its contents. As we dispiritedly turned again in our original direction, we decided to stop and ask if he had found anything in the road, a leather purse with papers and money. He took the basket off his head, untied the cloth, and handed me the wallet, with contents intact.

Coming into Niger Republic, we missed the last ferry across the Niger River and spent the night on our mats looking at the small city of Niamey, the capital, on the other side. After a day in this pleasant former French outpost, we motored on east.

December is the height of the harmattan season in West Africa, when dust storms in the Sahara blow fine-grained silica across all the Sahelian and coastal countries and even as far west as Brazil and the Caribbean. I was badly congested with lungs full of sand, so we decided to stop at a Sudan



Interior Mission (SIM) hospital, about midway between Niamey and Katsina, which is just inside the northern border of Nigeria. SIM had been active in Africa since the 1890s. The very accommodating Canadian doctor allowed us to sleep on the floor of his living room. The next day he gave me some antibiotics and then took us on a tour of his facility. He and two nurses treated an average of 400 patients a day. Based on word-of-mouth, Tuaregs, Mossis, Dioulas, Hausas, and others would walk hundreds of miles across the Sahel to reach this hospital, sometimes passing nearer clinics along the way. We watched as the doctor and his staff set broken bones and treated burns and cuts. He took us to the bedside of a case of smallpox, a four-year-old boy totally covered in pustules, with no more than two or three days of life remaining. And he took us to a lepers' colony that the hospital operated nearby, housing spouses and children as well as the stricken in order to keep families together, rather than cloistering away infected adults and leaving other family members at what might be even greater risk of malnutrition, starvation, and death. We all came away with a very large measure of respect for the work done by this fine organization, now merged into a larger group.

Late that afternoon, we're tooling along in southern Niger when we pass a line of white folks walking along the side of the road. Americans are recognizable almost anywhere, and these certainly were. We stopped and asked where we could get a hamburger and a milkshake, cheerfully bemoaning with these Peace Corps volunteers the lack of stateside amenities. One chap in his early twenties introduced himself as John Demos. I asked, "Any kin to Rafael Demos?"

He answered, "He's my father."

I had studied twentieth-century philosophical movements under Professor Demos at Harvard that preceding summer. Not only was he a stimulating teacher, he also had provided the classroom where I met Pauline, my wife-to-be. His son is now Samuel Knight Professor of American History at Yale.

Crossing into Nigeria, we drove on to Kano, a teeming city founded a thousand years earlier, with remnants of medieval mud walls still visible. More than a half-million tons of groundnuts (peanuts) in bags were being stacked in enormous manmade pyramids, awaiting rail shipment and export. Dyers working at scores of large communal vats produced indigo cloth for sale throughout West Africa. With paved roads once again, we motored

on through Kaduna and Ibadan to Lagos, completing 2,600 miles in 10 days, arriving at our destination on December 31.

Today, you would be taking your life in your hands if you made such a trip in much of West Africa. Bandits, carjackers, roaming thugs, corrupt officials, truck drivers stoned on hemp, AIDS, hospitals without medicines, dashed hopes, duplicity, and deprivation have combined to make many parts of the area inhospitable and unforgiving to strangers. The promises of political independence and economic development remain unrealized for millions of people. The onus for this outcome rests with both local elites and helpful foreigners, those who plundered and pillaged and those who abetted the process. The gap between early potential and later reality, not only for Africa but for scores of countries across the world, has stirred my imagination for years.

Settling down to work in 1962, I soon found myself managing the oldest bakery in the country, delivering bread daily to 200 market women spread around Lagos, at that time the nation's capital. By 1963, I decided to strike out on my own, so I incorporated a company in New York and returned to Africa's largest city to establish an office in Investment House. Pauline and I were married in New York some months later. For the next 13 years, from my ninth floor perch on the upscale side of Broad Street, I looked over the oldest part of Lagos, Isale Eko, two miles long by a half-mile wide (one square mile) with more than 200,000 people, making it one of the more densely packed places on Earth. I came to know the area extremely well and was often asked to take visiting foreigners on tours, particularly through Jankara Market, where thousands of traders sold food, utensils, native medicines, textiles, hardware, and just about everything else imaginable.

