INTRODUCTION: CRIMINOLOGICAL PERSPECTIVES OF THE CRISIS

Writing shortly after the economic turmoil that began in earnest since the fall of 2008, it is clear to any reader what is meant when reference is made to "the" crisis. The financial crisis that developed out of the implosion of the United States housing bubble that reached its peek around 2006–2007 no doubt can be told, in its origins and consequences, in terms of a complex economic tale. But even and especially for nonexperts, the crisis need not to be argued to be of special significance in any more detail than to consider the reality that, on a near worldwide scale, millions of people have lost their jobs and/or their homes, while governments have been scrambling to develop appropriate policies to rectify conditions which they had helped to create.

Naturally, the crisis is primarily a matter of economics, finance, and other such issues which, from a technical-practical viewpoint, are outside the purview of sociology and criminology. Yet, what can be valid as well as useful about social-science perspectives devoted to the study of crime and crime control, as the contributions in this volume will testify, is to focus on those dimensions, dynamics, and implications of economic crisis that belong most intimately to the scholarship of criminology, in general, and criminological sociology, in particular.

Social scientists have historically devoted much attention to a wide range of societal implications related to crises in the economic realm. Karl Marx (1867) virtually equated the study of the forces of capitalist production with the study of crisis, as he saw economic crises and their political and other social implications as a phenomenon inherent to the development of capitalism. More restrained and arguably more sociological in orientation were the relevant perspectives developed by Emile Durkheim and Max Weber. In his essay *Die Börse* (*The Stock Exchange*), Max Weber (1894) argued, on the basis of his theory of rationalization, that financial actors legitimize their work with reference to their specific expertise and that, therefore, any moral considerations may be less appropriate to consider than are financial-technical concerns. From a different approach, Durkheim (1893, 1897) offered a sociological perspective of the organization of labor in society that devoted special attention to the distinctly social or moral implications of crisis moments in the economic realm by examining the consequences for crime, suicide, and other behavioral patterns.

The intellectual foundations of criminology and criminological sociology have likewise on occasion focused on the impact of crisis on crime and its control, typically as part of a more general focus on economic development and organization. The seminal works of Bonger (1916), Sellin (1937), and Rusche and Kirchheimer (1939) come to mind. In the further unfolding of modern sociology and criminology, economic crisis has from time to time remained an issue of concern, especially among critical criminologists who aligned, in more or less explicit fashion, with Marxist theorizing (Godefroy & Laffarguelien, 1984; Greenberg, 1993; Greenberg & Humphries, 1982). Yet, it is also true, perhaps logically so, that the theme of economic crisis strikes scholarly thinking mostly then when a crisis occurs. By its very nature, a crisis is somehow delineated in time and space, even and especially when it is intense and highly consequential. The very nature of a crisis, then, perhaps explains why it has served as an inspiration for scholarly reflection only on certain moments, though this cannot be an excuse for scholarly indolence. In any case, the present day is a time for serious reflection on economic crisis, and the authors in this book show that social scientists with an attention for crime and crime control are up to the task.

Briefly reviewing the chapters in this volume, a first set of contributions deal with the mortgage crisis, arguably the most central component of the crisis from an economic viewpoint. Tomson Nguyen and Henry Pontell analyze how deregulatory fiscal policies created conditions that brought about a tension with legislation to foster racial and economic equality. Deregulation contributed to increase fraud by lenders, which disproportionately impacted minority populations. Laura Patterson and Cynthia Koller also address the fact that lenders were willing to take on more risks. They show how business practices associated with housing led to the creation of a criminogenic environment with homebuyers as its primary victims. Nicole Piquero, Marc Gertz, and Jason Bratton address the mortgage foreclosure crisis by analyzing the public perceptions of the crisis as one among other influences on crime control policy. The authors find that a majority of the public blames the banks and the lenders for the crisis and additionally that about half of the examined respondents favor regulation of relevant economic enterprise. Within the context of predatory lending, Harold Barnett, finally, discusses the case of a subprime loan made out to a straw borrower which victimized an African-American couple in Chicago. Barnett details this interesting and puzzling case of equity stripping fraud, including the role played by investment bank Goldman Sachs.

The chapters in Part II address various aspects of the criminologically long-standing topics of corporate and white-collar crime in the context of the crisis. Michael Levi examines the societal reactions to white-collar crime under conditions of the financial crisis. He argues that the crisis affected government reactions to fraud, yet also that the seriousness of business-elite crimes has been downplayed, unlike other crimes. Wim Huisman offers food for thought to unravel the causal mechanisms of corporate crimes and the economic crisis. Identifying four possible scenarios, Huisman astutely differentiates between the causes of criminal behavior and the processes of the criminalization of such behavior. Focusing on one specific form of white-collar crime, David Shichor, Henry Pontell, and Gilbert Geis analyze three cases of illegally backdated stock options. The authors dutifully recommend multidisciplinary attention to the issues by combining both economic and criminological expertise.

The final part of this book includes chapters that examine various consequences of economic crisis for criminal developments and law enforcement. Paul Harris offers a theoretical discussion of the criminal consequences of various changes that have been brought about in neighborhood structure as a result of home foreclosure. Reviewing strain, social disorganization, and disorder theories of criminology, the author introduces the notion of suburban insulation as an appropriate conceptual avenue to the problem at hand. Richard Peterson examines the relationship between (un)employment and intimate partner violence on the basis of data from the National Crime Victim Surveys. Contradicting suggestions made in the news media, he shows that unemployment is only weakly related to rates of intimate partner violence. Finally, Darrell Irwin investigates how local police departments across the United States have been affected by the economic recession, specifically by having faced budgets cut. This development, of course, has affected the quality of police work that can be offered, which in turn may have consequences with respect to criminal developments.

As a whole, the chapters in this book hope to offer a useful set of analyses of criminological issues concerned with important aspects of economic crisis that will appeal to students and scholars in criminology, sociology, economics, criminal justice, and other relevant social sciences. The unprecedented scale of the economic recession that has begun since the late 2000s on a global level will necessitate criminologists from various disciplinary background to take these issues seriously for quite some time to come.

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Mathieu Deflem

ECONOMIC CRISIS AND CRIME

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FRAUD AND INEQUALITY IN THE SUBPRIME MORTGAGE CRISIS

Tomson H. Nguyen and Henry N. Pontell

> Not only is home ownership an integral part of what many refer to as the "American dream," it also strengthens communities by turning mere residents into investors with an ownership interest in the places they live.
>
> *Remarks by Governor Mark W. Olson before the Consumer Bankers Association 2005 Fair Lending Conference, Arlington, Virginia* (Olson, 2005)

> The current financial crisis in the U.S. is likely to be judged in retrospect as the most wrenching since the end of the Second World War.
>
> *Alan Greenspan, March 16, 2008*

> This could be the single greatest loss of Black wealth since the Great Depression … .
>
> *New York City Councilman, James Sanders (CBS)*

ABSTRACT

This chapter examines how deregulatory fiscal policies undermined federal legislation intended to reduce racial and economic inequality through measures that included wider access to home loans among minority populations. We focus specifically on structural tensions that existed between fostering the goals of economic and racial equality within a political structure that also serves the needs of finance capitalism. The Community Reinvestment Act (CRA), typically considered a triggering point for the financial meltdown by conservative commentators, was passed to address racial and economic inequalities, yet financial

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deregulation and the growth of the subprime mortgage industry ended up completely subverting these goals. The unprecedented growth and evolution of the subprime mortgage industry that occurred largely outside of the law's reach helped minorities and other economically disadvantaged groups enter into the housing market. However, a crime-facilitative environment brought on by inadequate regulation resulted in a significant degree of fraud by lenders. While this expanded homeownership among minorities, it eventually pushed them into default and brought chaos to the entire U.S. economy. This chapter details how the collapse of the subprime industry disproportionately impacted minority populations, and exposes how deregulatory policies subverted the effectiveness and reach of the FHA and CRA. The history of the CRA provides a clear example of the contradictory tensions within the U.S. legal system that espouses equality yet ultimately fails those it was designed to help as a consequence of unfettered capitalism.

INTRODUCTION

Homeownership has long been considered the cornerstone of the proverbial "American dream." Owning a home comes with great pride and is viewed by most persons as a symbol of success and wealth. Moreover, homes are seen as among the most solid investments. Prior to the subprime mortgage crisis of 2007, most Americans believed that residential real estate would always appreciate in value. There were two major prevailing logics that were part of the American psyche: (1) the value of real estate would never depreciate and (2) people would always make their mortgage payments. The subprime mortgage meltdown and unprecedented loss of homeownership from the global economic crisis has proved this belief patently false (Ip, Whitehouse, & Lucchetti, 2007).

As the crisis unfolds, a significant number of families have either lost their homes or are financially trapped in their current mortgages and simply waiting for their homes to be taken from them. According to Realtytrac more than 900,000 homes were repossessed from American families in 2009, and the number is expected to climb over 1 million in 2010 (Veiga, 2010). At the time of this writing, there are currently over 2 million homes in foreclosure proceedings (Hoffman, 2010).

Progress toward economic equality in the financial industry has been fraught with turbulence similar to that experienced in the civil rights movement. Despite the achievements of the latter that greatly reduced forms of overt racism, scholars note the pervasiveness of a more subtle, yet pernicious form of intentional discrimination, they refer to as institutionalized, structural, or "the new racism" (Feagin & Feagin, 1978; Smith, 1995; Knowles & Prewitt, 1998). They argue that the absence of overtsegregation, lynching, burning crosses, shackles, and whips does not necessarily imply that racism and discrimination has actually disappeared since the civil rights era, but rather that the forms have changed, represented by less obvious manifestations. For example, in contemporary society, racism masquerades as racial "blindness" in schools (the idea that ignoring or overlooking racial and ethnic differences promotes racial harmony), anti-affirmative action campaigns, and conservative movements intended to thwart government spending on programs intended to aid the poor and ethnic minorities.

Until the early 1990s, the mission to provide greater access to the American dream was based on a primary premise – rather than denying mortgage applicants with credit problems, financial institutions should increase opportunities to less creditworthy borrowers, a disproportionate number of whom are African-Americans and Hispanics. Greater access to credit was considered a solution to economic inequality, and more specifically, the widespread problem of discriminatory lending practices that excluded minority groups from obtaining home loans. While the move to expand homeownership to a wider population began in the late 1960s, it was not until the early 1990s that the number of minority homebuyers skyrocketed. Homeownership among minorities would increase between1994 and 2004 more than any other time in U.S. history (Kochhar, Gonzalez-Barrera, & Dockterman, 2009).

The 1968 Fair Housing Act (FHA), an expansion of the Civil Rights Act of 1964, made it illegal to deny a mortgage loan or a real estate transaction to a borrower on basis of race or ethnic background. Despite these positive developments, minorities were still excluded from the housing market primarily due to strict credit requirements and issues relating to affordability. Homes were expensive. A 30-year fixed-rate mortgage with a large down payment was the only option available for borrowers who wanted to purchase a home. The solution was to establish niche loan industry that focused primarily on minority borrowers; an industry in which loan qualification standards were reduced, and the terms and conditions more varied to "increased" affordability. The subprime or nonprime mortgage industry was the result. These mortgages were intended for borrowers with poor credit histories and limited assets. As it turned out, these loan products contained higher costs, fees, and penalties, and increased affordability to the less creditworthy was just an illusion. Borrowers of subprime loans were generally less financially secure but paid more out of pocket premiums, monthly payments, and penalties compared to a prime loan of an equivalent amount.

DISCRIMINATION AND THE MORTGAGE INDUSTRY

According to Wellman (1993, p. 55), racism is a "structural relationship based on the subordination of one racial group by another … it involves the ideas and practices that create and maintain a system of white racial privilege." Contemporary forms of racial discrimination commonly manifest as institutionalized, economic, or class discrimination. In modern society, inequality can no longer be assessed by racial factors alone, but must be inclusive of social conditions that allow for the reproduction of stereotypes and prejudices. Modern forms of racism take on the form of nonracial dynamics, such as market dynamics, cultural limitations, and economic status. Bonilla-Silva (2006) explained this new form as "color-blind racism," and its consequences can be more devastating than the blatant racism that existed in the past. Post-civil rights era color-blind racism now appears as the chosen weapon of conservative status quo groups, politicians, and social movements to maintain white privilege.

April 2008 marked the 40th anniversary of the Federal FHA of 1968, which "prohibits discrimination concerning the sale, rental, and financing of housing based on race, religion, national origin, sex (and as amended), handicap, and family status" (U.S. Department of Housing and Urban Development, 2003). A primary goal of the act is to "achieve a truly integrated and balanced living pattern" by eliminating racial discrimination in real estate, such as racially restrictive covenants (RRC). Restrictive covenants refer to contractual agreements imposed on the buyer of a property by the seller of the property, and are common in real estate transactions. For the most part, restrictive covenants are simple, such as maintaining the front yard of the property. Racially restrictive covenants, however, prohibit the occupancy, sale, and/or rent of the property to "white persons only" (Monchow, 1928; Dean, 1947; Stach, 1988). Racial deed restrictions became common during the 1920s. These contractual agreements are intended to maintain the racial homogeneity of a community. Despite being declared illegal in 1948 by the U.S. Supreme Court, RRCs were still commonly in use since the decision failed to affect the informal structure of racial segregation (see *Shelley v. Kraemer*). Specifically, the

Court found that the enforcement of racially based covenants were unconstitutional, but not the covenants themselves. Transactions between private parties were legal; it remained perfectly legal for realtors and property owners to discriminate on the basis of race (U.S. Commission on Civil Rights, 1973). Only after Congress passed the Housing Rights Act in 1968 was the practice finally eliminated.

Despite these achievements, the FHA had little measurable effect on the overall discriminatory practices that existed in the financial industry. Banks and lenders created imaginative discriminatory lending practices that circumvented the restrictions imposed by the FHA of 1968. One such practice is known as redlining, or the refusal to extend credit to geographical locations that are historically and predominately minority communities (Eisenhauer, 2001). Economists and historians have pointed to redlining as a significant cause of urban decay and disinvestment (Holloway, 1998; Thabit, 2003). About a decade later, Congress passed the Community and Reinvestment Act (CRA-1) in 1977. The CRA-1 served two primary purposes: (1) to address discriminatory lending practices such as redlining and encourage local banks to invest in their communities and (2) to address economic inequality in the banking industry by increasing access to credit opportunities.

Despite the passage of both of these laws, discrimination-based lending still remained a major problem in the industry. In a Pulitzer Prize Award winning piece, "The Color of Money," Dedman (1989a, 1989b) found that redlining – refusing to lend in an area because of race – has persisted and may have grown worse since the passage of CRA (Dedman, 1989a, 1989b, p. A1). He found that between 1981 and 1986, banks and thrifts in metropolitan Atlanta favored lending to white areas by a margin of five to one. Among stable neighborhoods of the same income, white neighborhoods always received the most bank loans per 1,000 single family loans. Racially integrated neighborhoods received fewer loans and black neighborhoods always received the fewest. The report found that "that race – not home value or household income – consistently determine lending patterns of metro Atlanta's largest financial institutions" (Dedman, 1989a, 1989b, p. 1).

It became clear that overcoming emerging manifestations of institutionalized racism in the banking industry required more than just superficial regulatory efforts and symbolic regulation. When financial institutions have been found to violate the provisions of the CRA, they face fines and penalties that include denial of special applications (e.g., mergers, acquisitions, and new branch locations). Dedman (1989a, 1989b) found that the federal government's annual exams of banks to ensure compliance with community lending standards were trivial at best. Between 1979 and 1989, federal regulators ''denied a mere 8 out of 50,000 special applications by banks due to unfair lending'' (Dedman, 1989a, 1989b, p. 21). These annual government audits were ''tests that few banks fail – in the federal eyes'' (Dedman, 1989a, 1989b, p. 21).

To strengthen the federal law and to improve communities and home-ownership opportunities, the Clinton administration led the charge to modify CRA-1. The 1995 modifications to law (1) increased federal regulators' authority to monitor banking activities, (2) applied additional pressure on banks to provide loans within their communities, and (3) substantially increased the number of subprime mortgage and small business loans (Canner & Passmore, 1997). The modified law (CRA-2) also led to the emergence of a secondary market for CRA subprime loans. In 1997, the first CRA mortgage-backed securities were offered on Wall Street (Westhoff, Clark, Bainbridge, Smith, & Hubbard, 1998). Despite the noble intentions behind the new measures and subsequent changes of CRA-1, the law was harshly criticized by economists and the banking industry who charged that subprime loans posed greater risks for banks. Despite their increased profitability margins, financial institutions were extremely reluctant to extend credit to low-income minority populations. Apgar and Mark (2003), however, contend that the CRA resulted in significant positive changes in lending practices to minorities and minority communities.

The passage of these measures was intended to address discriminatory practices, but the subsequent growth of the subprime industry also led to an increase in a more discreet and mostly legal race-based lending practice – predatory lending.

PREDATORY LENDING

According to Berkowitz (2003, p. 4), predatory loans are a ''subset of subprime loans, which include terms that are designed to strip home equity and trap borrowers in high-cost terms.'' While most subprime loans are not predatory, Berkowitz argues that ''almost all predatory loans are subprime.'' The growth of the subprime industry or the growth of lending to minorities, and the low qualification and underwriting standards associated with such loans, led to an increase in predatory practices that take advantage of disadvantaged borrowers. The practice of predatory lending is not considered illegal in many states but is almost always extremely detrimental to the borrower. Families can lose equity in their homes (a primary source of wealth for most Americans), pay exorbitant amounts in fees and penalties, and ultimately lose their homes (Berkowitz, 2003).

Predatory lending includes such specific practices as charging excessive fees, steering borrowers into bad loans that net higher profits, and abusing yield-spread premiums (lender kickbacks or rebates to mortgage brokers for placing borrowers in loans with higher interest rates than they qualify for). Berkowitz argues that African-Americans have a history of credit denial, and the new opportunities created by wider credit access have given predatory lenders more opportunities to prey upon them. Subprime loans are three times more likely in low-income neighborhoods, five times more likely in African-American neighborhoods, and two times more likely in high-income black neighborhoods than in low-income white neighborhoods (Berkowitz, 2003, p. 5). ''Blacks and Latinos remained far more likely than whites to borrow in the subprime mortgage market where loans are usually higher priced'' (Kochhar et al., 2009). According to a study conducted by the Pew Hispanic Center that analyzed trends in homeownership from 1995 to 2008 among different ethnic groups, higher-priced lending in 2006 and 2007, and foreclosure rates across the nation 3,141 counties, it was found that in 2007, 27.6% of home purchase loans to Hispanics and 33.5% to blacks were higher-priced loans, compared with just 10.5% of home purchase loans to whites with similar incomes (Kochhar et al., 2009, p. i). The study also revealed that blacks and native-born Hispanics experienced the sharpest reversal in homeownership in recent years (Kochhar et al., 2009).

The findings of a study conducted by the Center for Community Change (CCC, 2002) found similar results. Analyzing over 300 metropolitan areas in the United States, the study concluded that:

> [L]ower income African Americans receive 2.4 times as many subprime loans than lower income whites, while upper income African-Americans receive 3 times more than do whites with comparable incomes. Compared to whites, lower income Hispanics receive 1.4 times the number of subprime loans. In every metropolitan area included in the study, high concentrations of racial disparities in subprime lending were found among African-Americans and Hispanics. (CCC, 2002, pp. vii–viii)

Predatory lending may not be illegal in many states but the practices are discriminatory in nature. The lack of regulation, accountability, and oversight in the industry has contributed to an environment in which race-based predatory lending practices has masqueraded as subprime lending.

TOWARD "ECONOMIC EQUALITY"

Racial discrimination and strict credit qualification standards in the financial industry had traditionally kept minorities from access to credit. Thus, the move toward economic equality began as measures to ensure that financial institutions insured by the federal government increase access to credit by "underserved populations" (CCC, 2002). Overcoming the deep history of social, political, and economic inequalities entails more than increasing access to exploitative terms of credit. Such failures of social and economic justice initiatives since the civil rights era have instilled among the African-American population, "a common and pervasive sense of inadequacy of remedies pursued to remedy the legacy of racism" (Lashley & Jackson, 1994, p. 7).

Traditional mortgage loans offered by banks through the early 1990s excluded many minorities from qualifying. Mortgages were almost always 30-year fixed interest rates mortgages, and underwriting standards were stringent and included such requirements as full documentation, and low loan-to-value and low debt-to-income ratios (Essene & Apgar, 2007). It might be reasonably argued that the history of exclusion and racism experienced by many African-Americans, Hispanic, and Latinos far transcend in importance their low credit scores. The legal, political, and economic structure of the United States since its inception has economically marginalized racial minorities. Such inequity would be reduced, it was successfully argued, by employing innovative industry approaches that address problems related to affordability.

In the early 1990s, the subprime mortgage industry began to experience dramatic changes, which increased affordability and thus, minority homeownership. The proliferation of alternative mortgage products (AMPs), low interest rates, and the continual pressure to reduce discriminatory lending practices all led to greater access to credit, especially among minority populations (Essene & Apgar, 2007). Alternative loan products include all, but are not limited to, reduced documentation requirements, interest-only payments, adjustable rates of interest, and option-adjustable-rate mortgage (ARM) loans. These mortgages, the majority of which contain an ARM clause, are almost "exclusively underwritten in the subprime market" (Joint Economic Committee, 2007). These loans increased the affordability of homes, a problem that most minorities faced with traditional mortgages. Despite higher interest rates associated with alternative loans, the loan structure equated to lower monthly mortgage payments. For example, on a 30-year fixed mortgage, the monthly payment on a $400,000 mortgage at 8% is approximately $2,900. On an option-ARM loan, also known as a "pick-a-payment" loan, the monthly payment may be as low as $1,700.

The growth of the subprime mortgage industry occurred predominately among African-American, Hispanic, and Latino families (Fernandez, 2009). "About 46% of Hispanics and 55% of blacks who took out purchase mortgages in 2005 got higher-cost loans, compared with about 17% of whites and Asians, according to Federal Reserve data" (Kirchhoff & Keen, 2007). According to more recent study by the Center for Responsible Lending (CRL), the proportion of subprime home-purchase loans originated to African-American families were over 50%.

Moreover, the low qualification requirements and underwriting standards set by the subprime mortgage industry allowed almost anyone who wanted a mortgage to qualify. The "stated" mortgage product, for example, did not require documentation to verify income or assets. Prospective borrowers only had to "state" their income or assets, and banks simply took their word. Subprime mortgages were also extended to borrowers who had horrific credit histories that include previous judgments, foreclosures, repossessions, or bankruptcies. The more problems a borrower had in his/her credit report, the more the loan cost in terms of fees, penalties, and interest charges. If the borrower lacked any money at all for a down payment on a house, this was not a problem as financial lenders offered 100% financing. Borrowers were able to buy homes without any personal investment in the property at all. If a borrower couldn't afford the traditional principle and interest payment on a mortgage, they could opt for an alternative loan that required only a monthly payment of the interest charges. The unregulated subprime mortgage industry created exotic alternative loans that allowed for anyone to qualify. If you wanted a home, all you had to do was ask.

President Bill Clinton and Federal Reserve chairman Alan Greenspan campaigned for the expansion of alternative loan products to meet the needs of minorities and minority communities. In 2004, Greenspan stated that financial institutions should offer a greater variety of "mortgage product alternatives" other than traditional fixed-rate mortgages (Greenspan, 2004). Between 1995 and 2006, the subprime mortgage industry grew exponentially. During this period, the number of minority families obtaining a piece of the American dream was more than any other time in U.S. history. On the surface, things looked very positive. Underneath this veneer, however, was a growing economic bubble that eventually burst in 2007, and the subsequent crisis that followed had devastating consequences for minority homeowners.

The growth of the subprime industry increased the demand for homes, which drove values through the ceiling. In the decade preceding the crisis, home values increased by 124% (The Economist, 2007). The rise of real estate values gave existing homeowners equity they could leverage that further fueled the growth of the subprime industry. As the subprime industry bubble grew, competition between financial lenders increased, which, absent any effective regulatory oversight, consequently reduced underwriting standards allowing more individuals to qualify.

> As rates declined, mortgage lenders also loosened their requirements and invented new types of loans based on the fallacious supposition that people would be able to pay more in the future, since real estate and wages would continue to increase indefinitely. (Lifflander, 2008, p. 4)

At the peak of subprime lending in 2007, the outstanding dollar amount of subprime loans reached $1.3 trillion, or 7.2 million separate nonprime mortgages (data according to a speech by Ben S. Bernanke at the Economic Club of New York on October 15, 2007).

FRAUD AND INEQUALITY

Investigations have found that the growth of nonprime lending attracted a great deal of fraud. For example, a review of subprime loan files by Fitch's analysts, an investment rating agency, found that fraudulent misrepresentations existed "in almost every file" (Black, 2010a, 2010b; Costello, Kelsch, & Pendley, 2007). Market incentives, absent regulation, and accountability – factors identified in connection with the savings and loan crisis – altogether created an environment in which unethical actors were substantially rewarded. These factors also contributed to the corruption of previous honest brokers and lenders who could not resist the perverse financial incentives associated with originating and funding subprime loans. Bill Black (2010b, p. 2), a criminologist, law professor, and former federal regulator, noted that "lenders and brokers encouraged fraud." In an interview with Bill Moyers, Black (2009) noted that mortgage lenders intentionally made really bad loans, or "liar's loans," since these high-risk products paid better compared to prime loans.

Mortgage fraud has emerged as a major problem in the United States in the last decade. In 2006, fraud cost the mortgage industry upwards of $4.2 billion (Mortgage Bankers Association, 2007). The federal Financial Crimes Enforcement Network (FinCEN), a unit of the Department of the Treasury, reported similar findings from data collected in the form of mortgage-related suspicious activity reports (SARs). According to FinCEN, the number of SARs filed in the first quarter of 2006 pertaining to mortgage loan fraud increased 35% during the same period in 2005. This follows a 29% increase from 2004 to 2005, and an almost 100% increase from 2003 to 2004 (FinCEN, 2006). Large mortgage lenders such as New Century Financial Corporation – once the second largest U.S. subprime mortgage lender – were found to have "engaged in a significant number of highly improper and imprudent practices related to its loan originations, operations, accounting, and financial reporting processes" (Kary, 2008). Smaller mortgage broker offices also were under criminal investigation by the FBI: "The question of fraud goes to the entire process – where the loans were created, whether there was fraud in their creation, or misrepresentation as to the quality of the loans in the sales process" (Sasseen, 2008).

As noted by white-collar criminologists regarding earlier financial debacles, material fraud built into financial markets could remain virtually undetected until its consequences reached epic proportions (Black, 2005; Rosoff, Pontell, & Tillman, 2010). Recent research and commentaries (see, e.g., Black, 2008, 2009, 2010a, 2010b; Nguyen, 2009; Nguyen & Pontell, 2010; Nguyen, 2011) on the current crisis by criminologists have revealed that a significant undercurrent of financial crime exists, particularly mortgage fraud or "the material misstatement, misrepresentation, or omission by an applicant or other interested parties, relied upon by an underwriter or lender to fund, purchase, or insure a loan" (Federal Bureau of Investigations, 2007, p. 2). According to a testimony before the Financial Crisis Inquiry Commission, Black (2010b, p. 5) stated that "when the nonprime lenders gutted their underwriting standards and controls and paid brokers greater fees for referring nonprime loans they inherently created an intensely criminogenic environment."

But how does mortgage fraud fit into and contribute to the context of economic inequality? Financial frauds completely changed the nature and intended goals of the subprime mortgage industry. No longer did the industry function to provide *bad loans to bad credit borrowers, BUT bad loans that were fraudulent to bad credit borrowers who never had the ability to repay the loan*. Qualifications and guidelines established by financial lenders during the last decade of "lenient lending," along with industry-wide loose underwriting standards, risky hybrid mortgages (e.g., limited-documentation loan products and adjustable-rate loans), and a virtually nonexistent regulatory structure comprised a crime-facilitative environment that allowed and encouraged fraud to be used as a tool for obtaining loans for large numbers of minorities borrowers.

Minorities who have historically been excluded from the credit system were able to obtain mortgages only with the assistance of fraudulent practices. If a loan applicant lacked the required assets or job to qualify for a mortgage, falsified documentation of assets would be established by the loan agent; therefore, allowing a borrower to obtain a loan they had no ability to repay. Fraudulent practices that include ‘‘cutting, pasting, and recopying’’ financial information using simple computer graphics software to create false documentations for example were found to be very common in the subprime mortgage industry (Nguyen, 2009; Nguyen & Pontell, 2010; Nguyen, 2011). These types of frauds were especially pronounced in a particular subset of subprime loans – stated income or ‘‘liar's’’ loans. ‘‘Liar's loans’’ are mortgage products that require little to no financial documentation that would demonstrate a borrowers' ability to repay.

But the frauds didn't end here. There were frauds in every sector in the primary mortgage market (appraisers, mortgage brokers, lenders, and title and escrow), which pushed honest lenders out of business and intensified the criminogenesis of the industry (Nguyen & Pontell, 2010; Black, 2010a, 2010b). Subprime lenders created perverse incentives for brokers, appraisers, and their own employees for their fraudulent involvement in these loans. According to the National Commission on Financial Institution Reform, Recovery and Enforcement (NCFIREE), perverse frauds can produce a series of Gresham's dynamics in which the bad professional forced out the good (NCFIREE, 1993, p. 76).

In the mortgage industry, profit margins and financial targets have superseded legal and ethical standards. Benson (1985, p. 593) argued that business rules governing profit making and survival in a competitive capitalist environment have outweighed legislation and governance, including laws that address equality. What aggravates the situation is the normalcy of such frauds. Perpetrators were found to commonly perceive many acts of mortgage fraud as inseparable from conventional lending practices that are necessary in any ‘‘successful’’ legitimate subprime business (Nguyen & Pontell, 2010, p. 601). Certain types of frauds are not only perceived by loan agents as acceptable but also are considered ‘‘good for business’’ (Nguyen & Pontell, 2010, p. 602). In contemporary society, the goals of capitalism have superseded the goals of equality. These financial crimes were used to place people in homes. They have been tools that have allowed corporations to grow at unprecedented rates

(Black, 2010a, 2010b). They have also contributed to the stripping minority wealth and dreams.

In order to better understand the role of fraud in the context of deregulation and the lack of accountability, underwriting standards, and regulation in the subprime mortgage industry, the following chart provides an illustration of the context in which fraud relates to the larger economic structure (Chart 1).

Subprime loans placed many minorities in precarious financial situations. Minorities who already owned property during the growth of the housing market experienced unprecedented growth in home equity, which was a tempting source of income for many homeowners. According to the Berkowitz (2003, p. 5), 63% of wealth that African-American's own is in home equity. During the real estate boom, the American culture of consumerism was more marked than ever as many minority homeowners as refinanced most, if not all of the newfound equity from their home. Increasing home values, low interest rates, and heavy marketing convinced homeowners to refinance and use the cash for home improvement, debt consolidation, and other purchases. Many homeowners who obtained refinanced loans were even convinced to switch out of their conventional mortgage and into a subprime loan in order to obtain more cash, believing that they could later refinance into a more stable loan. Between 1993 and 1998, subprime refinance loans increased 10-fold and 80% of all subprime loans were refinances (Berkowitz, 2003, p. 5).

Whether the loan was a refinance, home equity line of credit, or purchase, the use of various types of frauds victimized subprime borrowers, of whom a significant percentage were minorities.

ILLUSION OF AFFORDABILITY

Calavita and Pontell (1990) examine the structural conditions brought about from deregulation of the savings and loan industry and how specific changes influenced fraudulent lending practices that led to the crisis. They also examine the distinctive qualities of finance capitalism that can lead to differing types and amounts of criminality than that fostered through industrial capitalism. Similarly, it can be argued that finance capitalism has fostered racial inequality through new and unregulated loan schemes that often involved defrauding consumers as noted above. The "new racism" is apparent when African-American, Hispanic, and Latino populations become even more economically disadvantaged than they were before by

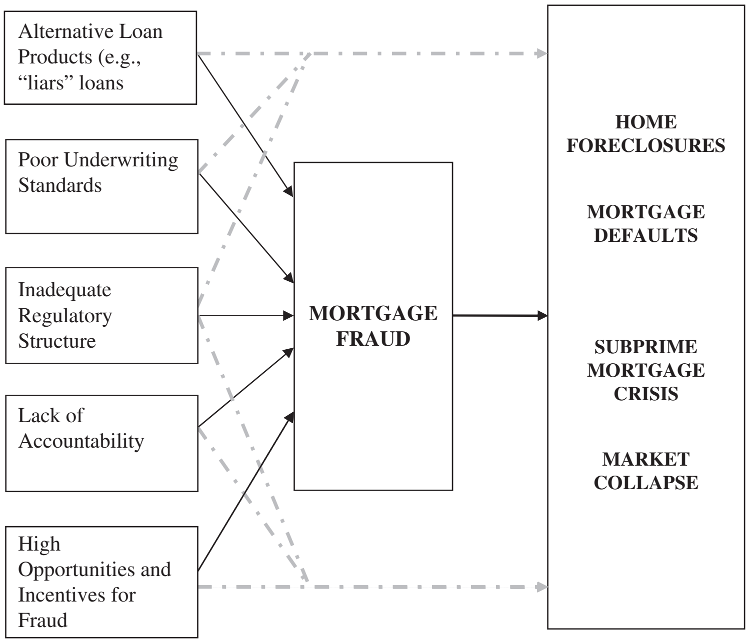

Chart 1. The Link between Origination Fraud and the Subprime Crisis. ⇢ current understanding of the crisis; ⟶ context of fraud in the subprime crisis.

the lending policies and practices of the subprime lending industry. The targeting of such populations by the industry through the use of alternative loan products provides a clear example of how minority groups were disproportionately disadvantaged by the economic crisis. According to a report by the General Accounting Office (GAO), AMPs can, on the surface, make homes appear more affordable.

> In recent years, however, AMPs have been marketed as an ‘‘affordability’’ product to allow borrowers to purchase homes they otherwise might not be able to afford with a conventional fixed-rate mortgage. Because AMP borrowers can defer repayment of principal, and sometimes part of the interest, for several years, they may eventually face payment increases large enough to be described as ‘‘payment shock.’’ (GAO, 2006, p. 2)

Have AMPs helped minorities enter the housing market by increasing the affordability of real estate? Compared to the traditional 30-year fixed-rate mortgage, nontraditional mortgages offer lower monthly payments that would clearly make them appear more attractive to those with limited incomes. However, the lower monthly payment is the only benefit to the borrower. When considering all long- and short-term costs, AMPs only possess "the illusion of affordability." Borrowers who assume these subprime loans unknowingly face financial consequences that can ultimately lead to foreclosure.

Instead of helping minorities achieve the American dream and equality in terms of homeownership, financial lenders took advantage of an unsupervised environment and legal and regulatory loopholes to create imaginative financial products that took advantage of those who were most historically disadvantaged. Subprime mortgages equate to higher fees, interest rates, and unreasonable terms and conditions. And "lenders have increasingly qualified borrowers for AMPs under 'limited documentation' standards, which allow for little to no proof of income or assets" in order to obtain credit (GAO, 2006, p. 8).

A joint study by the U.S. Department of Housing and Urban Development and U.S. Treasury found that subprime loans were issued five times more frequently to households in predominantly black neighborhoods as they were to households in predominantly white neighborhoods. "In New York City, black households making more than $68,000 a year are almost five times as likely to hold high-interest subprime mortgages compared to whites of similar – or even lower – incomes (Powell & Roberts, 2009, p. 1). Moreover, minority borrowers were steered into subprime loans when they qualified for less expensive, lower interest prime loans" (Joint Economic Committee, 2007, p. 4). By some estimates, the origination fees for subprime loans can reach five times the average fee of prime loans (Dedman, 1989a, 1989b; Berkowitz, 2003).

Subprime loans also have higher built-in fees and penalties compared to their prime mortgage counterparts. Several studies have examined the disparities in prepayment penalties among prime and subprime loans (Mortgage Asset Research Institute Inc., 2006; Center for Responsible Lending, 2007). An estimated 80% of subprime loans contain prepayment penalties (fines charged to the borrower for paying off the loan prior to a contractual period) compared to 2% of conventional loans. Fees assessed by brokers can also come in the form of yield-spread premiums, or bank "kickbacks," which is a financial incentive for "placing borrowers in loans at a higher interest rate than the lender would have given. Yield-spread premiums created an obvious incentive for brokers to make loans at the highest interest rates and fees possible … the broker also paid an additional bonus if they lock the borrower in a prepayment penalty" (Berkowitz, 2003, p. 9).

The complex terms and conditions of exotic loans make it extremely difficult for the typical unsophisticated borrower to comprehend. For most subprime borrowers, the math that is involved in a real estate loan can be very confusing. Borrowers entrust their brokers or lenders to act on their behalf, yet this trust is often compromised by the incentive structure of the lending industry. Rather than acting in the best interest of their clients, lenders and mortgage brokers often take advantage of unknowing borrowers by including hidden costs and fees into the mortgage loan. Minority borrowers who speak English as a second language are especially vulnerable to predatory and detrimental lending practices. Often, these borrowers do not audit their disclosure statements that detail the costs of the loan, and rarely understand exactly how much they paid for it.

Squires (2004) details how minorities, working families, and the elderly have been victimized and exploited by financial institutions who have ensnared vulnerable segments of society into high-cost predatory loans. The American dream of homeownership is highly enticing, especially for many low-income families who have been historically excluded from the dream. Minorities are particular targets for fraudulent harmful loan practices and deceptive marketing schemes that include detrimental loan terms and conditions (balloon payment loans, high LTV loans, and single premium insurance payments). For example, compared to a traditional loan, a negative amortization (NegAM) loan can reduce the monthly mortgage payment in half. The drawback to this loan product is that as time passes, a borrower can sink deeper into debt. Unsophisticated borrowers have been steered into NegAM loans because of the extremely low monthly payment option available. For mortgage lenders and brokers, NegAM loans are more profitable compared to other AMPs and thus steer unwary borrowers into these types of loans despite the obvious consequences. According to the CCC (2002, p. 1),

> lenders may exploit borrowers by imposing credit terms that are not justified by the risk posed by the borrower. Typically this is done by charging higher interest rates and/or charging higher fees than can be justified by the risk posed by the loan … often in schemes designed to take away the property. Lenders may also mislead or deceive borrowers as to the costs and conditions of the loan. In many cases, these practices are challenged as involving fraud and misrepresentation.

When all other factors are considered, the costs associated with AMPs completely outweigh the benefits. Unknowing subprime borrowers have been sold on these products under the premise that they are more affordable. In reality, these loans are much more costly and lower monthly payments associated with these products possess the illusion of affordability.

CONCLUSION

In 2006, the U.S. rate of homeownership reached 69.2%, the highest ever (Howley, 2010). While the growth of homeownership was broadly based, "minority households and households in lower-income census tracts recorded some of the largest gains in percentage terms" (Bernanke, 2007). The subprime mortgage crisis revealed a number of troubling factors regarding efforts to foster greater racial equality in the United States. First and foremost, the lending practices and collapse of the industry have disproportionately victimized minority families. Since last summer, minority families have seen their investments shrink and their property values plummet. The mortgage crisis continues to send families into panic and it is devastating minority families the most by costing them their homes and even their life savings. Second, minority communities are also disproportionately impacted by a rising tide of foreclosures. Neighborhoods that were previously beautiful are increasingly found with abandoned homes and increased crime rates (Kelling & Cole, 1998). Such areas include one in the New York City borough of Queens that has been decimated by foreclosures. In an interview, the district's City Councilman, James Sanders, stated that the collapse of the subprime mortgage industry has resulted in "the largest loss of black land since the Great Depression" (Owen, 2008). Third, African-American and Hispanic families are experiencing mortgage-related financial hardships on an epic scale, and financial fraud has been a significant factor in their economic misery.

The struggle for equality has stopped overt forms of racism in the financial industry. Minorities can take comfort in that they will very unlikely experience denial of credit on the basis of race alone. However, progress toward economic equality has also led to industry changes (e.g., alternative loan products, loose underwriting, and qualification standards) that have made homes seemingly more affordable for lower-income borrowers. Federal laws (e.g., the FHA and the CRA) and lending policies and practices, such as AMPs and loose underwriting standards, have greatly increased the rate of minority homeownership. These measures are considered "symbols" of economic equality in the United States. In the context of free market capitalism, however, these measures also represent a more latent and sinister element that has little to do with equality and more to do with continued victimization and exploitation.

Minorities who were previously denied credit were being granted loans but at the cost of their financial livelihoods. Some families invested their life savings into their homes only to later lose it all due to foreclosure. As a result, more African-American and Hispanic families have lost, and will continue to lose their homes throughout the course of the subprime crisis.

The experience of minority populations in the subprime mortgage debacle reveals the inherent structural contradictions regarding the goals of economic equality and finance capitalism. On the one hand, the measures that have been taken in the industry to increase affordability acknowledge the legitimacy of structural inequality inherent in finance capitalism. On the other hand, these policies have succumbed to the role social and institutional policies play in legitimating, justifying, and perpetuating this inequality (Piven, 1972; Galper, 1975; Sigelman & Tuch, 1997; Keiser, Mueser, & Choi, 2004).

Between 2007 and 2009, the National Association for the Advancement of Colored People (NAACP) filed lawsuits against 14 mortgage lenders, including two the country's largest – HSBC and Wellsfargo – alleging institutionalized racism in their subprime lending. According to NAACP Interim General Counsel Angela Ciccolo, "the NAACP is bringing this suit as part of its long-standing demand that offending lenders stop discriminatory practices and bring their activities into compliance with federal law including the FHA, the Equal Credit Opportunity Act, and the Civil Rights Act." After almost a half century after the passage of these measures, the fight for equality in the financial industry continues.

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DIFFUSION OF FRAUD THROUGH SUBPRIME LENDING: THE PERFECT STORM

Laura A. Patterson and Cynthia A. Koller

ABSTRACT

The 2000–2006 housing market bubble conformed to a classic boom–bust scenario that triggered the most serious and costly financial crisis since the Great Depression. The 2008 subprime mortgage collapse leveraged a financial system that privatizes profits and socializes risks. Several factors converge to set up the subprime mortgage market as an easy target for industry insiders to exploit. Enabling legislation expanded the potential pool of borrowers eligible for subprime mortgages and structured incentives to lenders willing to assume the risks. The securitization of subprime mortgages transformed bundles of high-risk loans into mortgage-backed securities that were in demand by domestic and foreign investors. Pressure to edge out competition produced high-risk loans marketed to unqualified borrowers. The final piece in the setup of the subprime lending crisis was a move from an origination model to a distributive model by many financial institutions in the business of lending. We find that the diffusion and totality of these business practices produced a criminogenic opportunity structure for industry insiders to profit at the expense of homebuyers and later investors.