As the Nigerian Civil War—the Biafran conflict—began to draw to a close in 1969, Pauline and I decided to reward ourselves for endless business and personal risks we had been taking. We made arrangements to move into a spacious house beautifully situated on Five Cowrie Creek (so named because in years past it cost five cowrie shells, the currency of the time, to take a canoe across) in the Ikoyi residential section of the city. Before relocating our abode and while attending a late-night party at the home of the Bank of America manager, a Biafran plane bombed Lagos and then was shot down, plummeting in pieces into the creek. We grabbed up Samuel, one of two Ibo young men we'd been hiding in our attic for months for protection from tribal pogroms, changed him out of the clothes he was wearing to help at the

party, rushed him back to the safety of our home of recent years, and then tore off to see if the new place was still standing.

Arriving on the scene, we found various aircraft and human parts spread all over the premises. The cockpit was largely intact a few yards into the water, so I waded out, leaned in, and retrieved the plane's documents. At that moment a squad of armed and agitated Nigerian soldiers raced up, which required some fast explanations on our part as I appeared to be emerging from the wreckage and turning for the shore. Handing over the papers, I pointed out that the plane was a converted Nigerian Airways Fokker F-27 that had been hijacked a year earlier.

We moved into our new home a few weeks later. What made this place special was its large patio next to the edge of the creek, sheltered by shade trees and cooled by a breeze off the water. A half-mile across on the other side stood the American and Soviet embassies. Despite the occasional corpse that washed up on the shore or four-foot monitor lizard that slithered into the backyard, this was a place of quiet and repose in the midst of usual tumult. It was here that we talked, welcomed visitors, and entertained, but most importantly for me it was here that I peered across Five Cowrie Creek at those two embassies, representing opposing economic and political doctrines. They, symbolically, focused my attention on competing ideologies and their effects on people separated by enormous variations in resources and opportunities. Much of what follows in this book is from the perspective of that patio and the views it afforded, grounded in one part of the world while contemplating what happens in another very different part of the world.

By the mid-1970s, with ongoing military turmoil and rising corruption, Nigeria was becoming uncomfortable for an expatriate family with young children, so we returned to the States and settled in the Washington, D.C. area. I organized a trading company and for the next 10 years did extensive business in Central and South America, other parts of Africa, Australia and New Zealand, Southeast Asia, and with our biggest buyer, the People's Republic of China. In the late 1980s my activities shifted into offering and providing trade and financial advisory services to governments in developing nations, which enabled me to undertake confidential investigative work in a dozen countries. With this accumulation of experiences, I associated with the Brookings Institution in 1996 as a guest scholar in economic studies.

Over a period now exceeding 40 years spread across more than 60 countries, I have watched the free-market system operate illicitly and corruptly more often than anyone of my acquaintance. I have also seen the impact of such behaviors on the lives of disadvantaged people on all six inhabited continents. And I have reflected on how these conditions—widespread illegality and severe inequality—can exist within the doctrine laid out by Adam Smith precisely to avoid such outcomes. These encounters and observations encompassing lawlessness, inequality, and philosophy have opened for me an unusual window on the state of capitalism and have led to a series of conclusions substantially at odds with prevailing wisdom. The basic structure of our global economic system has fundamental flaws, and the accompanying risks are beginning to be evident to wealthy and impoverished alike. This is what I explore in this book, concluding with steps that must be taken if capitalism is to achieve its potential and lift the whole of humanity.

Several prefatory comments may be useful to the reader. First, having spent 35 years in international business before joining the think-tank world, I'm all for the free-market system—free trade, free movement of capital, free convertibility of currencies. I do, however, add a proviso to this: provided it's legal. It's the illegal component of such flows and their destructive effects and attendant rationalizations that have interested me for years.

Second, I make liberal use of the first person. Many points arise out of my own activities and research and are related as such. Also, my venture along the linkage between illegality, poverty, and philosophy has been a rather unique experience. While there is ample work by others on questions of law, the dimensions of inequality, and utilitarian and egalitarian concepts, there is little that reaches across this terrain, attempting to comprehend their combined impact.

Third, most stories and anecdotes are told and people named with well-documented notes (found at the end of the book). Some notes provide published references on points about which I, in fact, have first-hand knowledge. Quotes are attributed where possible and are given without attribution to those who asked for or were offered anonymity. At every point my goal has been to write as honest a book as possible, which I hope will become clear in the pages to follow.