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INTRODUCTION

Before 2008, few financial analysts predicted the potential systemic risk posed by the collapse of the subprime market. Some of the innovations and fraud that diffused through the subprime mortgage market threatened to undermine financial markets and the broader economy. The collapse contributed to unprecedented losses that may approach $600 billion and beyond.[1] Precise estimates defy calculation given the complexity of structured investments traded both domestically and globally. The subprime market, representing a small share of the total U.S. mortgage market, produced global repercussions (Bullard, Neely, & Wheelock, 2009). The underlying cause increasingly points to the complexity of the market for the subprime mortgages securities. Securities represented pooled individual subprime mortgages, which, in turn, were bundled, repackaged, and tranched to create new, more complicated financial instruments (Demyanyk & Hasan, 2009, p. 4). Securitization drove the innovation and diffusion of these overvalued and misunderstood financial products. As a result, the subprime market meltdown rippled beyond the U.S. epicenter into the global credit market as write-downs by financial institutions increased risk premiums and decreased capital liquidity.

The first public signs of the ''perfect storm'' appeared in 2008, as a rapid decline in home prices, along with a dramatic rise in foreclosures, forced a market value downgrade of securities, which threatened the solvency of a number of large financial firms (Demyanyk & Hasan, 2009). These financial losses left many financial institutions with too little capital relative to their debt. Extraordinary government interventions hint at the systemic risks posed by the 2008 financial crisis. In mid-2008, the Federal Reserve assumed conservatorship of the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, while Lehman Brothers filed for bankruptcy. A ''systemic risk exception,'' invoked under the Federal Deposit Insurance Act, enabled the FDIC to provide emergency assistance to financial institutions deemed ''too big to fail.'' For example, when efforts by private investors to infuse American International Group (AIG) with liquidity failed, the Federal Reserve provided parachutes in accordance with its emergency lending authority under the Federal Reserve Act. These Federal bailouts and bank rescues speak volumes about the adverse economic conditions and financial instability resulting from the subprime mortgage collapse.

Some analysts link the subprime mortgage crisis to a boom–bust scenario, whereby deregulation encouraged unchecked financial innovation, unprecedented investor demand for securities, and a decline in underwriting standards and consumer protection (Tymoigne, 2009, p. 27). Others assign a key role to the issuance of complex mortgage-backed securities (MBSs) and derivatives with obscure and complex structures, as well as overleveraging, and inadequate risk management (Bullard et al., 2009, p. 403). As with Ponzi finance structures (Minsky, 1992), the system of mortgage lending relied on rising home prices (false equity) rather than gains in income to insure repayment of loans.

Testifying before the Financial Crisis Inquiry Commission on April 7, 2010 (see official transcript at http://www.fcic.gov/hearings/pdfs/2010-0407-Transcript.pdf), Alan Greenspan, former chairman of the Federal Reserve, recounts, "The rate of global housing appreciation was particularly accelerated beginning in late 2003 by the heavy securitization of American subprime and Alt-A mortgages, bonds that found willing buyers at home and abroad, many encouraged by grossly inflated credit ratings" (p. 12). Remarkably, economic analysts failed to appreciate the systemic risks that a subprime collapse posed to global financial markets. As late as April 2007, even investment banks failed to link unprecedented declines in housing prices to major losses for investors exposed to subprime mortgages through securitization.

What remains less clear is why key stakeholders – namely, subprime mortgage lenders, mortgage brokers, GSEs, investment bankers, credit rating agencies (CRAs), and investors – were blindsided by the enormity of the crisis and the time to disaster. This chapter examines the 2008 subprime mortgage crisis in light of innovative lending practices, low interest rates, a housing bubble, lax government regulation, excessive risk taking by lenders and investors, and fraud. We focus on economic conditions and enabling legislation that converged to promote the diffusion of fraud in a financial system that privatized profits and socialized risks. Furthermore, we introduce diffusion of innovation theory as a conceptual framework for interpreting the spread of subprime mortgage products and processes, and their associated incentive structures and marketing strategies that lured institutions and constituents (e.g., borrowers, brokers, lenders, and investors) to this boom–bust subprime market.

The chapter is organized as follows: in first section, the "housing boom" is assessed in light of the growth in subprime mortgage lending throughout the early 2000s. In second section, a description of the subsequent "housing bust" is provided, with attention focusing on the financial system's inattention to borrower creditworthiness and the asymmetrical risks associated with the securitization process. Third section begins with a brief review of diffusion theory with respect to the opportunity structures of white-collar crime and its applicability to criminology. This section continues with a discussion of how different mortgage system stakeholders managed the subprime innovation, some of the ways in which they also succumbed to the illegal profit opportunities it provided, and how a criminogenic culture of competition developed within the industry. The chapter concludes in fourth section with a summary of how the subprime mortgage innovation helped to facilitate a classic boom–bust financial crisis, and how the series of events leading up to this crisis can best be assessed within a diffusion theoretical framework.

THE HOUSING BOOM

At the close of the 1990s, housing prices began to rise to unprecedented levels relative to other economic indexes (e.g., consumer price inflation and median family income). Home prices continued to appreciate while the interest rates remained low, increasing the pool of potential homebuyers looking to upgrade, speculative buyers interested in a flip, and first-time homeowners. The diminishing pool of borrowers qualifying for prime loans created new challenges and opportunities for subprime lending. From 2002 to 2007, mortgage lenders and subprime borrowers exerted pressure on the U.S. government to expand subprime credit options. In response, the Department of Housing and Urban Development (HUD) launched its "affordable housing mandate." Mortgage incentives promoting homeownership for low-income borrowers provided down payment and closing cost assistance (see http://www.hud.gov/offices/cpd/affordablehousing/programs/home/addi/). Related pieces of legislation, with bipartisan support, also reduced regulation of subprime lenders. By essentially "lowering the bar," subprime lending addressed the demand for more mortgage credit to enable untapped, high-risk, marginal borrowers to purchase a home. In turn, innovative subprime mortgages made the American Dream of owning a home more feasible and affordable.

Subprime loans with unconventional terms carry higher risks or expected probabilities of default, as these loans typically involve a borrower with a poor credit history. Subprime mortgage credit expansion set the stage for mortgage lenders specializing in high-cost loans and certain hybrid mortgages (e.g., adjustable rate) not generally utilized in the prime market. These specialized mortgage lenders capitalized on borrowers that their competition turned away. The Government Accounting Office (GAO, 2009) reports the subprime share of the mortgage market expanded exponentially from about 12% or $125 billion in 2000 to about 34% or $1 trillion in 2006. Until very recently, almost 70% of subprime loans were fixed-rate mortgages, often held by originating lenders for life of the loan. Fewer than half of subprime loans were securitized and fewer still were resold and held in investment portfolios outside the United States. As the Financial Crisis Inquiry Commission (2010, p. 13) testimony documents, ''By early 2007 virtually all subprime originations were being securitized and subprime mortgage securities, outstanding, totaled more than 900 billion dollars, a more than sixfold rise since the end of 2001.''

Subprime mortgages enabled potential homeowners to borrow more and amortize the loan more slowly, while at the same time assuming a greater interest-rate risk (LaCour-Little & Yang, 2010). For example, introductory ''teaser'' rates insured manageable mortgage payments early on. Lenders convinced borrowers that appreciating home values would set them up for refinancing before the adjustable-rate mortgage (ARM) resets after two or three years (2/28 or 3/27). The housing bubble appeared to support the logic. Unfortunately, home values moved in the other direction. Declining home values and ARM resets soon moved many borrowers into a negative equity position, meaning the balances on mortgages exceeded the current value of their homes. Because of the diffuse utilization of subprime lending and securitization by this time, negative borrower equity conditions helped precipitate the consequent ''housing bust.''

THE HOUSING BUST

Mid-2007 marked a dramatic decline in housing prices, a virtual moratorium on subprime mortgage originations, and the start of a foreclosure crisis. By mid-2008, the subprime securitized market froze and evaporated. The declining value of homes and the negative equity increased risks of foreclosure and limited opportunities to sell or refinance. Mian, Sufi, and Trebbi (2010) argue U.S. government support for mortgage credit targeting low income, less creditworthy households also contributed to the severity of the 2008–2009 subprime mortgage crisis.

Likewise, Tymoigne (2009, p. 23) observes the ''capital gains on houses obtained through short sale or foreclosure'' offset the risks of default for vested parties in the industry. For instance, defaults offered speculators chances to acquire assets at discount prices. The only players to lose were the ones with ''skin in the game,'' such as borrowers who lost their homes, ruined their credit ratings, and risked bankruptcy. As Wyly, Atia, Foxcroft, Hammel, and Phillips-Watts (2006, p. 124) write, "The result of securitization is to shatter the traditional shared interest of all parties in cooperating to avoid adverse events." In sum, the move to a distributive model of lending, made viable and lucrative via securitization, widened the net of parties involved in the mortgage system.

Demyanyk and Van Hemert (2008) note that the subprime mortgage crisis conformed to the classic lending boom–bust cycle documented by Dell'Ariccia and Marquez (2006). The quality of subprime mortgages had been declining every year since 2001, yet, appreciating housing prices served to mask this significant warning. The declining quality of loans became evident only after the housing market started slowing down. Independent of the inferior quality of mortgages was the issue of borrowers' creditworthiness and unprecedented levels of misrepresentation throughout the origination and securitization process.[2]

Shiller (2008) described the ramp-up in housing prices from 1998 to 2006 as an asset bubble. That is, homebuyers were willing to pay inflated prices for houses *today* because they expect housing prices to appreciate *in the future*. The speculative housing bubble conformed to the boom–bust cycle of most asset bubbles in which short-term gains are vulnerable to rapid declines, and are not sustainable. Soon after the peak of house prices in early 2006, delinquencies and foreclosures began to rise. By this time, rates of delinquency and foreclosure for mortgages originated in 2006 and 2007 were exceptionally high. Avery, Bhutta, Brevoort, Canner, and Gibbs (2010) note the 2008 HMDA data provided the first clue of the impact of the subprime market on economic conditions during the year.

Analysts offer several additional reasons for the dramatic increases in foreclosures. Demyanyk and Van Hemert (2008) conducted an analysis of delinquency rates by "vintage" or year and found that subprime mortgages originated in later years had higher rates of delinquency than those originated earlier. Declining home prices had a more severe impact on later vintage loans, originated in 2006 and beyond, in that they lost their value more quickly. According to the "double-trigger" theory, these types of mortgage defaults result when borrowers move into negative equity *and* experience some sort of "income shock" or interruption that makes it difficult to continue making payments on the mortgage (Foote, Gerardi, & Willen, 2008). In the past, positive equity provided homeowners with a "way out" by selling the home or renegotiating lower payments.

In this housing crisis, however, homeowners with negative equity often faced difficulties with selling their homes. Most of the trouble encountered by subprime borrowers arose when higher adjusted payments kicked in. Faced with default, borrowers sought relief from their debt by putting their homes up for sale. The glut of homes available in regional markets through speculators flipping homes and builders' projects without locked-in buyers undermined this exit strategy for many borrowers (Tucker, 2009, p. 5). The decline in housing prices often produced a ‘‘clustering effect’’ of home foreclosures in some communities. These findings are consistent with the double-trigger model, where the 2006 sharp decline in home values left many borrowers with negative equity, risks that were unforeseen or ignored during the loan origination process.

Furthermore, technological advances in statistical modeling over the past few decades offered lenders new means of estimating borrower risk. For example, as the subprime market developed and spread, automated underwriting systems greatly expanded the use of credit scores in evaluating borrowers' risk of default (Gramlich, 2007). Yet Mayer, Pence, and Sherlund (2009) point to *deteriorating* underwriting standards and regional declines in housing prices as the immediate causes of mortgage defaults. The lax underwriting standards served to underestimate the borrower's ability to pay mortgage payments as the terms reset at significantly higher rates. Research underscores the importance of credit scores in predicting the likelihood of defaults among prime and subprime borrowers (see Demyanyk & Van Hemert, 2008). In both, the subprime and Alt-A (e.g., low-to-no documentation) market segments, foreclosures have grown most rapidly among adjustable-rate loans.

Declining housing prices precipitated this crisis by revealing the fatal flaw inherent in this boom–bust scenario. The prime driver of the subprime mortgage market was the appreciating value of home prices. The sharp rise in mortgage foreclosures was a direct result of the proliferation of loans with a high risk of default – due both to the terms of these loans and to loosening underwriting controls and standards (Interim Report to Congress on the Root Causes of the Foreclosure Crisis, 2009). Many new homeowners fell behind or missed payments as their adjustable mortgage rates reset.

On January 18, 2007, Moody's issued a special report, ‘‘Early Defaults Rise in Mortgage Securitizations,’’ which claimed that MBSs issued in late 2005 and early 2006 demonstrating significantly higher rates of foreclosure were concentrated in subprime and Alt-A mortgage pools (Moody's, 2007). Most of these MBSs and collateralized debt obligations (CDOs) had received investment-grade ratings by CRAs. The sharp rise in mortgage defaults that began in 2006 soon led to a mass downgrading of triple-A tranches of MBSs and CDOs, signaling unparalleled losses to investors. This write-down of approximately 80% of tranches continued in earnest until the middle of 2009 before leveling off (Financial Crisis Inquiry Commission, 2010). The write-downs on these securities stimulated a contagion effect, further fueling the housing bust and the impending financial crisis. As such, and in addition to negative borrower equity and defaults, analysts argue that the inflated credit ratings on mortgage-related securities contributed to the financial crisis in a number of ways. Most notably, the inflated ratings originally increased investor demand and mortgage lenders originated more risky subprime mortgages to accommodate the financial sector's demand for these investment-grade securities.

The CRAs also rated many financial institutions that held or insured those securities. The ratings of these institutions lagged behind the downgrading of MBSs and CDOs. Lehman Brothers was a notable exception, downgraded in June 2007. Yet the week before Lehman Brothers filed for bankruptcy, the firm rated in the upper-medium range of investment grade. Other companies playing key roles in the financial crisis, namely Bear Stearns, retained investment-grade ratings days before JPMorgan Chase acquired it with the help of the U.S. Treasury. Moreover, the bursting of the housing bubbles in the United States and Europe in 2007 led to a further surge in defaults and foreclosures, resulting in the plummeting of MBS values and the virtual evaporation of demand by national and global investors for these products.

Finally, as will be discussed in more detail in the next section, the spread of subprime lending simultaneously created a financial environment conducive to white-collar crime by innumerable parties in the mortgage process. For example, the U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN, 2008) reported that depository institution suspicious activity reports (SARs) pertaining to mortgage loan fraud sharply increased in 2002 and continued to rise through 2005. FinCEN also documented that SARs alleging mortgage fraud increased by 1,411% between 1997 and 2005. The SARs incident reporting system excludes the loans made by nonfederally insured institutions, a notable omission given its significant share of the subprime mortgage industry.

The types of crimes found by FinCEN and others, such as the FBI and HUD, have been predominately material misrepresentations (i.e., concealment or falsification of facts), with responsible parties ranging from borrowers to brokers and originators, as well as to rating agencies and investment banks. According to many assessments of the mortgage crisis, the characteristics of subprime products and practices, the breadth of their use, and/or the speed at which they spread contributed to these record amounts of fraud (see Barr, 2007; Bitner, 2008; Koller, 2010). The rapid diffusion of subprime lending and fraud, and the influence these factors had on the housing bust and ensuing financial crisis, will now be explored.

DIFFUSION OF INNOVATION AND FRAUD

Our focus turns to finance capitalism, the growth in business opportunities (legitimate and illegitimate) presented by the subprime market, the network of financial players, and the incentive structures guiding collective decisions to maximize profits and minimize risks at the expense of other stakeholders. These are important steps to building an appreciation of the extreme rates of fraud associated with subprime lending noted above. Understanding how the mortgage industry and its participants operated in a time of easy access, lax regulation, and global financial maneuvering, will provide further building blocks. For as Weisburd, Wheeler, Waring, and Bode (1991, p. 5) point out, "The most consequential white-collar crimes – in terms of their scope, impact, and cost in dollars – appear to require for their commission that the perpetrators operate in an environment that provides access to both money and the organization through which money moves." To this end, an assessment of the nature of the subprime mortgage market, with a focus on industry insiders, who maintained specialized knowledge of product innovations, marketing strategies, and regulations, as well as specialized access to a pool of eligible borrowers, will follow a review of diffusion theory.

Diffusion Theory

Explaining a "systemic" form of white-collar crime, such as the types of fraud found in the subprime mortgage market, requires an analysis of events and behavior at both the micro- and macrolevels. As such, the theoretic framework will need to move beyond an understanding of criminal motivation and the basic opportunity for crime; for as Koller notes, the opportunity for mortgage fraud has always existed:

> The subprime mortgage products and processes that were made available in the 1990s, however, increased the population of potential offenders, increased temptation and suitable targets, and increased the ease at which motivated individuals could take advantage of the opportunities to commit crime. As such, it was not necessarily the routines of the housing/mortgage industry that were problematic, it was the actual category of subprime "products" that created an environment rich with white-collar crime motivation and opportunity. (Koller, 2010, p. 125)

Diffusion of innovation theory (Rogers, 2003) models how innovations and innovative adaptations, criminal or unethical, are manifested and diffused through a system. This theoretical framework offers a good fit to the analysis of the subprime lending market. The focus herein is on the spread of innovative financial tools and the ''diffusion of illegal practices'' (Sutherland, 1983, p. 246) that permeated the mortgage business culture and the financial industry.

Diffusion refers to the ''process in which an innovation is communicated through certain channels over time among the members of a social system'' (Rogers, 2003, p. 5). Diffusion theory shares common ground with differential association learning and social learning theories; most notably, that behavior is learned through associations with others (Sutherland, 1983). Subcultures and social affiliations also influence the probability that normative values will be transmitted, assimilated, and adopted (Cloward & Ohlin, 1960). Rational choice theory offers a cognitive approach to behavior as a product of the assessment of skill, risks, and rewards (Clarke & Cornish, 1985). Furthermore, the social organization of routine activities structures probabilities for crime based on a convergence in time and place of targets, offenders, and opportunities (Cohen & Felson, 1979). The value added by diffusion theory to each of these criminological theories is an articulated process by which the ideas (e.g., products and processes), values, and opportunities are spread.

The primary components of the diffusion process are the innovation, communication channels, time, and the social system. The importance of each of these elements varies with the specific diffusion model being utilized to examine the phenomenon of interest. However, the perceived characteristics of an innovation, namely its relative advantage, compatibility, complexity, trialability, and observability, generally contribute to more explained variance in the rate at which innovations diffuse than all other factors combined (Rogers, 2003). This suggests that the perceptions of mortgage and finance insiders regarding the opportunities provided by subprime lending will be critical to any analysis of the rate of its diffusion and the extent of its use.

Moreover, diffusion theory, used rarely in criminological discourse and research, offers a multidisciplinary framework, which appears well suited for interpreting the spread of legitimate, and illegitimate, white-collar activities, including subprime mortgaging and fraud (see Koller, 2010). Rogers (2003, p. 196) suggests that one view social processes under a dynamic perspective that is capable of explaining the ''causes and sequences of a series of events over time,'' such as those found with the housing boom–bust reviewed above. According to Koller (2010), diffusion theory models (see Rogers, 2003) provide this view and are suitable for examining specific white-collar crimes based on four assumptions: (1) white-collar crime can be conceptualized as an ''illegal'' innovation or as a ''reinvention'' of a legitimate innovation; (2) the models' processes and variable characteristics can be operationalized to represent why, how, and at what rate, motivation, intentions, opportunity, and techniques are learned, cultivated, and reinforced; (3) both innovation and reinvention are facilitated by the properties of white-collar crime (i.e., specialized access, the superficial appearance of legitimacy, and spatial separation from victims; see Benson & Simpson, 2009); and (4) white-collar crime can be evaluated with comparable diffusion models at the individual and aggregate levels.

Diffusion theory extends white-collar crime opportunity theory by illustrating how the perceived characteristics of the subprime innovation influenced legal and illegal behavior, how the characteristics of mortgage practitioners and industry structures, processes, and products influenced this behavior, and, in turn, that the spread of white-collar crime opportunities may be predictable (Koller, 2010). In sum, it is hypothesized that beyond traditional criminological theory, diffusion theory can more generally account for a host of variables associated with the structure and spread of an opportunity, the associations within, and routines of, the social system and its members that enable an innovation's use and reinvention, and how this occurs over time.

The magnitude of the subprime mortgage financial crisis required complicity, if not facilitation, by the lending industry that was enabled by the rapid diffusion of questionable business practices throughout the system. Relatedly, Calavita, Pontell, and Tillman (1999) concluded in their analysis of the savings and loan debacle that finance capitalism invariably structures opportunities for ''collective embezzlement.'' Although time will tell, we are now in a position to begin an assessment of whether the diffusion of financial practices contributing to the subprime mortgage crisis constitutes comparable types of white-collar crime, or can be chalked up as simply ''business as usual.'' We begin by reviewing how primary stakeholders in the mortgage industry (i.e., originators, brokers, investment bankers, and CRAs) were influenced by the spread of the subprime innovation and the types of illegitimate activities they have been associated with.

Mortgage Originators

Until very recently, the origination of mortgages and issuance of MBSs represented loans to prime borrowers that conformed to underwriting standards. Increasingly, however, the growth in subprime lending encouraged mortgage originators to move away from an origination model to a distribution model, in which loans and bundled and securitized mortgage securities are offered for resale to other financial institutions and investors. In turn, unchecked competition by lending institutions within the subprime mortgage market increased.

The distribution model was also accompanied by changing ''opportunity''- type regulations that created new avenues, especially for independent lenders, to gain a competitive edge over depository institutions with greater federal regulatory accountability. At the same time, however, ''control''-type regulations failed to keep pace with the fundamental changes to the mortgage market that were developing. For example, a congressional report states that the Offices of Thrift Supervision (OTS) and Comptroller of the Currency (OCC) issued regulations that preempted state laws from applying to federal depository institutions.

Importantly, this preemption also applied to the mortgage banking operating subsidiaries of these institutions, which greatly reduced the number of lenders covered by these state laws. While federal regulators' concern with the safety and soundness of banking institutions provides a check against risky lending activities by these institutions, an increasing number of mortgage loans were made by independent mortgage banking institutions subject to less federal oversight than depository institutions and their mortgage banking subsidiaries (Interim Report to Congress, 2009, p. ix).

The Financial Crisis Inquiry Commission (2010) reported that depository institutions and their subsidiaries accounted for about 60% of all mortgage originations from 2004 to 2006. During the same period, affiliates of depositories accounted for 10% and independent mortgage companies accounted for about 30% of mortgage originations.[3]

The incentive structure for lenders is the upfront income from closing points, servicing fees, and sales of securities. However, changes to the asset-backed securities market ''shifted the primary source of mortgage finance from federally regulated institutions to mortgage banking institutions that acquired funds through the broader capital markets and were subject to much less regulatory oversight'' (Interim Report to Congress, 2009, p. ix). In a classic ''pump and dump'' scheme, industry insiders capitalized on the volume of loans and fees for services while off-loading risks before the collapse. When one considers that total subprime originations increased from $65 billion in 1995 to over $332 billion in 2003 (*Inside B&C Lending* as cited in Chomsisengphet & Pennington-Cross, 2006, p. 37), it is not difficult to imagine that competition for a share of this growth was significant.

Mortgage Brokers

The increased reliance on third-party brokers by both financial institutions and nonfinancial institution lenders also created opportunities for organized fraud by mortgage industry professionals during the diffusion of subprime lending. During the 1990s, the number of new independent mortgage brokers increased 14% annually, and by 2000, brokerage firms were responsible for processing "approximately 55% of all mortgage originations" (Immergluck & Smith, 2005, p. 365). This is crucial according to Immergluck and Smith, as the mortgages originated by these independent brokers were twice as likely to be subprime than those originated by traditional lenders.

There is a general recognition that fraud on the part of mortgage brokers and borrowers may have made a significant contribution to the foreclosure crisis (Bitner, 2008). Commissioned brokers marketed hybrid mortgages to conventional and high-risk borrowers on behalf of specialized mortgage lenders. The subprime mortgage market generates significantly higher commissions for brokers than conventional loans with lower rates and better terms. Higher commissions may have encouraged some brokers to direct borrowers to subprime "teaser" loans without disclosing the terms of these loans. Inexperienced borrowers may have failed to appreciate their risks of default. In either case, the effects were devastating and far-reaching for targeted high-risk borrowers. Meanwhile, brokers pocketed their commissions without assuming any long-term risks associated with foreclosures.

Commissions incentivized brokers' performance and productivity. According to Warren (2007), some subprime mortgage lenders offered brokers a "yield-spread premium," whereby the lender's wholesale rate (7.2%) would be presented to the borrower at a retail rate (9.2% interest rate) by the broker. Warren documents that 85–90% of subprime loans involved a yield-spread premium, providing mortgage brokers substantial kickbacks. Lenders are ethically bound to be sure borrowers can afford the introductory rate as well as the readjust rate. However, no legislation regulating the fiduciary responsibility or rate of compensation existed for brokers prior to 2008.

Brokers and lenders advised new borrowers to refinance loans before reset. A good strategy assuming the loan-to-value (LTV) of the home continues to appreciate. Borrowers would lose everything, however, if prices decline; a likely scenario given that the housing bubble was approaching its tipping point. Regardless, neither brokers nor lenders assumed any of the long-term liability with these original and refinance loans. The brokers never held the debt, and the risk transference associated under this "distributive model" set up the lenders to sell off subprime mortgages to investment banks and the GSEs who converted them into MBSs. The "cut and run" profits accrued through upfront commissions and closing costs for brokers, lenders, and securities dealers increased further competition in the subprime market.

Investment Bankers

During the rise in subprime lending, investment banks began to compete with GSEs to meet market demand for MBSs, which, in turn, increased revenue, earnings, stock prices, and management compensation. As indicated previously, the volume of mortgages originated took precedence over the creditworthiness of subprime borrowers and loan default probabilities, since lenders would bundle and off-load mortgages (e.g., principal and interest) to these "Wall Street" investors, who kept the higher rated mortgages and rebundled riskier securities for resale to global investors (Tucker, 2009). Yet many of these investment firms were also "nonbanks," and therefore, not regulated by the FDIC.

A self-perpetuating cycle emerged as securitization attracted investment capital to the U.S. mortgage market, while, in turn, the international demand for capital investments drove the securitization process. The timing was perfect, as the wealth and assets available for investment globally surged in the early 2000s. Murdock (2010, p. 4) reports, "While assets under investment over the decades had grown to $37 trillion by 2002, these assets basically doubled between 2002 and 2007 to $73 trillion." The excess of capital drove a general demand for low-risk investments yielding a nice return. However, the sheer complexity of these structured securities tended to obscure the underwriting standards backing the financial assets.

Bullard and colleagues describe the bundling and securitization of complex securities for resale by these investment banks:

> The banks and other financial institutions that purchased nonprime mortgage loans typically created residential mortgage-backed securities (RMBSs) based on pools of mortgage loans. An RMBS redistributes the income stream from the underlying mortgage pool among bonds that differ by the seniority of their claim. Sometimes additional securities, known as collateralized mortgage obligations (CMOs) or collateralized debt obligations, are created by combining multiple RMBSs (or parts of RMBSs) and then selling portions of the income streams derived from the mortgage pool or RMBSs to investors with different appetites for risk. (Bullard et al., 2009, pp. 405–406)

Securitization of these structured products involved the pooling of assets into nontransparent "special purpose vehicles" (SPVs). Tucker (2009) notes these SPVs generally received investment-grade ratings from the rating agencies enabling investment bankers to sell tranches of the bundled debt to interested buyers. The subordination of SPV ranked the securities according to payment rights; that is, payoffs go to investors holding more senior tranches before those holding subordinate tranches.

According to Tucker (2009, p. 4), "the investment-grade ratings helped fuel the market with cash infusions providing capital for more loans further pushing up housing prices." Investment bankers and investment firms rely on credit ratings in decisions to extend credit or purchase securities. Credit ratings provide a measure of the creditworthiness of debt securities to prospective investors.[4] In seeking credit ratings, investment bankers may not have been forthcoming (intentionally or unintentionally) regarding the quality of the underlying mortgages. Yet, credit and bond rating agencies such as Standard & Poor's, Moody's, or Fitch routinely granted "A" ratings (Pleven, Lucchetti, & Mollenkamp, 2008). As former Moody's Managing Director Jerome Fons has acknowledged, structured products, like MBSs or CDOs, offer little transparency into the quality or nature of the loan collateral. Many institutional investors, such as pension funds, do not have access to the loan-specific data or the resources to evaluate all of the securities they purchase. Securitization by the investment banks and GSEs had the effect of transferring risks from people in a position to understand it to investors who do not (Guha & Tett, 2008).

Credit Rating Agencies

The 1970s mark an important change to the credit ranking industry. CRAs, including Standard and Poor (S&P), Fitch, and Moody's, moved from a *subscriber pays* model, in which bond investors pay the agencies for access to their analysis and ratings, to an *issuer pays* model, in which the bond issuers choose and pay the CRAs that rate their bonds (Bullard et al., 2009). In hindsight, the "issuer pays" model raises a concern of conflict of interest and introduces an opportunity to shop for ratings. A notable omission to this new system was also the general absence of federal oversight of the rating agencies. Rating agencies only began registering with the Securities and Exchange Commission in September 2007 as mandated under the Credit Agency Reform Act of 2006.

CRAs have been accused of blindly stamping their seals of approval on securities that attracted institutional investors and regulated financial firms seeking AA- or AAA-rated investments. The rating agencies either ignored or failed to appreciate both the risks associated with subprime mortgages (and the securities built on these loans) and the compensation structure whereby the firms that sold securities paid the rating agencies for their investment-grade ratings (Bitner, 2008; Lander, Barker, Zabelina, & Williams, 2009). The increasing demand for high-yield, investment-grade securities from both domestic and foreign investors and their willingness to purchase risky mortgages underscores the misperception that these structured and "rated" financial instruments were shielding them from default risk.

In an understatement, Bernanke (2008) claims that many investors blindsided by the collapse of the subprime market failed to appreciate or manage the level of risk in their portfolios. As such, he assigns the "miscalculation" to investors who may have placed too much confidence in the credit ratings associated with the securities and the issuing financial institutions. Surprisingly, Bernanke fails to acknowledge the structure of the bundling and the rating system that enabled wholesale misrepresentation to occur at these and prior steps in the origination and securitization process.

Summary

The "culture of competition" (Coleman, 1987) that developed in the mortgage finance system as a result of the opportunities provided by subprime lending and the housing boom is evident in the above narratives. Once legislation and regulation commenced the diffusion of subprime origination, securitization, and investing, existing and new parties entered the mortgage process in search of what appeared at the time to be limitless financial profits. Nevertheless, to edge out the competition, many players, from brokers and originators to the investment banks, illegally manipulated the process through a variety of means, and ultimately contributed to a devastating global financial crisis.

That the belief system and culture of the mortgage industry turned criminogenic should come as no surprise in consideration of the value businesses place on wealth and success (see Coleman, 1987). What is surprising is how a traditionally benign and risk-aversive financial process could be illegitimately transformed in such a short period of time. This last point substantiates the need to assess the role of subprime lending and fraud in the housing boom–bust period from a systemic perspective, one which Coleman claims requires an assessment of both micro- and macrolevel factors; one that can be accomplished from a diffusion theory perspective.

CONCLUDING COMMENTS

The subprime securitized mortgage market in the United States boomed from 2001 to 2006, began to collapse in 2007, and triggered the global financial crisis in 2008. Explanations include adjustable mortgage interest rate resets, deteriorating quality of loans (e.g., low-to-no documentation), poor underwriting, unstable economic conditions (Bullard et al., 2009), and widespread fraud. Likewise, critics offer the rapid downgrade of MBSs as evidence of flaws inherent in an "issuer pays" credit rating system and an incentive structure that subordinated due diligence (Fons, 2008).

The housing market sustained a relatively long period where residential real estate prices appreciated and default rates were stable. These economic indicators drove the proliferation of originally high-performing securities during a time of declining government regulation and oversight. Yet the financial system structured incentives for financial entities and investors to engage in high-risk financial decision-making that set the stage for the current financial crisis. Ponzi-like and oftentimes fraudulent transactions during a time of steady economic expansion and lack of regulatory oversight contributed to the intrinsic instability of the market. High-risk decisions remained one of the few ways for financial institutions to compete for market share and profitability (Tymoigne, 2009).

In July 2007, S&P announced a downgrade of subprime debt and restructured how it intended to rate MBSs (Hildebrand, 2008). Moody's followed soon thereafter, downgrading hundreds of classes of MBSs in response to "unprecedented levels of misrepresentation and fraud, combined with potentially shoddy initial loan data'' (Barr, 2007, p. 1). These actions appear to have activated the bust cycle in earnest. Yet many agree the entire boom–bust cycle of subprime mortgaging was predictable (Davis & Karim, 2008; Hildebrand, 2008).

Davis and Karim claim there is a specific sequence of events precipitating most boom–bust financial crises. These events include (1) regime shifts-first to laxity (e.g., deregulation) that provokes a credit cycle, later to rigor (e.g., monetary tightening) that triggers a crisis; (2) easing of entry conditions to financial markets, leading to heightened competition and risk taking; (3) debt accumulation and asset price booms, generating vulnerable balance sheets in the financial and nonfinancial sectors; (4) innovation in financial markets, which increases uncertainty during the crisis; and (5) risk concentration and lower capital adequacy for banks, which reduces robustness to shocks (Davis & Karim, 2008, p. 44).

Koller (2010) notes evidence of each of these factors at some point before the subprime mortgage finance system collapsed. She notes the pattern began with the diffusion of the untested and unpredictable subprime innovation, the subsequent entrance of unregulated brokerage firms, low-to-no documentation loans, relaxed underwriting standards (see Foote et al., 2008), and the like. Combined with escalating housing prices and equity accumulations, this represented a regime shift with an upward credit cycle. Homebuyers, brokers, lenders, securitizers, and investors all enjoyed eased entry conditions, which in turn increased competition, risk taking, predatory lending, and fraud. All the while, housing values, origination volumes, and investment profits soared, and what appeared to be manageable debt continued to accumulate across the board. For example, Aalbers (2009) explains that leveraging (funding MBSs with borrowed money) was a common practice, which led to substantial risk concentration and vulnerable balance sheets. When the rating agencies tightened the credit by downgrading billions of dollars in MBS debt, the *perfect storm* ensued.

To promote an understanding of how a criminogenic culture and white-collar crime were nurtured and proliferated within the competitive mortgage finance system, as Rogers (2003) suggests, the sources and progression of a chain of events over time must first be unveiled. Using the diffusion of innovations theoretical framework, which provides for a focus on the innovation, the channels by which information is communicated, the structure and nature of the system, and the time, this discussion has provided a straightforward review of the sequence of events that helped to facilitate the diffusion of fraud through subprime lending.

NOTES

1. In its annual Global Financial Stability report (2008), the International Monetary Fund (IMF) predicts losses will approach $945 billion, while analysts at UBS expect a nominal $600 billion loss (see http://www.nytimes.com/2008/04/08/business/worldbusiness/08iht-imf.3.11771908.html).

2. The FICO score substitutes for laborious underwriting based on documentation of creditworthiness, so long as the prices of the collateral continue to go up. Tymoigne (2009) notes the standard for creditworthiness should account for expected cash outflow from debt service payments based on the normal interest rate and amortization rate, not the introductory terms.

3. These specialized mortgage companies dominated the market for higher-priced mortgages, disproportionately subprime mortgages, which grew to 50% of such mortgages from 2004 to 2006. The following year in 2007, their market share dropped to 21%.

4. Standard & Poor (S&P) and Fitch base their ratings on the probability of default; while Moody's bases its ratings on expected loss, which is a product of (1) the probability of default and (2) the proportion of the investment that investors on average lose in the event of default. However, investors and regulators tend to view the ratings of the major credit rating agencies as roughly equivalent.

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PUBLIC ATTITUDES TOWARD BLAMEWORTHINESS AND CONTROL OF THE MORTGAGE FORECLOSURE CRISIS

Nicole Leeper Piquero, Marc Gertz and Jason Bratton

ABSTRACT

The twenty-first century has seen a wave of white-collar and corporate crime scandals and the economic crisis associated with the home mortgage foreclosure debacle is but one prominent example. Understanding who is to blame for this crisis and what steps can be taken in the future to limit a reoccurrence are important topics of inquiry. Similarly important is understanding public perceptions associated with the mortgage foreclosure crisis, especially since public sentiments are potentially important in influencing crime control policy. Using data from a random sample survey of American adults, this chapter examines the degree to which the public blames banks/lenders as opposed to individual homebuyers for the American foreclosure problems as well as the extent to which they favor specific control and prevention strategies such as government limitations on executive pay or bonuses and legislation aimed at increasing the regulation of business.

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INTRODUCTION

Much has been written in both the popular media and in academic journals about the mortgage foreclosure crisis, its ensuing effects, causes, and potential solutions. The subprime mortgage crisis began to unfold in 2007 when a large number of home mortgage loans became delinquent or went into foreclosure and its effects continue to be felt today. How and exactly why did this happen has been discussed and debated at great length, with a variety of different explanations having been proposed to account for the debacle. One leading argument focuses on the significant role that mortgage fraud has played in the crisis (Black, 2010; FBI, 2009; Friedrichs, 2010; Nguyen & Pontell, 2010), and the lack of oversight regulating the banking industry.

The Federal Bureau of Investigations (FBI, 2009) defines mortgage fraud as "a material misstatement, misrepresentation or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan" and divides it into two categories: fraud for property/housing and fraud for profit. Fraud for property "entails misrepresentations by the applicant for the purpose of purchasing a property for primary residence" (FBI, 2009). In cases such as these, the borrowers tweak their loan applications, usually by inflating income or concealing debt, in order to ensure that they qualify for the home loan but intend to repay the loan. On the other hand, fraud for profit involves gross misrepresentations that often "involve multiple loans and elaborate schemes perpetuated to gain illicit proceeds from property sales" (FBI, 2009). According to the FBI (2009), one of the most common schemes of fraud for profit in 2009 was the mortgage origination fraud, which "involve[s] the falsification of a home buyer's financial information to qualify the buyer for a loan and/or the use of a fraudulently inflated appraisal" (FBI, 2009).

Therefore, mortgage fraud is defined as being committed by either one of two parties, the individual borrowers who misrepresent their own financial situation when taking out the loans or the bank and lending institutions who find ways to defraud or inflate the borrowers' record in order to secure the new loan application. Specifying the source of the fraud is important for understanding not only the reasons behind the fraudulent misrepresentations but also for shedding light on the approaches needed to control and prevent its occurrences. To date, most of what is known about the mortgage fraud crisis has been derived from official records and reports and has seldom asked the public for opinions and perceptions of who is to blame for the current economic crisis and what steps can be taken in the future in order to avoid another crisis.

The purpose of this study is to twofold. First, it explores who (banks/ lenders or the individual homebuyers) the public holds responsible for the recent mortgage foreclosure problems as well as the correlates associated with that blame attribution. Then, it investigates public sentiments regarding two commonly employed control strategies, (a) government placing limits on business executives pay and bonuses and (b) legislation increasing regulation of business, implemented in response to the foreclosure debacle.

LITERATURE REVIEW

Understanding the Reach of the Mortgage Foreclosure Crisis

There are a myriad of sources and data that have been collected and reported in an effort to provide some concrete economic figures that emerged – and continue to grow – with respect to the mortgage foreclosure crisis. For example, using data on mortgage delinquencies and foreclosure starts based on the Mortgage Bankers Association's *National Delinquency Survey*, the U.S. Department of Housing and Urban Development (HUD, 2010, p. 3) reports that between the third quarter of 2006 and the first quarter of 2009, the 90-day delinquency foreclosure rate went from just under 1% to over 3.5%, while the foreclosure start rate increase from less than half a percent to almost 1.5%. HUD (2010, p. 4) also reports that between 2005 and 2008 foreclosure start rates showed the largest increase for subprime mortgages, which increased from about 1.5% of all mortgages in 2005 to over 4% in 2008, but that other mortgage market segments (e.g., prime and Federal Housing Administration (FHA) market sectors) are also trending upward. During the summer of 2010, the Mortgage Bankers Association reported that almost 10% of homeowners had missed at least one mortgage payment (Zibel, 2010).

It is also the case that the rates of foreclosures have been experienced differentially across the United States. Although there are some slight variations over time, since 2005, ''sand states'' (Arizona, California, Florida, and Nevada) have experienced the highest increase in foreclosure starts – in addition to their large run-up in home prices before the crisis hit (HUD, 2010, p. vi). And while putting a precise economic estimate on the cost of the mortgage foreclosure crisis is difficult – as it continues to compound over time – one thing is certain: the costs of the foreclosure crisis to both the government and taxpayer are enormous and will be long-lasting.

Why did this occur? One set of reasons point toward individual homebuyers, who sought to live extravagant lifestyles by purchasing large expensive homes all the while putting little or no money down and with what appears to have been very little to lose over time with low mortgage premiums. Another set of causes focus on mortgage fraud, largely at the hands of banks and lending institutions. Portrayals of these institutions and the individuals who work for them tend to focus on the role of greed but also have incorporated the actions as being part and parcel of "doing business." For example, Nguyen and Pontell (2010) found that mortgage frauds in the subprime lending industry resulted from inadequate regulation, indiscriminate use of alternative loan products, and the lack of accountability and oversight in the industry.

Law enforcement resources have also reported increases in mortgage fraud. According to the FBI (2009), mortgage fraud continued to increase in 2009, just pending investigations have increased – about 71% from fiscal year 2008 to fiscal year 2009 despite government interventions such as scrutiny of loan applications and stimulus interventions.[1] Sixty-six percent of all pending FBI mortgage fraud investigations in 2009 involved dollar losses totaling more than $1 million (FBI, 2009). The federal Financial Crimes Enforcement Network (FinCEN) also reported a 5.1% increase from fiscal year 2008 in suspicious activity reports (SARs) from financial institutions indicating an increase in mortgage fraud reports. The economic impact of mortgage fraud is staggering. In one single estimate for the year 2006, the Mortgage Bankers Association reports estimated costs of fraud in the mortgage industry to have ranged from $1 to 4 billion, while the SARs reported in fiscal year 2009 have revealed losses at $2.8 billion an 86% increase from fiscal year 2008 (FBI, 2009).