Fourth, some paragraphs are disparaging of some elements in certain groups. I confess to struggling with the tension between candor and diplomacy and have decided to err on the side of clarity. Some readers may feel

that criticisms are inadequate, while others may feel they are overdrawn. I apologize to anyone who is disappointed or offended. At a minimum, the questions posed need to be carefully considered and answered.

Finally, I want to note, so it will not come as a surprise, that the tone of this work shifts as it flows through its stories and subjects. It moves from irreverence and disquiet and perhaps a familiar voice in the early pages to a more serious and at the same time hopeful spirit toward the end.

My objective in writing this book is to contribute to reform of the free-market system, not with any intent that it should be replaced. I sincerely hope that no one will come away thinking that this is an anticapitalist screed. My purpose is the opposite—to make the case for renewal of capitalism's immense capacity for good. It has long been clear to me that the best way to deal with a problem is to hold it up to the bright light of day and examine it from all sides. I arrive at this task having benefited abundantly from a process that rewards vitality and creativity, and I would hope to see similar opportunities extended to everyone. We must accomplish this in the future with a greater commitment to justice than now characterizes the way capitalism operates. Change within the system is necessary to its long-term success.



# GLOBAL CAPITALISM: SAVIOR OR PREDATOR?

*Candidates for fortune too frequently abandon the paths of virtue; for unhappily, the road which leads to the one and that which leads to the other, lie sometimes in very opposite directions.*<sup>1</sup>

—Adam Smith, 1759

*Today, the system of capitalism is at a crossroads.*<sup>2</sup>

—Joseph Stiglitz, 2002

“I’M NOT trying to make a profit!” This rocks me back on my heels. It’s 1962, and I have recently taken over management of an enterprise in Nigeria. The director of John Holt Trading Company, a British-owned firm active since the 1800s, is enlightening me about how his company does business in Africa. When I ask how he prices his imported cars, building materials, and consumer goods, he adds, “Pricing’s not a problem. I’m just trying to generate high turnover.”

Two years in graduate school reading balance sheets and income statements leave me totally unprepared for this bit of wisdom. I haven’t a clue why anyone would run a business with disdain for the bottom line. Staring at myself in the mirror every morning for the next two months, I ask, “Now why did you get an MBA?”

What could possibly be going on here? You know and I know that people will invest their money where they can earn a profit. Right? This is the fundamental precept, the foundation of capitalism. Right?

Wrong! A lot of people will invest their money in one place in order to earn a profit in a different place. John Holt was using artificially high import pricing as a mechanism for transferring all its profits out of Nige-

ria and back to Britain. It took me two or three years to realize that most foreign-owned companies were doing largely the same thing. And then it took another couple of years to learn that most wealthy Africans involved in foreign trade were illegally moving money abroad by the same means. As the decades rolled on and my activities spread to dozens of countries across the planet, I observed that countless forms of financial chicanery are prevalent in international business. Like an iceberg, the little that is visible is supported by vastly more hidden beneath the surface. Thus arose my understanding that the free-market system has a problem, which I have come to appreciate is a combination of several interrelated and undeniably serious problems.

“If a system cannot correct its major malfunctions, then it will be replaced.” Pierre Defraigne, director of north-south affairs at European Commission headquarters in Brussels, was my guest at breakfast. “Capitalism can become very corrupt. Profits should be made in the marketplace through quality of goods and prices, not through illegalities.” The topic was dirty money. “We think this is part of the normal functioning of the capitalist system. But it can be corrected and won’t limit efficiency. It’s up to those who defend the system to put their house in order.”<sup>3</sup>

House in order? It is difficult to argue that the free-market system is currently performing at the top of its game. While this is a book about global capitalism, a brief detour into what has been transpiring domestically, that is, within western countries, is useful. In North America and Europe, the breadth of business scandals and the recklessness of officers and directors in recent years have been simply astonishing. An assortment of frauds, thefts, corrupt practices, accounting irregularities, earnings restatements, asset write-downs, tax shenanigans, conflicts of interest, and other charges, probes, malpractices, and allegations have corroded the reputations of dozens of companies and sapped the net worth of untold numbers of shareholders and retirees. The list of financial institutions tarnished in the press reads like what should otherwise be the Who’s Who of propriety: Citigroup, J.P. Morgan Chase, Bank of America, Bankers Trust, Bank of New York, and some 55 more on the roster I maintain. The corporate rap sheet, ranging from spectacular failures to merely disgraced executives, includes Enron, WorldCom, Global Crossing, Halliburton, and nearly 100 more on my list. All Big 5 accounting firms have been tarred and feathered. The number of law firms taking heat is too long to recount.