Victims of mortgage fraud include not only individual borrowers and those in the mortgage industry but also those living in the neighborhoods and states hardest hit, by experiencing depreciating home values, and by local and state governments who rely upon property taxes to provide public services to its residents. The FBI (2009) reports that the states most effected by mortgage fraud during 2009 include: California, Florida, Illinois, Michigan, Arizona, Georgia, New York, Ohio, Texas, the District of Columbia, Maryland, Colorado, New Jersey, Nevada, Minnesota, Oregon, Pennsylvania, Rhode Island, Utah, and Virginia. Clearly, the impact of mortgage fraud is being felt deeply in important locations and cities throughout the United States.

As can be seen, the scope of the mortgage problem is far-reaching, and there is likely to be blame placed on both individuals and banks/lenders. Yet, an understanding of how the public perceives the cause of this crisis has been slow to come. Just who does the public blame for the mortgage crisis, what factors relate to these views, and what do citizens believe could be done about preventing such a repeat occurrence in the years ahead. Before these questions are addressed, the extant literature on public perceptions associated with white-collar and corporate offending[2] is first reviewed, since it most closely relates to the foreclosure crisis especially as it relates to mortgage fraud.

Understanding Public Perceptions

Gauging the public's interest and concern on matters regarding crime and the preferred methods to control its occurrences are not new topics of criminological inquiry. In the early 1960s, Sellin and Wolfgang (1964) conducted the first empirical study of public perceptions regarding crime seriousness and found that the public was quite consistent in the rankings of violent crimes. Over the years, criminologists have continued to focus on issues of crime seriousness rankings and perceptions of associated punishments. Many advances have been made over the years in this area of research, for example, measurement strategies regarding seriousness rankings has greatly improved (Stylianou, 2003), but only recently has exploration into white-collar crime been included in the discussion (Cullen, Clark, Link, Mathers, Niedospial, & Sheahan, 1985; Cullen, Clark, Mathers, & Cullen, 1983; Holtfreter, Van Slyke, Bratton, & Gertz, 2008; Kane & Wall, 2006; Piquero, Carmichael, & Piquero, 2008; Rosenmerkel, 2001; Rossi, White, Bose, & Berk, 1974; Schoepfer, Carmichael, & Piquero, 2007; Wolfgang, Figlio, Tracy, & Singer, 1985). Not surprisingly, much remains to be learned.

Most research assessing public perceptions of crime and punishment tends to ask samples of respondents how they view or perceive certain types of crimes, asks them to rank the crimes in terms of their seriousness, and then queries them about what is believed to be an appropriate response or punishment for the wrongdoing. This line of research focuses on understanding the priorities of the public by focusing on which types of crime are deemed to be "serious," who should be blamed for the wrongdoings, and to probe what course of action is most preferred. This gained knowledge is then (presumably) used by policy makers in setting local and national priorities as to which crime types should receive attention and how best to handle them.

A series of studies have explored public perceptions and opinions associated with white-collar and corporate crimes, with most focusing on whether the public believes these types of crimes are serious (usually in relation to street crimes), and also asks questions regarding the punishments that the public believes should be administered to each of the criminal acts in question. Cullen, Hartman, and Jonson (2009) traced the evolution of this public opinion research regarding white-collar crime and identified three time periods: inattention, rising attention, and transformed attention. They note that during the first phase (prior to 1970), the vast majority of the public was disinterested in the issues of white-collar crime but such views began to change during the second phase (1970–2000), wherein a series of research studies found that people were not only aware of white-collar crime but were also ranking them as serious if not more serious than some street crimes. The final phase (2000–present) continues the admonition against white-collar crime, with views tending to become much more punitive, and in line with public sentiments regarding crime punishment in general (Cullen et al., 2009). In short, during this final phase the public has started to view and demand white-collar crimes to be treated just like street crimes by the criminal justice system such that they wish the criminal law to handle and control these misconducts appropriately.

The overarching trend in public perceptions regarding economic crimes appears to be not only simple awareness but also a demand for the government and the criminal justice system to get involved and do something about the wrongdoings. This reaction is not surprising given recent business scandals (e.g., Enron, Worldcom, Madoff) and the overall economic crisis of the past few years. This is consistent with the pattern of criminalizing and regulating business wrongdoings as outlined by Unnever, Benson, and Cullen (2008). These scholars note that there is a three-step process involved in cracking down on business and economic wrongdoings that includes a scandal being discovered, a public outcry demanding the government do something to correct the wrong(s), and some sort of government action usually by means of prosecution(s) and/or implementation of new laws and regulations.

Public perception research has not only focused attention on assessing whether or not the public believes white-collar crime is serious and adheres to specific punishments with those crimes, but this line of research has also sought to examine the factors that influence these views. For example, Unnever and his colleagues (2008) analyzed data from a 2002 ABC News and *The Washington Post* poll to examine public support for getting tough on corporate crime. Their findings revealed that overall Americans favored harsher penalties for corporate crime, but also found that group differences existed. That is, even though they found that both liberals and conservatives equally supported punishing such criminals more harshly, they also found that Blacks were more likely than Whites to endorse more restrictive and more punitive policies toward corporate offenders (pp. 176–177).

Schoepfer and her colleagues (2007) examined data from the National Public Survey on White Collar Crime to examine whether public perceptions of the certainty and severity of punishment varied between specific types of white-collar (fraud) and street (robbery) crimes. They found that while citizens believed street criminals were more likely to be caught and to be sentenced more harshly than white-collar criminals, they also believed that both crimes should be treated equally in terms of receiving the similar punishments. As was true in the Unnever et al. (2008) study, they also found group differences in perceptions. Specifically, they uncovered that the more highly educated respondents and those with higher incomes were more likely to indicate that street crimes would be detected and punished more severely than the white-collar crimes while city dwellers, conservatives, and the highly educated were more likely to believe that both robbery and fraud should be treated similarly by the criminal justice system. As such, Schoepfer et al. reported an important distinction between the public's view of what is currently being done to handle the two crime types and what should be done. Similarly, Holtfreter and colleagues (2008) used data from a 2005 national sample of adults to also examine citizen perceptions of white-collar and street crime, as well as attitudes regarding apprehension and punishment. These authors found that citizens' perceptions consistent with the prior findings – that respondents believe the street crimes are more likely to be detected and receive harsher punishments but that they also desire more social controls be put into place for white-collar crime, which in their investigation was measured as fraud. These authors also uncovered similar group differences.

As can be seen, there is a small but slowly growing knowledge base with respect to public attitudes toward white-collar and corporate crimes, but these efforts are limited by their focus on a generally narrow set of offenses and do little to explore blame attribution and future prevention beliefs. Further, none of them have explored more specific economic and crime issues such as the mortgage foreclosure crisis which not only hit many residents personally, but whose far reach surely led to vicarious knowledge about the scope and eventual cost of the problem that produced ripple-effects noticed at all strata of business and society at large in the United States and subsequently around the world (though see Braithwaite, 2010).

CURRENT STUDY

This study uses data from a random sample survey of American adults to assess the degree to which the public blames individual homebuyers or banks/lenders for the mortgage foreclosure problems and crisis, and also the extent to which they favor specific control and prevention strategies such as government limitations on executive pay or bonuses and legislation aimed at increasing the regulation of business.

An analysis of public perceptions associated with the economic crisis generally and the mortgage foreclosure problem in particular is important not only from a purely academic interest but also because public sentiments are important in helping the dialogue that shapes crime control policy (Roberts, Stalans, Indermaur, & Hough, 2003). As it pertains to the economic crisis, the current study extends the literature on public opinion about white-collar crime since the literature has tended to focus on knowledge about how white-collar crimes relate to street crimes and more generally solidifying a ‘‘narrative about white-collar offenders that depicted them as bad guys’’ (Cullen et al., 2009, p. 33). By focusing on blame attribution as well as the public's views with respect to preventing the economic crisis from repeating, this study provides an initial empirical exploration that is situated more generally in this volume's focus on crime and the economic crisis.

METHODS

Data

A nationwide survey of 420 household interviews was conducted between September 9, 2009 and December 28, 2009. The random-digit dial sample was developed using a list-assisted sampling methodology (Tourangeau, 2004, pp. 778–779). The average interview lasted 22.9 minutes and was conducted with an adult household representative. Only one member of each household was interviewed. Household respondents were selected by interviewing the person in the household who was over the age of 18 and who had celebrated the ‘‘most recent birthday’’ (Kish, 1965).

The overall response rate was 32.8%.[3] Cases of unknown eligibility, such as answering machines, busy signals, no answers, and known ineligibility (e.g., disconnected numbers, businesses, and fax machines) were excluded from this calculation as recommended by the American Association for Public Opinion

Research (2008). A five-callback rule before substitution was implemented for records of unknown eligibility.[4] In order to increase response and completion rates,[5] respondents who initially refused to participate were contacted again by an interviewer and asked again to complete the survey. Those respondents who continued to refuse were contacted once more by a supervisor who encouraged his or her participation.

Dependent Variables

In order to assess public attitudes of blameworthiness regarding the mortgage foreclosure crisis, respondents were asked ''Whom do you think is primarily responsible for the foreclosure problems in the United States?'' A dichotomized response option was provided to include banks and lenders (coded 1) or individual homebuyers (coded 0). More than three-quarters of the sample (77%) blamed banks and lenders.

Respondents were also asked about two specific strategies for controlling and preventing future occurrences. These questions were developed largely because banks had made large profits via mortgages and top executives received significant compensation and bonuses and because the U.S. government took active steps in delineating oversight procedures (Friedrichs, 2009, 2010). They were asked ''Do you favor government limits on CEO pay and bonuses?'' and ''Do you think that new legislation that increases regulation of business can have a major effect on correcting the problem of corporate corruption?'' Response options for each question were yes (coded 1) or no (coded 0). More than half of the respondents were supportive of each of the proposed control strategies (56% and 55%, respectively).

Independent Variables

A number of independent and control variables were collected in line with extant public perception research. Respondents were asked to describe themselves politically as one of the following: very liberal, liberal, middle of the road, conservative, or very conservative. The variable was recoded to indicate liberal (coded 1) versus not liberal (coded 0), with 21% of the sample self-identifying as liberal. Respondents were also asked to indicate what race they considered themselves to be, with response options including: White, Black, Hispanic (including Latino and Mexican-American), Asian/Pacific Islander, American Indian, or other. Due to the fact that the majority of the sample (85%) was

White, the variable was recoded as Non-White (0) and White (1). Additional controls were included for age (mean = 52.33, range 18–94), sex (coded male = 1, 48%; female = 0), marital status (coded married = 1, 70%; not married = 0), homeownership (coded owning one's home = 1, 86%; other = 0), and whether or not the respondent was currently working outside the home on a full-time basis (coded yes = 1, 40%; no = 0).

In addition to the control variables, two other variables were collected to assess respondents' beliefs about executive greed in the workplace and overall impressions of corporate corruption. Respondents were first asked "Would you say top executives of large corporations taking actions to help themselves at the expense of the corporation is very widespread, somewhat widespread, happens occasionally, or never happens." Responses were coded so that higher values indicate that respondents believed executive greed was a rare occurrence (or never happens). Next, respondents were asked whether they thought "The problem of corporate corruption has gotten worse in the past few years or has always been like this." This variable was coded such that higher values indicated that the problem of corporate corruption has always been like this (coded 2), while perceptions that corporate corruption has gotten worse was coded as 1.

Descriptive information for all variables can be found in Table 1.

Table 1. Descriptive Statistics.

Variable	Mean	Standard Deviation	Minimum Value	Maximum Value
Dependent variable				
Blameworthiness (banks/ lenders)	0.77	0.42	0	1
Limit CEO pay	0.56	0.50	0	1
Increase legislation	0.55	0.50	0	1
Independent variables				
Liberal	0.21	0.41	0	1
White	0.85	0.36	0	1
Age	52.33	14.61	18	94
Homeownership	0.86	0.35	0	1
Full-time employment	0.40	0.49	0	1
Male	0.48	0.50	0	1
Married	0.70	0.46	0	1
CEO greed	1.84	0.81	1	4
Corporate corruption	1.48	0.50	1	2

RESULTS

The analysis begins by examining the correlates associated with blame attribution. As respondents were asked whom is to blame for the mortgage foreclosure crisis (individuals = 0 or banks/lenders = 1), a logistic regression was estimated. The first column (Blameworthiness) of Table 2 shows that four variables emerged as significant predictors: liberal, age, marital status, and executive greed. Liberals are four times (OR = 4.02) more likely than non-liberals to assess blame to banks/lenders, while older respondents are less likely to blame banks/lenders and more likely to blame individuals (OR = 1.02). Married respondents are less likely to blame banks/lenders and more likely to blame individuals (OR = 0.43). Finally, respondents who believe that greed was not a common occurrence among executives are more likely (OR = 0.63) to attribute blame of the mortgage foreclosure crisis to the individual homebuyers than to banks/lenders. Conversely, and as would be expected, respondents who believe greed to be common among executives are more likely to attribute the mortgage foreclosure crisis to banks/lenders.

The analysis next turns to an examination of the correlates associated with public sentiments regarding two commonly employed government control strategies. The second column (Limit Pay/Bonus) of Table 2 presents the logistic regression results for those who favor government limits on executive pay and bonuses (coded 1). The results indicate that liberals (OR = 1.85), those who work full time (OR = 1.60), and females (male OR = 0.46) are more likely to support government limits on executive pay

Table 2. Logistic Regression.

	Blameworthiness		Limit Pay/Bonus		Increase Legislation	
	OR	Standard error	OR	Standard error	OR	Standard error
Liberal	4.02*	1.95	1.85*	0.56	2.30*	0.70
White	0.60	0.30	0.85	0.30	0.65	0.23
Age	1.02*	0.01	1.01	0.01	0.98**	0.01
Homeownership	1.30	0.67	1.10	0.43	2.98*	1.15
FT employment	1.54	0.48	1.60**	0.42	1.03	0.26
Male	0.63	0.18	0.46*	0.11	0.63*	0.15
Married	0.43*	0.17	1.11	0.31	0.65	0.18
CEO greed	0.63*	0.12	0.57*	0.09	0.81	0.12
Corporate corruption	0.77	0.23	0.61*	0.15	0.58*	0.14

$^{*}p<0.05$, $^{**}p<0.10$.

and bonuses than non-liberals, those who do not work full time, and men. Additionally, those who indicated that greed is not a common occurrence among executives (OR = 0.57) and those who believe that corporate corruption has always been like this (OR = 0.61) are more likely not to agree with the government placing limits on executives pay or bonuses. Conversely, respondents who believe greed to be common and respondents who believe that corporate crime has gotten worse are significantly more likely to prefer government limits on executive pay or bonuses.

Finally, the logistic regression results predicting favorable responses toward legislation designed to increase regulation of business are presented in the final column (Increase Legislation) of Table 2. Five variables attained significance. Liberals (OR = 2.30) and homeowners (OR = 2.98) are each over two times more likely than non-liberals and non-homeowners to believe that business regulation legislation could affect (and help curb) corporate corruption. Older (OR = 0.98) respondents along with male respondents (OR = 0.63) are more likely to believe that increased regulation will not be helpful in curbing corporate corruption, while younger and female respondents are more likely to believe that increased legislation will be effective in curbing corporate malfeasance. Finally, those who believe that corporate corruption has always been like this (OR = 0.58) are less likely to believe that legislation regulating business could correct corporate corruption.

DISCUSSION

The United States has a chequered past with respect to money, the accumulation of wealth, and white-collar and corporate malfeasance. The past three decades have witnessed record-breaking profits and record-breaking losses, the latter of which has directly targeted average citizens (compare the Savings and Loan debacle, the Enron investigation, and the focus of this study, the mortgage crisis).

As previously noted, much research has attempted to document and estimate the reach of the devastating effects of the mortgage foreclosure crisis to individuals, communities, and local governments. Additionally, both federal and state governments have taken actions to help stem the flow of financial losses to all parties involved. What has been lacking in this growing body of official reports, however, was how the general public views the economic crisis in terms of who is to blame and what the government should do about forestalling a future crisis. The pattern of mobilizing government action as articulated by Unnever et al. (2008) clearly came into play in the current financial crisis; the mortgage foreclosure debacle (the scandal) came to light, the public demanded something be done about it, and the government responded by passing a number of stimulus interventions and increasing enforcement and prevention efforts at protecting the financial system (e.g., the creation of Financial Fraud Enforcement Task Force in November 2009).

Past research has shown that the public is growing increasingly more punitive in their attitudes and perceptions about what should be done to curb economic crimes, such as white-collar and corporate crime (Cullen et al., 2009; Unnever et al., 2008), but what has been little understood and even less investigated is who the public believes should be blamed or held accountable for the actions and what policies are believed to stop and prevent these events occurring in the future. In order to provide an initial inquiry into these issues, the current study collected data from over 400 adults from across the United States during the midst of the mortgage financial crisis (in the fall of 2009) to assess blameworthiness and to gauge support for two crime control policies. The findings revealed that the public overwhelmingly blamed the banks and lenders (77%) for the foreclosure problems in the United States and more than half supported government limits of executive pay and bonuses (56%) and the implementation of legislation designed to increase business regulation to combat corporate corruption (55%).

An examination of the correlates associated with these outcomes revealed several notable findings. First, the liberal effect was, not surprisingly, significant and quite strong. Respondents who self-identified their political ideology as liberal were more likely to blame the banks/lenders for the foreclosure problems and likewise strongly favored government interventions in terms of limiting executive compensation and increasing business legislation. Second, men do not favor government interventions to regulate business even in spite of the mortgage foreclosure crisis and the corresponding economic downturn faced by the nation. On the other hand, women strongly supported government interventions. Why this gender divide emerged is most interesting. One potential explanation is grounded in the notion that women espouse different views of morality than do men. Gilligan (1982) argues that females' moral development tends to be guided by the primacy of human relationships and focuses on avoiding harm while males tend to construe morality in more utilitarian terms. The differences in socialization, then, may lead to stronger moral prescriptions against (all sorts of) criminal activities for women, which in turn produces more support with ideas of prevention and formal social controls. Research by Hurwitz and Smithey (1998), using data on a small sample of White Kentucky citizens confirms the finding that women are more supportive of more general crime prevention efforts than men. Finally, a tone of overall apathy toward the business environment and executives was also revealed by the respondents. While it appears that a villain in the mortgage debacle has been identified as the banks/lenders, there also appears to be a perception that little can be done to curb, stop, or prevent the behavior from occurring. This ''Eeyore'' effect seems to suggest that this is the way things do and have always operated in the world of business and finance and there is little that can be done to stop it. Apathy seems to be an important characteristic in our sample.

To be sure, there are several limitations to the current study that are noteworthy. First, the dichotomous restriction of who is to blame for the foreclosure crisis, the individual homebuyers or the banks/lenders, forced respondents to choose one group or the other and did not provide an option that attributed blame to both groups. It is plausible that some respondents did in fact believe that both parties are responsible for what has happened. Future studies examining public perceptions of blameworthiness need to consider expanding public blame attributions in this regard. Relatedly, ensuing studies should consider public perceptions of alternative forms of punishment and regulation, including restorative justice efforts, which seek less to punish in a deterrence/punitive manner and more as a way of preventing further occurrences in a communitarian fashion (Braithwaite, 2010; Piquero, Rice, & Piquero, 2008).

Second, the data were collected during the height of public discussions regarding the doom and gloom associated with the economic downturn. It is, therefore, possible that some of the perceptions reflect the tone and emotional fervor of the time rather than the reality of the public's own situation. Third, the current study did not unpack the impact of the foreclosure crisis by region, by state, or at even smaller units of analysis. Given that states felt the economic impacts at different points in time and that some states were hit harder than others, regional (or state) variations may also be relevant when studying public perceptions of the mortgage crisis.

Fourth, the current study focused attention on the mortgage economic crisis in the United States; yet, the ripple-effects that occurred (and continued to occur) throughout the world – especially in other countries in the European Union, remain little documented and understood. Unemployment and debt problems in those countries – especially Spain, Greece, and Portugal, dwarf the problems experienced in the United States. Empirical research is needed an international manner so as to examine how public sentiments and policy proscriptions have dealt with the more global economic crisis. Finally, it will be interesting to consider public perceptions over time, especially with respect to how citizens have coped with the economic crisis, the new mortgage loan requirements, and what they perceive to be the effectiveness of government and business regulations over the banking/mortgage interest.

NOTES

1. The stimulus packages include the $300-billion Housing and Economic Recovery Act (HERA) of 2008, the $4-billion Community Block Grant, the $700-billion Emergency Economic Stabilization Act (EESA), the $787-billion American Recovery and Reinvestment Act (ARRA), and the Neighborhood Stabilization Program (FBI, 2009).

2. The long-standing debate over the exact definition and nature of white-collar and corporate crimes is beyond the scope of this chapter (see Helmkamp, Ball, & Townsend, 1996 for a review). The focus on these types of crime in the current study is because they tend to be economic in nature and, as such, influence the larger economy. They also tend to be treated differently by both the general public and the criminal justice system, although for presumably different reasons.

3. American Association for Public Opinion Research response rate calculation RR6.

4. Of increasing concern to survey research is the use of call-screening devices (Tuckell & O'Neill, 2002). The Data-Tel predictive dialer used in this research anticipates call-screening devices used to indicate that a household is ineligible, commercially known as a "Tele-Zapper." This software passes calls that it deems as screened through the use of privacy blockers and screening services to an operator to determine the appropriate disposition code or action. This operator then continues the call normally.

5. Of those beginning the survey, 91.1% completed the interview while 8.9% ($n = 41$) did not answer all the questions.

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THE SECURITIZATION OF MORTGAGE FRAUD

Harold C. Barnett

ABSTRACT

A subprime loan to straw borrower Charlotte Delaney was used to fraudulently strip equity from an elderly African American couple in Chicago. Following this loan from origination to securitization highlights responsibility for the wave of early payment default loans that contributed to the implosion of subprime lending. The Delaney loan, funded by subprime lender Mortgage Investment Lending Associates (MILA), was representative of the stated income, no down payment loans that defaulted in 2006 at the peak of the subprime bubble. MILA was suffering financially from demands to repurchase loans and was insolvent as early as 2004. MILA underwriters approved the Delaney loans despite obvious indications of fraud. Goldman Sachs bought MILA loans for inclusion in a $1.5 billion residential mortgage-backed security. Goldman Sachs warned investors that subprime loans were high risk and promised extensive due diligence. When subpoenaed for evidence of due diligence on MILA, Goldman Sachs provided none. The drive to generate profits through securitization explains why Goldman Sachs did not investigate and did not uncover MILA's inability to repurchase a growing portfolio of early payment default loans. Competition to buy subprime loans for securitization relieved lenders like MILA of pressure to verify that their loans were sustainable and not fraudulent.

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INTRODUCTION

In January 2006, Henderson Hall and Mary Hawthorne, an elderly African American couple living in Chicago's North Lawndale neighborhood, lost $82,000 to an equity stripping fraud.[1] They had responded to a foreclosure rescue advertisement and signed a sale-leaseback contract, which they believed would let them keep their home. Instead, their home was sold to Charlotte Delaney, a straw buyer, using a no money down, stated income loan from subprime lender MILA (Mortgage Investment Lending Associates, Ltd.). MILA bundled the loan along with 1,762 other subprime loans and sold them to Goldman Sachs to securitize. Delaney made no payments on her loan. Several months later, Hall and Hawthorne were informed that their home was in foreclosure. They subsequently received help from attorney John Elson and the Bluhm Legal Clinic at Northwestern University Law School. The case was settled in their favor in September 2009 for an undisclosed amount.

The Delaney loan was among the 2006 vintage of subprime loans that defaulted soon after closing and were found to be characterized by fraud and misrepresentation. Following the Delaney loan from origination to securitization affords insight into this wave of subprime loans that contributed to the implosion of subprime lending and the subsequent financial meltdown. These loans were a result of aggressive lending combined with extremely lax underwriting on the part of subprime lenders like MILA. They were facilitated by competitive pressure and inadequate due diligence on the part of loan securitizers like Goldman Sachs.

In the first section, I briefly discuss subprime loans, predatory lending, and mortgage fraud. Hall and Hawthorne fit the profiles of subprime borrowers (minority and elderly), homeowners facing foreclosure due to medical and employment issues, and victims of foreclosure rescue fraud.

In the second section, I examine the Delaney loan file and identify red flags that would be observed by a prudent underwriter. Against the backdrop of MILA's aggressive use of automated underwriting systems (AUS), the Delaney file provides a clear example of the failure of underwriting to detect fraud and misrepresentation and helps to explain the surge in subprime early payment defaults in 2006.

In the third section, I focus on the subprime lender MILA, one seller of loans to Goldman Sachs for securitization in residential mortgage-backed securities (RMBS). MILA's cash flow had suffered as early as 2004 from growth in early payment defaults on its loans and demands from investors that they repurchase them. Like other subprime lenders, MILA pursued an "originate to distribute to securitizers" business model. It marketed high-risk stated income and no down payment loans in an attempt to maintain originations in the face of increased competition in a slowing market. MILA eventually ran out of funds to repurchase loans and declared bankruptcy in April 2007.

In the fourth section, I turn to Goldman Sachs, the investment bank that purchased the MILA loans for securitization. The Prospectus for this pool of securitized loans presents a straightforward assessment of the risks posed by these subprime loans and Goldman's commitment to minimize risk through due diligence. A suit by MILAs bankruptcy trustee reveals the red flags that Goldman Sachs would have observed had it performed the promised due diligence. Like the other investment banks at the top of RMBS food chain, Goldman Sachs succumbed to competitive pressure, took its fees, and left investors to suffer the burden of mortgage fraud and misrepresentation.

SUBPRIME LENDING AND MORTGAGE FRAUD

Community reinvestment groups had long characterized subprime mortgages as a vehicle for predatory lending that disproportionately targeted African American and Hispanic borrowers.[2] The Community Reinvestment Act of 1977 outlawed redlining, but the banks that made prime loans did not expand their branch networks into minority neighborhoods (Immergluck & Wiles, 1999). Instead these neighborhoods were served by independent mortgage brokers who specialized in subprime lending, by the subprime divisions of national lenders such as Wells Fargo, and by national subprime lenders like Household International who would become affiliates of major bank holding companies.

Subprime loans are for borrowers with bad credit and other issues that could exclude them from the prime credit mortgage market. Predatory subprime loans target home equity, in particular as a resource for serial cash-out refinances and a pool of funds to allow the lender or broker to charge excessive fees. The market for subprime/predatory loans grew as the rate of home price appreciation accelerated into the mid-2000s.

Predatory lending is often distinguished from mortgage fraud in that the former targets borrowers, while the latter targets lenders. However, what they have in common is that both are facilitated by the characteristics of subprime lending. The same origination practices, lending guidelines, and underwriting practices that allow mortgage brokers to victimize borrowers allow borrowers to victimize lenders.

As a matter of definition, the subprime loans to Delaney fit into the FBI category of fraud for profit – illegal actions taken jointly by a borrower and real estate insiders to inflate the value of property and to borrow with no intention of repayment (Federal Bureau of Investigation, 2006). At the same time, the loan that victimized MILA was used to execute a foreclosure rescue scheme to strip equity from the Hall and Hawthorne property. As discussed in the next section, Hall and Hawthorne lived in one of Chicago's African American and Hispanic neighborhoods with high incidence of predatory lending. It is well possible that a mortgage broker might have "helped" them out of their foreclosure dilemma with an unaffordable subprime loan that, like the loan to Delaney, would have ended up again in foreclosure. Both scenarios would yield outcomes characteristic of many other 2006 vintage subprime loans sold for securitization.[3]

ORIGINATING AND UNDERWRITING FRAUDULENT LOANS

Henderson Hall had lived in his North Lawndale duplex since 1977. The neighborhood was Bohemian from 1890s to the 1920s when these first residents began leaving for Chicago's western suburbs.[4] Between 1918 and 1955, Russian and Eastern European Jews were the majority ethnic group. In the 1950s, blacks moved in from the southern states and the south side of Chicago. Unscrupulous real estate dealers all but evacuated the white population using blockbusting and scare tactics. A former resident wrote that the area just west of the Hall and Hawthorne home had "developed a reputation for being one of the rougher places in the city." It was where his grandfather "and all other black folks that flocked to the West Side during the mid- to late-1950s bought proud brick houses on tree-lined streets with crackless cement sidewalks."[5]

Much of North Lawndale's built environment was destroyed as a result of riots in the 1960s, poverty, and urban decay. Established employers left the area and neighborhood population dropped from around 125,000 in 1960 to less than 42,000 in 2000. In that year, about 94% of the population was black and 5% was Hispanic. Median income was $18,342. A local resident told author Jonathan Kozol that North Lawndale was "an industrial slum without the industry."

Foreclosures rose in the Chicago area with the economic downturn of the early 2000s. Much of the foreclosure activity was concentrated in lower-income and minority communities. Neighborhoods with 90% or greater minority populations experienced a 544% increase in foreclosures, about twice that in neighborhoods with less than 10% minority population. While minority census tracts represented 9.2% of owner-occupied housing, they accounted for 40% of the 1995–2002 increase in foreclosures (Immergluck & Smith, 2005, p. 3).

The number of foreclosure filings in Chicago fell by 26% from 2002 to 2004 and then increased slightly in 2005. Filings exploded by 37% in 2006 and another 35% in 2007. For the 2007 filings, a quarter of the loans were originated in 2001–2004, 28% in 2005, and 35.4% in 2006 (Woodstock Institute, 2008). North Lawndale was among those minority communities with a high rate of foreclosure activity.

Henderson Hall rented and then purchased his North Lawndale home in 1993 with joint titleholder Mary Hawthorne. Hall left his fabricating metal employment due to medical problems. He and Hawthorne then lived on social security and disability payments. They fell behind on their mortgage and were threatened with foreclosure. A solicitation from Unity Management Development Corporation (Unity) promised to stall the foreclosure, buy and hold their property, and lease it back to them. Unity would also improve their credit so they could be refinanced back into their home in 12–18 months. Mr. Hall was ill, had an 11th grade education, and was not sophisticated in financial transactions. He and Hawthorne signed multiple papers that they believed were to refinance their home.[6]

The papers signed included a contract to sell their home for $235,000 and a sale-leaseback contract that would allow them to repurchase their property in 12 months for the same $235,000 if they remained current on their rent. There was also a promissory note for $100,000, although they had never received that sum from Unity and were not aware of that debt.

On January 13, 2006, Hall and Hawthorne were taken to Unity's office for a closing. They were told by Unity that they would need to deed their home to Unity's manager and then lease it back for a period of one year. Unity would get a bank to pay off the mortgage, Hall and Hawthorne would make mortgage payments for a year, and then the home would be resold to Hall and Hawthorne at no cost to them.

In fact, the property was sold to Charlotte Delaney, Unity's office manager, for $235,000. The purchase was financed with a no money down, stated income loan from MILA. Hall and Hawthorne's mortgage was paid off but the roughly $82,000 difference between the sale price and the mortgage payoff and reasonable closing costs was kept by various participants in this foreclosure rescue/equity skimming scheme. Hall and Hawthorne thought that the transaction was a refinance, they would not have expected to receive their home equity in cash at the closing since in their minds they still owned the home.

Ms. Delaney never made any payments on her MILA mortgage and by spring 2006 Hall and Hawthorne received notice that their home, now owned by Delaney, was in foreclosure. MILA had already sold Delaney's first mortgage to Goldman Sachs that in turn had included it in a $1.5 billion securitized mortgage trust. The trustee was subpoenaed for all records pertaining to the Delaney loan and the securitized trust. The records would be used to help establish whether MILA had performed due diligence with respect to the Delaney loan and whether Goldman Sachs had performed due diligence with respect to Delaney and MILA.

The Delaney loan file shows that MILA approved an $188,000 first mortgage and $47,000 second mortgage for Delaney's $235,000 purchase of the Hall and Hawthorne property. Delaney made no mortgage payments on her first mortgage. Subsequent research revealed that the Delaney loan was just one of numerous instances of early payment default, a serious and growing problem associated with the 2006 vintage of subprime loans.

A Fitch Ratings report documents that the 2006 vintage of subprime residential mortgage backed securities (RMBS) was remarkable for early payment default.[7] It attributed a significant portion of these early defaults to the rapid growth in high-risk affordability features in subprime mortgages such as no money down and stated income and saw mounting evidence that in many instances risk was not controlled through sound underwriting practices. "[M]ortgages appear to have become vehicles for misrepresentation or fraud by participants throughout the origination process" (Fitch Ratings, 2007).

Fitch analyzed a sample of 45 early payment default loans contained in 2006 vintage subprime RMBS. They believed that poor underwriting quality and fraud accounted for as much as one-quarter of the underperformance of recent vintage subprime RMBS. The Fitch report goes on to state that "[t]he high volume of mortgage applications over the past few years, coupled with the consumer's demand for more rapid responses to applications, led to use of automation via Automated Underwriting Systems (AUS) and the use of validation to ease heavy underwriting workload" (Fitch Ratings, 2007). Brokers provided information on the borrowers that was only subject to a cursory validation (i.e., check off) process. Information was not verified. Critical data points or red flags that could materially affect the underwriting decision or pricing would be overlooked.[8]

An earlier study by BasePoint Analytics LLC examined over 3 million loans originated between 1997 and 2006 that included 16,000 examples of early payment defaults and loans that went into foreclosure. They found that as many as 70% of the early payment default loans could be attributed to a fraudulent misrepresentation on the original application. These misrepresentations included fraud such as income inflated by as much as 500%, appraisals overvaluing the property by 50% or more, fictitious employers and falsified tax returns. They found that loans with egregious misrepresentations were up to five times more likely to default in the first six months than other loans in the sample (BasePoint, 2007).

The purpose of underwriting is to evaluate the borrower's risk of default and to determine whether the risk of default falls within an acceptable range for a loan program. Underwriting can be automated or manual. The same general characteristics of the borrower and property are taken into account in both. Automated underwriting programs contain algorithms to calibrate the risk associated with primary and secondary loan characteristics. If the loan is approved, the automated system specifies the documentation that is required to verify the information entered into the AUS.

MILA, an aggressive subprime lender, had developed an AUS to enhance its growth and efficiency in origination. As reported in late 2004 by MILA owner Layne Sapp, "MILA's AUS features exclusive software that enables loan applications to be submitted and processed online in less than a day … ." "Launched in 2002, the automated online system draws upon knowledge gained from MILAs many years in the mortgage business to anticipate and account for all of the variables involved in submitting and processing loan applications – variables that can prolong the process for days and days when addressed the old-fashioned way" (Broberg, 2004).

The MILA loans to Delaney were high risk. The first mortgage was a stated income, interest only, 3/27 adjustable-rate mortgage (ARM). The second was a 30-year fixed interest rate loan with a balloon payment due in 15 years. A 100% loan with Delaney's 720 FICO score might be considered to pose a moderate risk. However, her loan involved stated income resulting in an enhanced risk of default since income is not verified. She was self-employed (as Unity's office manager), an employment status that also increased risk. The interest-only feature made her loan riskier as did the fact that she was a first-time homeowner. The risk she posed as a borrower would be even greater had she not misrepresented herself as an owner occupant rather than an investor.

Fitch and BasePoint Analytics both point out that credit scores lose their power to predict default risk when other information provided by the borrower is false. Prudent underwriting can minimize this inherent risk. Examination of the Delaney loan file highlights a series of significant red flags that would have raised questions of misrepresentation or fraud in the mind of a prudent underwriter. Details are provided to demonstrate the clearly flagrant behavior of Unity, Delaney, and the mortgage broker and the fact that even a cursory examination of the file by a knowledgeable underwriter would have revealed the fraudulent nature of the loan and the transaction. The details also reveal that the loan file was passed through many hands and that data was altered in an effort to have the Delaney loan approved.

The most striking red flag in the loan file is documentation of a prior lien on the property. As noted above, Unity had Hall and Hawthorne sign a $100,000 promissory note. The MILA loan file contains documentation of this $100,000 mortgage recorded on January 12, 2006, one day before the closing.[9] The mortgage note provides for "monthly installments of principal and interest, with the balance of the indebtedness, if not sooner paid, due and payable on December 31, 2005." The file does not contain any evidence that this debt was discharged by Hall and Hawthorne nor is there a release recorded with the Cook County Recorder. In the absence of evidence that this debt was paid off, MILA's $188,000 loan to Delaney becomes a second lien and its $47,000 loan becomes a third lien. There would be $325,000 in debt on a $235,000 property. MILA was already having problems with early payment default loans and clearly should have demanded at least a minimal review of loan files by its underwriters.

In addition to the $100,000 lien issue, the HUD1 closing statement forwarded to MILA for funding lists Hall and Hawthorne's actual mortgage plus an additional mortgage lien of $70,472.54 to be paid off at closing. The loan file does not contain any payoff information for this lien or other information to establish its existence. The $100,000 lien above and the lesser payoff here should have resulted in a request for additional documentation to determine if this payoff was to cancel the $100,000 lien. A prudent underwriter might also have asked whether this $70,472.54 payoff was actually a cash-out to the purchaser that would alter the loan risk profile and call for a pricing adjustment in MILA's favor. There is little doubt that this phantom lien was entered to help account for the $82,000 in equity stolen from Hall and Hawthorne.

There is contradictory information regarding Delaney's income that should have raised a red flag for the underwriter. The loan application shows $4,500 in stated self-employment income for Delaney. The appraisal estimates income for the duplex property's rental unit at $1,100/month with operating expenses of $105, a net monthly receipt of $995. No rental income is reported on Delaney's loan application. Nevertheless, MILA calculated debt to income ratios using rental income of $1,125. Had they used the income reported on Delaney's loan application, her ratio of debt to income would have exceeded MILA guidelines for loan approval.

Delaney reported no reserves on her loan application, another red flag. The loan application lists $65,000 in personal property as her only asset. In contrast, MILA's loan overview reports $0.0 in preclosing liquid assets and a negative $9,712.75 in postclosing liquid assets based on the figures in Delaney's loan application. A stated income loan with no liquid assets would be an issue for an underwriter. One test of the reasonableness of stated income is the relationship between stated income and assets. Liquid reserves are also the buffer between any unexpected change in income or expenditures and the ability to pay monthly mortgage debt.

Despite multiple red flags, MILA approved and funded $235,000 in loans to Delaney. The loan facilitated two interrelated frauds. First, Unity, Delaney, and accomplices defrauded MILA by taking out a $235,000 loan with no intention of repayment. Second, that loan allowed Unity et al. to strip $82,000 in equity from Hall and Hawthorne since they put up the latter's home as collateral for the MILA loan.

THE ORIGINATE TO SECURITIZE MODEL

MILA originated loans for sale to Goldman Sachs and other securitizers and was one among scores of subprime lenders who ceased operations or declared bankruptcy in 2007. A single lender cannot represent a random or representative sample of subprime originators. But in examining MILA, we can gain some insight into the behavior of lenders that sold good and bad loans to investment banks like Goldman Sachs.

Until its demise, the saga of Puget Sound-based MILA and its founder, Layne Sapp, was an American success story. Layne Sapp, CEO of MILA, Inc., bought his first house at 18, made his first million at 23, and at 42 was running a billion dollar Internet mortgage company. Sapp took real estate courses while still in high school and learned how to buy houses with zero money down. By age 19 he had purchased 10 homes and organized a private lending fund. In his 20s, Sapp moved from making loans with his own money to "catering to home buyers who for one reason or another – no down payment, unwilling to verify income, and so on – couldn't qualify for a mortgage with a bank but who were still worthy risks … . Those borrowers," said Sapp, "remain MILA's focus today" (Broberg, 2004). MILA became a wholesale lender when Wall Street became interested in mortgage banking. MILA bundled the loans it funded through a warehouse line and sold them to investment banks.

MILA funded $1.5 billion in loans in 2003 and expected to top $3 billion in 2004. In that year, MILA had 550 employees and purchased a new office building that it expected to house 1,200 employees by 2007. By 2006, MILA had 640 employees and $4.5 billion in mortgages (mostly subprime) distributed across 26 states. It expanded to 14 more states and moved into jumbo mortgages (residential loans for more than $417,000) (Frishberg, 2008).

Sapp gained brief notoriety in 2004 when he bought a 130-foot, $15 million yacht and claimed it as a business expense. The next year he was dubbed Entrepreneur of the Year by Inc. magazine (Frishberg, 2008).

MILA was in the business of funding, packaging, and reselling residential real estate loans. Its business model was the same as many other prime and nonprime lenders during the real estate boom – originate loans for distribution to securitizers. Funds to originate the loans came from warehouse lenders, and MILA used its inventory of unsold loans as collateral against this funding source. MILA would usually sell its loans after 30 days seasoning. Like other lenders, MILA agreed to repurchase loans under several conditions, including early payment default. Investors usually had up to 90 days to return the loan to MILA. MILA thus bore the risk of borrower default especially within the first 90 days of funding. A suit filed by the MILA bankruptcy trustee notes that the more loans MILA made, the greater that risk become.

Sapp developed specialized mortgage origination software that helped fuel MILA's growth. The software, AccessPoint, enabled loan applications to be submitted and processed in less than a day and eventually less than four hours. Sapp formed a separate company, Next Online Mortgage Technologies, to develop the software, although MILA absorbed the cost of its development.

AUS, like AccessPoint, need to be calibrated to only approve loans that have an acceptable risk of default. The borrower's credit score and the property's loan-to-value ratio are the two most important variables to predict default. A higher credit score indicates a more consistent history of paying all bills on time, and a lower ratio of loan-to-value means the borrower has more equity at risk. As it turned out, subprime lenders faced several insurmountable problems in deriving a robust AUS algorithm that could minimize default, although most learned this after it was too late.

First, there was virtually no historic data to predict default rates for new products with zero down payment and stated income features. Credit scores were increased marginally to account for the fact that these and other new features raised the risk of default. But the credit score differentials lacked predictive value since they were derived from populations who shared few characteristics with the newer, high-risk borrowers. Second, model predictions of default risk were based on the assumption that the AUS was using accurate data on income, assets, credit, and property values. As subsequently noted by the Fitch and BasePoint studies, credit scores can't accurately predict risk if the AUS is fed inaccurate data. In the absence of a procedure to also streamline the time-intensive task of verifying borrower and property data, an increased rate of loan origination and approval would also increase the rate of delinquency and default. As demonstrated in the Delaney loan file, some borrower and property information were neither checked for consistency nor verified for accuracy.

MILA's financial health was suffering from deterioration in loan quality well before its 2007 demise. Despite growth in its 2004 loan volume, its ratio of revenue to loan sales was worsening. The ratio fell from 3.2% in 2002 to 2.89% in 2003 and declined further to 2.5% in 2004. The trustee notes that even "MILA's overly optimistic 2004 forecasts predicted that those margins would continue to shrink to 2.21% in 2005 and 1.95% in 2006" (In re: MILA, 2008, p. 5). MILA's actual ratio was 1.96% in 2005.