Frank Partnoy, in his superb book, *Infectious Greed*, writes about how U.S. stock markets lost \$7 trillion of the wealth accumulated in the 1990s, and he goes on to say:

To any close observer of the changes in financial practices since the late 1980s, the collapse was not a surprise. New forms of risk and deceit now permeated every corner of the financial markets. Financial instruments had continued to develop in complex ways, and no one—including accountants, bankers, directors, regulators, or even plaintiffs' lawyers—was in a position to exercise even a modicum of control.<sup>4</sup>

For several years, the most publicized wrongdoings have captured our attention. They revealed to us just how wrong we were. We thought that these fine companies and their prestigious bankers and critical auditors and cautious attorneys were upholding the highest standards of corporate conduct, only to find out they were in cahoots to cook the books and deceive their employees, shareholders, and regulators. We felt thoroughly violated.

This is a book that also addresses violation but on a global scale. Much more disturbing than what has been happening inside our borders in recent times is the destructive manner in which we have been operating the capitalist system beyond our borders for many years. Subterfuge and dissembling have been far worse in the international arena.

The accumulated outrages of late began to embed themselves into our collective consciousness barely a decade after the twentieth century produced one of history's great turning points. The strength of capitalism became vividly clear, achieving its pivotal moment in the waning years of the last millennium. On November 9, 1989, young people wielding sledgehammers broke through the Berlin Wall, signaling the failure of the major competing ideology, socialism. The end of almost all remaining communist regimes swiftly followed, freeing Central and Eastern Europe and creating 15 independent nations out of the ashes of the Soviet Union. Even the surviving centrally planned economies—China, Vietnam, Laos, North Korea, and Cuba—were forced to recognize that private enterprise brought higher standards of living, leading each of the contrarians to begin or advance its march along the capitalist road. No alternative arrangement had demonstrated such an ability to marshal the initiatives and energies of so many people. After generations of uncertainty, capitalism had flat out won. The

most vocal free traders crowed that, despite occasional blips in emerging markets, the system was working as intended.

But the hubris was short lived. Aircraft were hijacked and crashed, the World Trade Center fell, and part of the Pentagon was destroyed on September 11, 2001, killing and injuring thousands in the world's greatest concentrations of financial and military might. As capitalism's most robust symbols toppled, a dozen years of hauteur ended for some people and were shelved by others. Terrorists had focused on the soaring self-confidence of America and by extension its allies and had, at least for a moment, set back the measure of certainty, of inevitability, that had come to characterize the western example and the tone of advice given to the rest of the planet. A realization that powerful and determined forces viewed the world in very different terms came as a rude shock to many.

Americans responded to 9/11 with incredible resilience. Yet, months later, even as deep pain and a thirst for revenge lingered, introspection began to creep into public dialogue and press commentary. Was it just religious extremism that brought on the terrorists, or were deeper frustrations, power disparities, income imbalances, and social disaffections evident in their motivations? Those who thought that democracy, capitalism, and globalization had emerged as standards after 1989 were set back when terrorists thrust a dagger into the body of the strongest nation in 2001. The anticipation that some fundamental consensus had been reached across vast stretches of humanity yielded to renewed uncertainty. As the Peruvian scholar Hernando de Soto had predicted a year earlier, "The hour of capitalism's greatest triumph is its hour of crisis."<sup>5</sup>

Within the critical review now hesitantly unfolding, some of the old arguments about capitalism are being revoiced. Optimists extol dazzling improvements in living comforts over the past 50 years, as incomes for the average person have more than doubled, and they are right. Pessimists lament that billions of poor are living at historically low standards or are only marginally better off than their ancient ancestors, and they are right. How can both be right? Or, more pointedly, if the first is true, why should the second also be true? The answer is, the second does not have to be, and the fact that it is true poses a danger to rich and poor alike.