MILA's experience was not unique among subprime lenders. Lender profits reflect the spread between the cost of short-term money and the mortgage rate. The spread had widened after 2001 with a fall in short-term interest rates and then began to shrink in 2004 as short-term rates began to rise while mortgage rates remained relatively flat until late 2005. Competition for borrowers had also increased while the rate of growth in originations had slowed from 83% in 2003, to 78% in 2004, and finally to 24% in 2005. The rate became a negative 66% in 2006 (Zimmerman, 2007).

While revenue per loan sale was shrinking, MILA's obligation to repurchase loans was growing. MILA repurchased about $2.7 million loans in 2002, $8.26 million in 2003, and $37.66 million in 2004. Repurchases represented 0.53% of loan sale in 2002 and had risen to 1.27% in 2004. MILA projected that its loan repurchases as a percentage of total loan sales would triple in 2005 through 2007 (In re: MILA, 2008, p. 5). MILA may have expected that the revenues from good loans would more than compensate for the burden of bad loans. Regardless, by March 2005, MILA was delaying payments, even to important investment banks, to conserve cash.

MILA was ahead of the early payment default curve.[10] While the surge in early payment default seems to have taken most of the industry and analysts by surprise, the reasons are clear in hindsight (Zandi, 2009, pp. 16–18). As subprime loan originations began to top out, lenders needed new products that would allow an expanded pool of eligible borrowers. An expanded pool would generally mean a riskier pool. Hybrid ARMs with low initial teaser rates could allow borrowers to qualify at a start rate even if they could not qualify at a fully indexed and amortized rate. Low or no down payment loans (an 80% first mortgage and a 20% second mortgage) could work for cash-starved borrowers. Stated income loans could eliminate income as a constraint on qualifying. Stated income loans were originally for self-employed borrowers who might have trouble documenting their income, perhaps because they reduced their taxable income by loading their returns with business-related deductions. Now they were available to any W-2/ salaried employee, most of whom should have had no difficulty documenting their income. As already noted, there was little historic basis for determining the risk of default on stated income loans to this population.

To sustain originations, MILA would have had to at least match its subprime competitors in reliance on newer, riskier products. Between 2002 and 2006, the percentage of subprime loans with less than 20% owner equity went from 45.3% to 62.8%. The percentage of ARM loans increased from 73.5% in 2002 to 80.9% in 2005 and then dropped in 2006. More of these ARMs had teaser start rates, offered interest-only features (0.7% in 2002 versus 16.3% in 2005), and allowed 40-year amortization to minimize monthly payments (0.0% in 2002 versus 22.9% in 2005). Low documentation loans (including stated income) rose from 30.5% of the total in 2002 to 42.9% in 2005 (Zimmerman, 2007, p. 10).

Salvation through growth did not work. MILA ceased operation and declared bankruptcy in April 2007. Its Chapter 11 filing listed $7.8 million in assets and $175 million in liabilities. By 2008 creditor claims had ballooned to nearly $2 billion (Grunbaum, 2008). According to one contemporary report, the investment banks that held its mortgages were demanding that MILA buy back those that did not meet their lending standards. Some of these loans were being returned to MILA due to early payment default. Sapp gradually put up about $100 million, including several million of his own, to meet margin calls from his warehouse lenders, but to no avail (Frishberg, 2008).

A lawsuit filed by the trustee for MILA's Chapter 11 bankruptcy raises questions as to whether MILA's demise was inevitable (In re: MILA, 2008). The suit claims that Layne Sapp improperly drained MILA assets as its fortunes declined, depriving it of much needed liquidity. The trustee accused Sapp of ‘‘surreptitiously’’ seizing the mortgage software that MILA paid for and developed, charging MILA for the cost of a yacht and business jets used by Sapp, and buying an office building and leasing it to MILA rather than having MILA own the property.

The suit further alleges that MILA's 2004 after-tax income of some \$17 million was overstated by \$4 million because it failed to recognize losses from loan repurchases. In 2005, MILA records reflected pretax income of about \$7.6 million but the company actually lost \$1.35 million after adjustments for repurchase loss. MILA paid substantial cash dividends to its shareholders in both years. The trustee's complaint alleges that MILA was insolvent as early as 2004.

MILA was not able to resolve the tension between speeding up origination and approval through automation, on one hand, and a commitment to a more time-intensive scrutiny of loan files to avoid early payment defaults, on the other. Analysis of the loans returned to them for repurchase might have revealed that MILA was facing the same situation that BasePoint would report in a 2007 study: ‘‘most risk of early payment default for lenders comes from approximately 6% to 8% of brokers. The overwhelming majority of brokers [in their study] submitted no early payment defaults, even those brokers that submitted extremely high volumes.’’ Less than 10% of the brokers accounted for 100% of the early payment default loans at one nonprime lender included in the study (BasePoint, 2007, p. 6).

Despite what might have been, MILA increasingly approved loans that would experience early payment default, many of which were most likely fraudulent and based on misrepresentation. In making these loans, MILA contributed to the demise of subprime lending. Among the victims of the originate to securitize business model were homeowners like Hall and Hawthorne who lost their equity to a fraud facilitated with a MILA loan and the investors in the Goldman Sachs RMBS that included MILA loans.

GOLDMAN SACHS, SUBPRIME RISK, AND DUE DILIGENCE

Goldman Sachs shared in the \$448.6 billion in subprime RMBS issued in 2006. It bought loans from subprime originators, created structured vehicles and bankruptcy-remote trusts to hold and sell the loans as securities to investors, and partnered with other financial institutions to manage the various fee-generating activities of the trust.

High margins to be earned in packaging and selling RMBS created intense competition for the available pool of subprime loans. Besides direct purchases, financial institutions variously bought existing subprime lenders to access their stream of new originations, partnered with existing subprime lenders, and some like Goldman Sachs, created their own subprime mortgage conduits to get loans from mortgage brokers.

Most of the risk associated with RMBS was passed on to investors who bought the certificates. Investment banks did bear the risk of securities held in inventory before they were sold and for the portions they retained in their portfolios. RMBS could be used as collateral for the short-term funds required to purchase new loans for securitization. Securitizers provided funds to subprime lenders and were the main facilitators of subprime originations.[11]

The Delaney loan was one of a pool of loans originated by MILA and securitized by Goldman Sachs Mortgage Company (GSMC). Goldman Sachs, as sponsor, put together a $1.5 billion RMBS that included a total of 1,762 MILA loans with a principal balance of $243.5 million.[12]

The GSAMP Trust 2006-HE3 closed on May 2006 and consisted of subprime, first and second lien, fixed rate and adjustable-rate residential mortgage loans. Its Prospectus reported sufficient credit enhancements and subordinations such that at least $862 million of its subprime certificates were expected to have the highest S&P and Moody credit ratings. The top-rated tranche included some prime loans to boost the credit rating.

The GSAMP Prospectus provided potential investors with a comprehensive disclosure of the risk factors associated with loans in the pool. It noted that the mortgage loans were made to borrowers who were not able, or did not wish, to obtain financing from traditional sources. These mortgage loans may be considered of a riskier nature. The underwriting standards were generally less stringent than those of Fannie Mae and Freddie Mac. The borrowers may have impaired or unsubstantiated credit histories. As a result, the mortgage loans purchased by the trust may experience higher rates of delinquencies, defaults, and foreclosures than mortgage loans underwritten in a manner that is more similar to the Fannie Mae and Freddie Mac guidelines. Further, the Prospectus notes that in recent years, borrowers have increasingly financed their homes with new mortgage loan products (i.e., stated income and no money down/100% loan-to-value loans). There is little historical data with respect to these loan products. Consequently, as borrowers face potentially higher monthly payments it is possible that, combined with other economic conditions such as increasing interest rates and deterioration of home values, borrower delinquencies and defaults could exceed anticipated levels.

Goldman Sachs also warned investors that there has been a continued focus by local, state, and federal law enforcement and regulatory agencies on certain predatory lending practices by some companies in the subprime industry.

The Prospectus assured investors that prior to acquiring any residential mortgage loans GSMC would conduct a review of the mortgage loan seller. The review would cover select financial information to allow a credit and risk assessment, would review underwriting guidelines, conduct senior-level management discussion, and perform background checks. The underwriting guidelines review would consider mortgage loan origination processes and systems. In addition, the review would consider origination practices by jurisdiction, historical loan level loss experience, quality control practices, significant litigation, and material investors. The Prospective states that the scope of the mortgage loan due diligence would depend on the credit quality of the mortgage loans, which would lead one to expect a more intensive due diligence as the 2006 vintage subprime loans were extended to an increasingly riskier pool of borrowers.

The attorney for Hall and Hawthorne subpoenaed Goldman Sachs for records of all due diligence associated with MILA and its subprime originations. Goldman Sachs provided no documentation to establish that it had performed the due diligence promised in the Prospectus. The files provided did not contain any MILA loan guidelines nor acknowledgment or discussion of MILA's AUS or financial condition.

The purpose of performing due diligence on originators is to provide assurance that the characteristics of the loans purchased for securitization are what the lenders say they are. Ratings agencies then use loan characteristics as reported by the lenders to help structure the mortgage-backed securities and assess the risk of default. Just as credit scores are a meaningless predictor of default if a borrower's profile is fabricated, a credit rating is meaningless if the underlying loan data is fraudulent or misrepresented. Further, while lender representations and warranties require them to repurchase loans under conditions including early payment default, these promises are only meaningful if the lender has the resources to make the repurchase. Moody points out that an originator's ability to honor its obligations is crucial. The originator needs to have adequate tangible net worth relative to the liabilities created by representations and warranties (Ashcraft & Schuermann, 2008, p. 74).

Goldman Sachs had warned investors that there was a significant risk of delinquency and default associated with "new loan products," that there was the possibility of illegal or unethical behavior on the part of originators, and, consequently, that there was a need to perform due diligence reviews on originators in the interest of its potential investors. The MILA loans were high-risk loans. Regardless, we have no evidence that Goldman Sachs performed due diligence on MILA.[13] We can reasonably speculate that had Goldman Sachs carried out due diligence as outlined in the Prospectus, it would have uncovered the financial data that was subsequently reported in the MILA bankruptcy suit.

As reported above, the bankruptcy trustee alleged that MILA was insolvent well before Goldman Sachs purchased the MILA loans to securitize. Goldman Sachs was one of MILA's unsecured creditors (In re: MILA, 2008, p. 5). MILA had been required to repurchase loans worth $37.7 million in 2004 and was projecting that its loan repurchases as a percentage of total loan sales would triple in 2005 through 2007. We do not know how many of these loan repurchases were with GSMC. The lawsuit claims that by the end of 2004, MILA had unreasonably small capital in light of its future anticipated expenses and growth. By March 2005, MILA was already delaying payments, even to important customers, to conserve cash. We do not know whether MILA was delaying payments to GSMC.

In hindsight, we know that Goldman Sachs and other securitizers seriously underestimated the risk of default associated with subprime loans originated in 2006. Regardless, they did know that the risks were substantial and that due diligence was necessary. Intense competition for subprime loans to securitize and the fact that compensation was based on volume provides the best and simplest explanation of their lack of due diligence. Any securitizer that raised the bar on underwriting, verification, and disclosure of financials by subprime originators was likely to lose out to competitors who were less demanding. Securitizers like Goldman Sachs thus took the pressure off subprime lenders to adhere to their guidelines, warranties, and representations. In providing funding to subprime lenders while not performing due diligence, Goldman Sachs facilitated the fraud and misrepresentation associated with loans from MILA and its other subprime originators.

Securitizing subprime RMBS was hugely profitable, but all investments have their limits. In a Michael Moore moment, I asked a retired Goldman Sachs managing director why subprime securitization continued despite warning signs. He cryptically said that trees do not grow to the sky; that developers move forward until someone tells us to stop. Goldman Sachs would securitize if profitable and then move on. When Goldman Sachs saw the looming crises in the subprime sector in late 2006, it responded by reducing its inventory of mortgages and mortgage-backed securities and buying insurance against further losses (Anderson & Bajaj, 2007).[14]

CONCLUSIONS

The narrative in this chapter goes from bottom up in that it follows the investigation of the Hall and Hawthorne case. Responsibility for what transpired, however, runs from the top down.

Goldman Sachs and other securitizers funded subprime originators like MILA while there were profits to be made. In the case of Goldman Sachs and MILA, the legal obligation to perform due diligence appears to have became an afterthought in the competitive race for new mortgages to package and sell. Goldman Sachs did not turn a blind eye to all signs of distress since it successfully insured against some loss from its inventory of 2006 vintage subprime loans.

In this highly competitive environment, subprime lenders could sell all the loans they could originate. They aggressively marketed their new affordability products to borrowers whether or not they were likely to sustain long-term homeownership. They believed that their AUS could predict default in these untested waters. In the absence of due diligence from the securitizers, the originators could forego verification of borrowers income, assets, credit, and property in a rush to maximize volume. In so doing they created an opportunity for the unscrupulous and a temptation for the greedy and the naïve. The result was an increase in predatory lending practices and fraud and misrepresentation. These in turn caused an unprecedented increase in early payment default loans that helped to end subprime lending.

Fraud has winners and losers. Foreclosure rescue/equity stripping perpetrators like Unity, Delaney, and their associates often walk away with the equity of distressed homeowners and that of the investors in securitized residential mortgages. The originators and securitizers of subprime mortgages took billions of dollars in fees at closing, while those left holding toxic assets suffered substantial loss. There is an unprecedented incidence of abandoned and foreclosed properties in many communities and the media is filled with stories of distressed homeowners.

Originators, securitizers, and regulators were aware of predatory lending and mortgage fraud but assumed that they were no more than unfortunate adjuncts of subprime lending. The story of Hall and Hawthorne, MILA, and Goldman Sachs suggests that the risk of fraud was seriously underestimated.

It provides an illustration of the contribution of subprime securitization to mortgage fraud and the contribution of mortgage fraud to the subprime meltdown.[15]

The subprime and broader financial meltdown leaves us with two huge problems. First, we have bailed out some of the biggest contributors to mortgage fraud through securitization and have created programs to encourage mortgage servicers to apportion losses between RMBS investors and distressed homeowners.[16] FBI mortgage fraud-related suspicious activity reports continue to grow suggesting that loan modification programs have left many without reasonable options and exposed to offers of help that will leave them worse off. There is clearly a need for more viable options to avoid subjecting homeowners to serial victimization.

Second, regulation did little to limit the subprime lending that precipitated the meltdown. The Federal Reserve promulgated rules, after the fact, that would have made some difference, and a consumer finance protection agency is in a state of becoming. This is a move in the right direction. However, any system that raises the bar for some property owners provides an incentive for others to cross that bar via fraud. Therefore, deriving meaningful controls that involve more than an increase in the volume of unread paper signed at closing remains an obvious challenge. A further challenge is to guarantee that new regulation aimed at mortgage market excess will remain in place when the next financial boom exposes borrowers and investors to losses from fraud and misrepresentation.

NOTES

1. An earlier version of this chapter was presented to the American Society of Criminology (Barnett, 2009). A sequel (Barnett, forthcoming) traces mortgage fraud through the financial meltdown and the SEC suit against Goldman Sachs in relationship to its bets against the housing market.

2. A recent summary of this argument is provided by the National Community Reinvestment Coalition civil rights complaint against Fitch and Moody rating services, submitted to HUD on November 17, 2008.

3. An extended discussion of the relationships between subprime loans, predatory lending, and mortgage fraud is provided in Barnett (forthcoming).

4. Information in this and the following paragraph are from North Lawndale, Chicago, Wikipedia, http://en.wikipedia.org/wiki/North_Lawndale,_Chicago, downloaded on October 11, 2009.

5. From John W. Fountain (2005): *True Vine: A Young Black Man's Journey of Faith, Hope, and Clarity*. Public Affairs, quoted in *ibid.*

6. The details of the case are from the complaint in Hall versus Unity Management Development Corp., et al., Circuit Court of Cook County Illinois,

Chancery Division, Case 7CH36731, and Expert Report of Harold C. Barnett, Ph.D., September 2, 2009.

7. Early payment defaults are typically classified as loans that become delinquent by more than 60 days in the first year after closing. The definition varies by lender.

8. The characteristics of the Delaney loan match most of the Fitch findings for their early payment default sample.

9. The note was recorded the day before the closing so that it would not be included in the preliminary title search. Title company records from their ''plants'' lag recording by a week or more. Cook County records show that Delaney had recorded a promissory note for another property on January 12 for a closing on January 13. It is reasonable to assume that it was another version of the same fraud.

10. Zimmerman (2007) reports that the rate of subprime early payment default was less than 1% before 2006. MILA's was 1.27% in 2004.

11. Warehouse lenders provided short-term funding for loans that was then sold to a securitizer. The proceeds of that sale would pay off the warehouse loan.

12. The details of the Prospectus for the Goldman Sachs RMBS are taken from the file provided to Hall and Hawthorne's attorney. A copy of the same Prospectus for GSAMP Trust 2006-HE3 is available online using the Edgar database at http://www.sec.gov/edgar/searchedgar/companysearch.html

13. It has been alleged that securitizers contracted out to due diligence firms but often ignored the reports and did not pass their findings on to credit ratings firms. The files provided by Goldman Sachs in the Hall case show that RMBS servicer Litton did not act on its authority to have the Delaney loan repurchased by MILA even though Delaney had made no payments since the loan closed.

14. The federal bailout of AIG helped to pay off credit default swaps that Goldman Sachs had used as insurance against subprime mortgages.

15. In an October 20, 2009 PBS Frontline program on efforts to regulate derivatives, Fed chairman Alan Greenspan is quoted as stating that in the late 1990s fraud was not an issue for regulators since it would be controlled by the market.

16. For an analysis of TARP distributions to subprime securitizers, see John Dunbar and David Donald, ''The Roots of the Financial Crisis: Who is to Blame?'' Available at http://www.publicintegrity.org/investigation/economic_meltdown/

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SOCIAL REACTIONS TO WHITE-COLLAR CRIMES AND THEIR RELATIONSHIP TO ECONOMIC CRISES

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ABSTRACT

A number of approaches might be taken to the relationship between economic crises and white-collar crimes. One is to review the role that white-collar crimes played in causing economic crisis, but this is legally problematic. This chapter begins with a discussion of social reaction to different forms of white-collar crime, and then goes on to examine briefly the evidence for the impact of the economic crisis on levels of frauds. The core argument is that the economic crisis did affect social and official reaction to some frauds – though the impact of this may be temporary – but that unlike most "law and order" issues, politicians around the world have typically downplayed fears of elite criminality and serious misconduct. Most reactions to white-collar crime reflect longer-term populist sentiments that prioritize offenses such as identity theft and fraud. Furthermore, there is little evidence that the Global Financial Crisis did much to increase the risk of fraud, though it is easy to misattribute the revelation of longer-running frauds to the crisis instead of to the fact that the recession smoked them out of the woodwork.

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INTRODUCTION

> What is a pick-lock compared to a debenture share? What is the burgling of a bank compared to the founding of a bank? What is the murder of a man compared to the employment of a man? … Nowadays a man must work within the law; it's just as much fun! … In this present age one uses peaceful methods. Brute force is out of date.
>
> Berthold Brecht *The Threepenny Novel* (1961, p. 226)

There are a number of approaches that one might take to the relationship between economic crises and white-collar crimes. One, not taken forward here (partly because of libel risks) or by the Financial Crisis Inquiry Commission (2011), is to review the role that white-collar crimes played in *causing* economic crisis. Instead, this chapter begins with a discussion of social reaction to white-collar crimes (the plural intentionally selected to emphasize variation within the category), and then goes on to examine briefly the evidence for the impact of the economic crisis on levels of frauds. The core argument is that the economic crisis did affect social and official reaction to some frauds – though the impact of this may be temporary – but that most reactions to white-collar crime reflect longer-term populist sentiments. Furthermore, there is little evidence that it did much to increase the risk of fraud, though it is easy to misattribute the revelation of longer-running frauds to the recession itself rather than to the fact that the recession smoked them out of the woodwork.

Sutherland and Cressey (1960, p. 3) began their famous textbook with "Criminology … includes within its scope the processes of making laws, breaking laws, and reacting towards the breaking of laws … This sequence of interactions is the subject matter of criminology." They acknowledged the impact of social attitudes on the lawmaking process, but they were writing in the period before mass television, let alone the rise of social networking sites and (mainly neo-Conservative) Think Tanks. When seeking to account for social reactions to "crime" generally, criminologists hardly ever use crimes by or even against business as anything other than homogeneous outliers against which to juxtapose the severe reactions to "crimes of the underclass": this is implicit in the rhetorical bite of the title *The Rich Get Richer and the Poor Get Prison* (Reiman & Leighton, 2009). Much of the white-collar crime literature also is concerned with how such "offenders" avoid the criminal label, as prosecution typically is "the road not taken" (though unlike Robert Frost's traveler, those avoiding prosecution seldom pine for the other road). Yet as the new (or allegedly new) crimes of globalization surge quite regularly into the media, public and social consciousness, we should examine more carefully the relationship between white-collar crimes and the economy, and also the relationship between such crimes and the institutional and media manufacture of fear. There is scope for consideration about whether white-collar crimes and criminals have been inappropriately neglected by both the moral panic literature and the broader literature of "cultures of control" to which Garland (2008) connects moral panics: though in the search for clarity of perspective he, like many other writers on contemporary penality (e.g., Simon, 2007), neglects important cross-national variations.