Despite banking and corporate scandals in North America and Europe, practitioners generally regard capitalism as tested and proven in its ability to produce and distribute wealth. "Capitalism is the most successful wealth cre-

ating economic system that the world has ever known; no other system . . . has benefited 'the common people' as much."<sup>6</sup> It "encourages and rewards business behavior that is honest, fair, civil, and compassionate, and . . . heroic."<sup>7</sup> The misconduct of a few is seen as an aberration and certainly does not detract materially from the high level of perfection the system has achieved. "Not only are markets not too free, but they cannot possibly become too free."<sup>8</sup> For market fundamentalists, competitive self-regulation in economic and commercial affairs led by a wealthy vanguard is the panacea for society's ills. "Instead of an aristocracy of the merely rich, we are moving to an aristocracy of the capable *and* the rich. The financial revolution is opening the gates of the aristocratic clubs to everyone."<sup>9</sup> The prospect of a new aristocracy is offered as a wonderful design for the years ahead.

This book presents a different view. It penetrates the depths of crime, corruption, money laundering, tax evasion, and illegal transactions, joins these concerns to the impact they have on global inequality, relates both issues to some very basic conventions and ideas underpinning market economics, and hopefully extends perspectives on improving capitalism into new territory.

Lawlessness has permeated global commercial and financial affairs far more extensively than is commonly perceived, as explained in Part I. Writing on "the widespread incidence of fraud, corruption, organised crime and abuse of power" influencing the world economy since the 1970s, Harry Shutt, formerly with the Economist Intelligence Unit in London, laments "the progressive removal of restraints to such criminal activity and indeed increasing incentives to engage in it."<sup>10</sup> On the other side of Earth, a Pakistani banker groused to me, "We have lost the distinction between what is legal and what is illegal. No one hates people who get their money through illegal means. Society is not acting as a restraint."<sup>11</sup> The astute observer of Latin American affairs, Norman Gall, talking with me at the Fernand Braudel Institute of World Economics in São Paulo, characterized international capitalism as "perversities built upon perversities."<sup>12</sup> Yet, we willingly tolerate and indeed encourage a level of lawlessness in global trade and investment that threatens the capitalist system.

The linkage between gross violations of legal norms and the diminished lives of billions of people surviving on a dollar or two a day is not often discussed in polite circles, but will be here, in Part II. "If we have no answer to our appetite for dirty money, we have no answer to the alleviation of

poverty,” confided a French banker.<sup>13</sup> But “the question of income disparities has been lost in the competition for growth rates,” contended Gil-Sung Park, a sociologist sharing views with me in Seoul. “Growth and distribution; can they go together in a common debate? They must go together.”<sup>14</sup> Peter Dougherty, an editor at Princeton University Press, ponders “. . . why no one seems to be paying any attention to the social and political dilemmas that continue to beset capitalism—such as deepening inequality in the presence of soaring affluence. These dilemmas are brought about by the very success of economics, . . . at the expense of a more expansive and critical worldly philosophy.”<sup>15</sup> Yet, for most people, poverty and inequality are peripheral issues properly left to specialists in international financial institutions, largely irrelevant to capitalism’s more fundamental concern with market access and wealth accumulation.

Both of these conditions—lawlessness and inequality—find justifications in twisted interpretations of the free-market system’s founding tenets, addressed in Part III. Adam Smith, who opted for the interest of the poor rather than the rich at every intersection in his writings, is rolling over in his grave. While appreciating a rise in wealth, widespread abuses in global movements of trade and capital, combined with staggering gaps in income levels taken as inevitable and tolerable, is the opposite outcome from what he hoped would arise. “No society,” he said, “can surely be flourishing and happy, of which the far greater part of the members are poor and miserable.”<sup>16</sup> Smith’s vision has been largely set aside, and instead capitalism has drawn its sustaining rationale from his contemporary, Jeremy Bentham, who despised the idea of inalienable rights and argued that it is acceptable to sacrifice the rights or the interests of some people for the good of others. This core idea—that the well-being of a part of society can be overridden for the advantage of another part of society—brutalizes our practice of capitalism in a way completely unimagined by its seminal thinkers.

These three—illegality, poverty, and distorted philosophy—exist on a continuum, and it is these combined systemic shortcomings that reveal capitalism’s Achilles heel, summarized in Chapter 11 of Part IV. Looking at each one yields insights into the other two, and an understanding of all three is necessary to an understanding of each. Illegality contributes to inequality. Inequality is worsened by warped philosophy. And perverted philosophical maxims underpinning capitalism serve to excuse rank illegitimacy and severe inequality.

We give short shrift to such concerns when we consider each in isolation. Frankly, as I have learned over many years, it does little good to look at illegal financial dealings detached from the larger context within which they thrive. How many times have I heard the question, “Why should I care?” It is too easy to view such machinations simply as games played by the rich. Grasping the impact these subterfuges have on the whole of humanity has been missing in public dialogue for too long.

Equally, it does little good to look narrowly at inequality and poverty and shrug our shoulders, self-satisfied that this is their problem. For many people, meting out foreign assistance, however begrudgingly, is the limit of obligation. The contrasting fact is, our gains in income in the West flow in part from losses in income in other regions, a point I hope will become unmistakably clear in later sections of this book.

Equally again, philosophical inquiry is now largely separated from public policy. Philosophy can and often does become culture, embedded in the way we rationalize and live our lives. Today, the prevailing precepts underpinning capitalism lend a measure of comfort to justifications for a divided and hypocritical world.

The harmful aspects of modern capitalism which I am addressing—illegality, inequality, and misapplied philosophy—can be viewed as segments on a line, with illegality on one end, inequality in the middle, and economic philosophy on the opposite end. Dropping down on any part of this line leads logically to the other parts of the line. And what becomes evident with growing clarity is the connection of each to the others. This is what has fascinated me for years: the juncture, the nexus, between illegality and inequality, between inequality and philosophy, and between distorted philosophy and its outcomes in poverty and lawlessness.

It does not really matter to the story I am telling whether you start with illegality and trace it through to its effect on inequality and its sustenance in outdated philosophy. Or you do the opposite, and start with misshapen philosophical precepts and trace them through to their impact on inequality and lawlessness. Or you start in the middle with inequality and look on either side at its contributing causes. The linkages are evident wherever the starting point. What I strive to do is integrate these three into a continuum, a triptych, a multiscreen picture, that provides a perspective on the nature of global capitalism as it has come to be practiced today. Together, it is the

interrelated parts of this continuum that constitute capitalism's Achilles heel and present the threat to stability and prosperity that must be resolved.

Are the challenges of these three issues so overwhelming as to be insurmountable? Absolutely not, the subject of Chapters 12 and 13. First, illegalities that permeate our pursuit of global free markets can be greatly curtailed with a few strokes of the pen and without harming efficiency and growth. This is not a defeatingly complex issue; it is instead a matter of political will. Second, inequality can be markedly reduced to the advantage of rich and poor together. This will occur, not through the timid pursuit of poverty alleviation, but through sensible steps underlying our own commitment to shared good fortune. And third, a major contradiction needs to be confronted—the contradiction between fresh thinking emerging from schools of philosophy in America and Europe and entrenched justifications for the status quo in the free market's supporting canons. Revised canons can guide us beyond an economically disjointed planet toward one in which capitalism extends its opportunities and benefits to the whole of humankind.

Anything less than addressing all three of these concerns means that capitalism will remain far short of its full potential. This book quite purposefully takes a holistic view of global capitalism and seeks resolution of problems created or worsened by what has now become a deeply flawed system.

"Markets are made to serve man, not man the market," wrote John Gray, a leading British intellectual.<sup>17</sup> "We take a great risk if we don't combine freedom of markets with social policies that address imbalances," asserted Muhammad Yaqub, a distinguished central bank governor talking with me in Pakistan. "Globalization is driving impatience. People are living in dirt. It's not a vocal minority but a silent majority that must be heard."<sup>18</sup> "With its victory over communism," wrote Hernando de Soto, "capitalism's old agenda for economic progress is exhausted and requires a new set of commitments. It makes no sense continuing to call for open economies without facing the fact that the economic reforms underway open the doors only for small and globalized elites and leave out most of humanity."<sup>19</sup>

Among the readers of this book, I hope that businesspeople and bankers will come away with a heightened awareness of just how badly we are undermining one of the greatest systems ever devised. I hope lawyers and accountants will seriously reconsider the advice given to corporate clients that places them in a position of risking felony offenses. I hope that development economists will resolve to seek better data on the hundreds of billions, accu-