I have developed the argument elsewhere (Levi, 2009) that:

1. White-collar criminals are folk devils in disguise (with apologies to Elvis) because the management of elite corporate crimes that do not involve explicit embezzlement is difficult to bracket off dramatically from the routine functioning of capitalism, making social exclusion far more difficult than for those offences and offenders normally subjected to moral panics (i.e., it is in a sense "normal crime," and "offenders" are "normal citizens"). There are, however, some social groups and (relatively) elite individuals who commit frauds who can be "folk-devilled" as outsiders, and treated as "organized criminals."
2. White-collar crime violates so many moral precepts that it is tolerated only if it has the decency and self-control to keep its subterranean status.
3. When it becomes embodied in "celebrities" there can be a media outcry and moral panic, partly because society is seen to be changing or becoming less moral ("greed is good"), but also because law enforcement and politicians need to satisfy the public taste for retribution and for a "just world." In other words, the white-collar offender is only folk-devilled when he (or, far more rarely, she) "frightens the horses."

Sometimes, moral outrage following dramatic events leads to legislation being passed that has a significant potential effect on corporate elites. These include the Foreign Corrupt Practices Act 1977 after Watergate; the Sarbanes–Oxley Act 2002 after Enron; and the USA Patriot Act 2001 to deal with financing of terrorism after "9/11." However, their application may be contested by elites on the grounds of cost-(in)effectiveness in a globalized economy, in ways not open to drug-takers, gangs, pedophiles, or other socially constructed "groups" whose interests are of less importance to "respectable society" and controls over whom are not believed to affect "us" negatively. Here, it is important to appreciate that there is a long period of lawmaking and particularly of law implementation, whose visibility is usually much lower than is the lawmaking process. These are all affected by election cycles and the structures of political decision-making

(Lacey, 2008) which, for example, are much more fractured and devolved in the United States than in the Anglo-Welsh political system for criminal law (see Savelsberg & Bruehl, 1994, for a discussion which observes how less influenced by public opinion German white-collar crime prosecutors are compared with American ones).

Feeley and Simon (2007) and Garland (2008) suggest that there has been a change in the *general* social construction of crime since the 1960s, raising the issue of what happens when society is in a more or less perpetual state of (artificially) heightened fear of a range of folk devils. In this contested space for anathematization, how – if at all – do different sorts of white-collar criminals rise to the fore? Part of the answer might lie in Christie's (2000) discussion of crime control as industry, combining economic with political profit from fear as a driver of consensual "solutions" to fear. What measures of control of corporations or wealthy individuals drive profit, for example, income for consultancy firms from advising on money laundering and transnational bribery risks? However, such panicking-for-profit models neglect the fact that "too much" fear undermines perceptions of competence of politicians, police, and security services, and the personal careers of their leaders, and this reputation creates an internal elite tension between reassurance and alarmist policing. This is a tension that is felt not only with respect to white-collar crimes but also to financial regulation generally, as we may note in the management of "the credit crunch" of 2007–2010. Trust that counterparties are both willing and able to repay losses underpins economies, so moral or even just economic panics are destabilizing, and the logic of that awareness disciplines reactions to those white-collar crimes and criminals that are not readily separable from core business activities, encouraging sophisticated risk management rather than uncomplicated efforts at suppression that are often found in policing the poor and reductions in welfare.

Rosoff (2007) has highlighted the way in which the business press acted as uncritical cheerleaders for Enron until the scandal of its insolvency broke, at which point the "local" *Houston Chronicle*, presumably reflecting the economic hardship caused to its readership, turned against it. Similar points could be made about British financial scandals, though the UK coverage is shaped by far more plaintiff-friendly libel laws than in the United States. By contrast, frauds committed by social "outsiders" such as Nigerian "419" frauds or identity thefts are treated far less gently by both press and electronic media (Levi, 2008a).

C. Wright Mills (1956, pp. 343–344) famously observed: "As news of higher immoralities breaks, people often say, 'Well, another one got caught today', thereby implying the cases disclosed are not odd events involving occasional characters but symptoms of a widespread condition.'' Yet the media and corporate and political commentators typically discuss white-collar crimes and corporate corruption as ''rotten apple'' cases, at least in the developed world. In some less developed societies, ownership is less dispersed and more visible, so business activity may be less easily distinguished from fraud or ''exploitation.'' Yet such media coverage – the WikiLeaks revelations of 2010 notwithstanding – is normally dependent on criminal or published regulatory action by the authorities, and these may be politicized (with a large or small ''p'') in ways that vary not just according to economic crises but the ''tone'' of administrations. Thus, the prosecutions and lengthy imprisonment of Khodorkovsky, the former CEO of Yukos Oil, by the Russian authorities is well understood to have nothing to do with economic crises and everything to do with his wealth and overt political opposition to Putin (Freeland, 2011). The more active prosecutions and regulatory fines by the UK Financial Services Authority are indirectly affected by the financial crisis, but are probably better explained by bureaucratic survival instincts and a dynamic enforcement director unleashed by the acknowledged failure of the ''light touch'' regulatory model formerly adopted by the UK government. Before 2010, longer-term data for the United Kingdom show only a modest and fluctuating level of sanctions (Freshfields Bruckhaus Deringer, 2010) but in 2010, the gross take from regulatory fines and sanctions against individuals trebled to reach a record high, though regulatory debate continues about how we can affect trust in our financial institutions (Sants, 2010). After the politically charged non-prosecution of BAE in 2007 for transnational bribery (Leigh & Evans, 2008), the pressure on the UK Serious Fraud Office to show that they are *not* lackeys of the corporate and political establishment created severe pressures to prosecute corruption cases, but this was unrelated to events in the economy.

FOLK-DEVILLING BUSINESS ACTIVITIES

An important symbolic dimension of moral panics is that the threat posed is seen to be ongoing and must be visualizable in the minds of the public. White-collar crimes are viewed seriously by the general public in Australia, the United Kingdom, and the United States (Levi & Jones, 1985; Levi, 1987, 2006; Piquero, Carmichael, & Piquero, 2008). However, is public resentment against them whipped up by the media and any bureaucratic, cultural/ ideological, economic, and personal interests which happen to coincide?

How might this apply in any forms of white-collar crime, and what might be its connection to economic crises?

It is in the consumer movement and its leading entrepreneurs that we see the closest to a powerful social movement against business crime, for example, Internet Fraud Watch, with an actively managed and updated website on the most recent scams. Such scams – and reactions to them – are not obviously connected with economic crises, though some fraudsters may exploit unemployment to offer fake jobs abroad (for a down payment) or multilevel marketing/pyramid selling schemes. Strong public reaction occurs most visibly where physical health is endangered in some way, as in 2007, when serious illnesses from lead paint led to the recall of 21 million Mattel toys and other dangerous imported Chinese toys into the United States. With the support of American unions concerned about their own members' jobs, the US media developed this into a storm about the subcontracting of safety standards to (amoral) Chinese and demanded tighter controls over outsourcing to protect American consumers: despite their desire to retain cheap labor to maximize profits, US corporations could not state publicly that such risks were unimportant, but nor did they fan the flames of anti-Chinese sentiment, except insofar as they did not want to take responsibility for their own poor supervision of safety or design flaws. This campaign led to the Consumer Product Safety Improvement Act 2008, which was signed in August 2008, to very little fanfare. Although shortcuts in consumer safety are connected to globalization and the search for corporate profits, they are not closely connected to the global crisis generated by reckless and dishonest behavior in the financial services sector.

Other forms of white-collar crime have different rhythms of reaction. Whereas identity thefts tend to be periodically repeated single incidents (though sometimes with several million people whose personal and financial details have been "stolen"), investment fraud, transnational bribery, and cartel investigation, prosecution and civil litigation cases may last for decades, making campaigns and moral outrage difficult to sustain, especially given short media cycles.

The area of social and economic life most ripe for the creation of widespread alarm is that of "identity theft," which conjures up visions of having one's private self copied and misused for profit by some malevolent unknown avatar. People applying for credit may suddenly find themselves denied because of some debts previously unknown to them; or even may find bailiffs seizing their property to satisfy a debt that their true selves never incurred. In the 21st century, "identity fraud" (often described as "theft," though the identity itself is mostly duplication or "borrowing" rather than a pure zero-sum game) has become a particularly popular theme in the electronic and print media; in spite of guarantees by many card issuers to consumers against suffering losses from fraud when making Internet purchases, it appears to evoke significant levels of fear, enhanced by media coverage whenever large quantities of data are hacked or merely lost. Some aspects of this are developed elsewhere (Levi, 2009; Marron, 2008), but for this chapter, the question is whether there is any relationship between the economic crises and such crimes or fears about identity crimes.

"Identity fraud" and "identity theft" have indeed become "signal crimes" that are treated as symbolic of the way in which technology has rendered us defenseless to preserve what many of us still regard as our unique selves, notwithstanding postmodernist constructions that treat such ideas as illusions. The aim of commercial interests such as credit intelligence firms is not to create a moral panic, but to get people to take greater care of their personal data and to sell "protective services." The consumer movement in the United States has been more active than that of the United Kingdom or continental Europe in relation to identity theft, possibly because of a greater volume of such behavior and poorer general privacy in the United States, but possibly also because of a stronger tradition of participatory politics and more devolved powers in the United States. The media are generally happy to give voice to anger and call for "something to be done": but there is no coherent, visible set of offenders upon whom to focus that anger. And the real rise in identity theft offenses may coincide with the economic crisis but it significantly preceded it; and its incidence relates mainly to the growth of technology and the presence of technologically savvy offenders outside as well as inside the "victim countries." The e-criminals may be stimulated by their relative deprivation but in Eastern Europe, there has never been a time of shared plenty.

By contrast with identity fraud, in mortgage origination and control frauds generally (Black, 2010; Nguyen & Pontell, 2010), "the bankers" represent a largely faceless target of resentment in which the "Main Street versus Wall Street" symbolic politics can be played out, even if the subtleties of the derivatives market remain incomprehensible to the general public in any country. In other financial crime cases still, the harm is less obvious, taking the form of abstractions like "free and fair markets" rather than people being ripped off. The Boesky/Milken insider trading scandals of the mid-1980s came to be represented not so much as a dull issue of investor protection but as "a manifestation of undue greed among the already well-to-do" (Langevoort, 1991, p. 1). However, it is moot whether this has any new social significance or merely reflects the continuity of the mid-West populist resentment at ‘‘unjust enrichment’’ among those who get lots of money without working for it that also motivated Sutherland (1985, originally 1939).

The collapses of Enron and WorldCom in the early 21st century – though not seen to relate to a more general ‘‘economic crisis’’ – had and were seen as having a closer relationship to ordinary people and their pension schemes than did the earlier Boesky/Milken cases of the 1980s (despite their popularization in *Wall Street* and *Bonfire of the Vanities* which questioned boundary maintenance between ‘‘good capitalism’’ and ‘‘bad capitalism’’). There is a difference between (a) taking improper benefit from inside knowledge and (b) making outright deceptions of financial viability when they were looting the businesses for personal gain. The media readily find *individuals* to stigmatize when they can juxtapose expenditure of thousands of dollars on personal umbrella stands (Tyco) or hundreds of thousands of dollars flying people on ‘‘business trips’’ to celebrate the CEO’s wife’s birthday in exotic locations (Lord Conrad Black): but who knows how typical or atypical such junkets are when companies are not in distressed circumstances or subjected to ‘‘whistle-blowing’’? It is rare to find larger networks/groups of people running genuine businesses that can be stigmatized, in the way that is done to ‘‘outlaw biker gangs’’ throughout the world.

It is also important to differentiate crises of profitability for particular firms or business sectors from the more general financial crisis. There was a media scandal about the collapse of British food hamper business Farepak at the end of 2006, which left around 122,000 mainly poor people without the food and drink for Christmas that they had saved up for (Spalek & King, 2007). But, in spite of enormous condemnation, especially of the well-heeled directors who continued to live luxuriously while the poor struggled to replace the lost food and drink, it would have been defamatory in the United Kingdom to label this a ‘‘fraud’’ case, and the readers/viewers of every national and many local newspapers had to be content with the juxtaposition of the ‘‘victims’’ with company ‘‘owners’’ or ‘‘directors.’’ A website for victims was created but, given the age and other demographics of losers, the most users it had ever online was 180 on December 4, 2006 (data accessed January 7, 2011 from http://www.unfairpak.co.uk/forum/). In the end, despite massive protests and very sympathetic ongoing coverage for months in national and local press and radio/television, there was no formal investment compensation for Farepak savers because they were not regulated by the financial services regime. At the end of 2010, it was announced that after recovery of

£4 million from the directors without admission of liability, creditors will receive around 15 percent of their savings (http://www.farepak.co.uk/). In February 2011, The Insolvency Service announced that it would seek the disqualification of the nine directors from becoming a director for up to 15 years. The collapse of a ''posh'' wedding gift firm Wrapit led to a march of brides to the HSBC bank headquarters (which had refused to give Wrapit further loans) and gave rise to unflattering populist comparisons with the plight of Farepak savers, at least in *The Guardian* (August 11, 2008). Neither of these related to the general economic crisis, which had not yet developed fully in the United Kingdom. In Farepak and Wrapit (and other cases), the directors tried to divert blame to the banks, who also have some ''folk devil'' status.[1] By contrast, the savers (but not shareholders) in Northern Rock Bank *were* protected when the government took the Bank into public ownership in 2007 (Brummer, 2008), partly for political reasons but partly because their potential losses were deemed to pose a systemic risk to the United Kingdom's reputation and to the banking system as a whole. These important differences in responses to victimization reflect past legislative frameworks, but media campaigns may use this as a ''cause'' to change. However as with prior campaigns, the government is wary of granting new rights to compensation, especially when (unlike financial services compensation in the United Kingdom) they have no firms from which they can generate the funds via annual levies or regulatory fines.

The ''crime'' component is difficult to disentangle from the generalized hostility toward the bankers' bailout, the credit crunch, and the crisis of jobs. However once stirred, this amalgam led to televised status degradation rituals of bankers and regulators before the US Congress and in some states.[2] Likewise, in relation to the much-discussed US Savings and Loans crisis during the 1980s (e.g., Black, 2005; Calavita & Pontell, 1994; Pontell & Calavita, 1993). The recent crisis led to the need for FBI investigations, whose resources had been largely diverted from white-collar crimes to counterterrorism since 2001, and to some belated prosecutions. The language in the initial FBI press statement is intriguing, emphasizing the national scope and large roundup of arrests, and also the involvement of senior managers of ''failed Bear Stearns hedge funds'' (http://www.fbi.gov/pressrel/pressrel08/mortgagefraud061908.htm) – a prosecution that subsequently failed:

> ''Mortgage fraud and related securities fraud pose a significant threat to our economy, to the stability of our nation's housing market and to the peace of mind of millions of

> American homeowners,'' said Deputy Attorney General Mark R. Filip. ''Operation Malicious Mortgage and our other mortgage-related enforcement actions demonstrate the Justice Department's commitment and determination to combat these criminal schemes, hold their perpetrators accountable and help restore stability and confidence in our housing and credit markets.''

(For the press conference, see http://www.youtube.com/watch?v=9fMlGGABcHs.) The aim here appears to be to reassure the public that the FBI and other federal agencies were doing something serious about the phenomenon. In media interviews, the FBI was keen to communicate that much of the proceeds would have been dissipated, so victims could not expect great returns on their losses. In short, this has more to do with management of expectations and ''reassurance policing'' than it does to the deviance amplification spiral. The Madoff and other Ponzi schemes also created the correct impression that elites could bypass controls. Subsequent broader investigative sweeps such as Operation Broken Trust have been accompanied by high level conferences including the Attorney General, which reflect the government and FBI's awareness that they need to enhance their public legitimacy in this area of crime (http://www.fbi.gov/news/stories/2010/december/fraud_120610/fraud_120610).

Unlike the Savings and Loans crisis of the 1970s – where the vast multi-billion dollar direct losses (only some clearly attributable to fraud) were confined to the United States – the losses from subprime loans were globalized through the sale to international financial institutions of Collateralized Debt Obligations rolling up large numbers of mortgages into a ''security'' (sic!). However here again, fear of economic and status loss is not the same as fear of fraud, and despite the postlapsarian juxtaposition of bankers' greed with serious economic harm, neither the neo-Conservative ideology nor the complexity of responses to these crises lend themselves readily to the creation of folk devils or moral panics.

MORAL ENTREPRENEURS AND BUSINESS CRIMES

Police and prosecutors can encourage media interest to gain publicity for themselves personally, to generate a positive image for their activities and to get more powers and resources to do their jobs better. One route is to dramatize the past harm of and future threat from the activities. US prosecutors are elected or are political appointees; and in some parts of the United States at some periods, dynamic action against visibly harmful corporate actors may please their constituents (while at others, corporate interests may be alarmed and may fund campaigns to vote them out). Katz (1980) and Benson and Cullen (1998) point out that prosecutors – national and local – provided the most powerful impetus for the prosecution of white-collar crimes in the United States. Election is not a necessary condition for white-collar crime activism, since it is true also of the *unelected* investigative judges in France, Italy, and Spain and (in tandem with regulators) in Swiss action against proceeds of corruption involving kleptocrats from developing countries. However historically, British legal careers have been better served by ‘‘not rocking the boat’’ than by becoming aggressive white-collar crime prosecutors (Levi, 1987; interviews with lawyers and journalists, 2008): no leading UK prosecutor has developed a campaign stressing the harmfulness of white-collar crimes or the dangerousness of white-collar offenders. Nor has any UK politician ‘‘majored’’ on corporate crime-fighting. In Opposition in the early 1990s, Tony Blair received prominence from his attacks on the Conservative government's handling of fraud and corruption scandals, but no one in the United Kingdom has enjoyed the ‘‘white-collar crusader’’ status of Manhattan District Attorney Robert Morgenthau or of New York State Attorney General Eliot Spitzer (before the latter's fall from grace in a 2008 prostitution scandal), whose activism long preceded the economic crisis (Masters, 2007). For decades between his election in 1984 and his retirement in 2009, Morgenthau used the fact that Wall Street banks were headquartered in his constituency as a legal lever for fraud and money laundering prosecutions. But the aim was to protect investors by eliminating the most egregious practices of major Wall Street firms as well as outside scammers, rather than to develop a *Jihad* against corporate greed. After all, financial services firms are deemed socially useful and employ millions of people, and make a large proportionate contribution to London and New York taxes, whatever offshore tax avoidance measures they may take themselves and promote among their clients to reduce their tax burdens (Shaxson, 2011; www.taxjustice.net/).

Transnational bribery is one sphere in which the ‘‘moral’’ component is uppermost, though it would be difficult to create a ‘‘panic’’ about increasing business profits at the expense of developing countries. Reisman (1979) has discussed the history of anticorruption legislation in the United States, including the role of major corporate scandals such as Lockheed in Japan, which led to the Foreign Corrupt Practices Act in 1974. Though prosecutions were few in the United States, the later US-advocated development of the OECD's Transnational Bribery Convention in 1997 enabled the Americans to mandate equal pressure for their commercial competitors, and the economic crisis may have increased the pressure on them to push this. Foreign countries and campaigning NGOs can also be important in putting political and media pressure on prosecutors, for example, in the case of transnational corruption allegations involving BAE and the Saudis over the Al Yamamah defense contracts, signed in 1985 and 1988. The UK government claimed that though there had never been a single prosecution for transnational bribery, the legislation was adequate: but "for the avoidance of doubt," clarifying provisions were included in the Anti-Terrorism, Crime and Security Act 2001 and further legislation promised. The OECD, anticorruption and antipoverty NGOs,[3] and Britain's defense competitors – assisted not just by "the usual liberal media suspects" such as *The Guardian* but also by the *Financial Times* – were all keen to paint the United Kingdom as the folk devils of the nonenforcement process of transnational bribery prosecutions.[4] Despite business and professional lobbying against what are depicted as Draconian controls and the pressures on jobs aggravated by the economic crisis, the United Kingdom was pushed into adopting a more proactive stance against corruption in the Bribery Act 2010, but these forces in favor of a clamp down on overseas bribery owed nothing to the economic crisis in the first world.

Unlike other symbolic crusades against "crime," few proposed increases in the governance of *business* are seen as cost-free by business or government (see, e.g., the Financial Crisis Inquiry Commission, 2011 – especially the Republican dissenters, who developed the counterintuitive narrative that Big Government was responsible for the crisis). Although more attention is paid to the impact of fraud on victims than used to be the case, and politicians are sensitive to the implications of scandal, the desires (i) not to stifle enterprise and (ii) to economize on regulatory staffing (whether paid for directly by taxpayers or by the financial services industry collectively) inhibit responses to fraud. Moreover, these costs may involve other jurisdictions and raise broader issues of policy and power. Following a concerted moral panic about money laundering in "tax havens" encouraging "organized crime" and "financing terrorism," from 2000 to 2005, the Financial Action Task Force engaged in a blacklisting process which happened only to harm relatively powerless countries (though – Shaxson, 2011, notwithstanding – it also had an undisclosed but non-negligible impact on the profits of major international banks). The FATF's Non-Cooperating Countries and Territories initiative made it harder and more expensive for those "on the list" to do international business. However, the listing was not so much (just) to dramatize evil as to get countries to change their legislation and enforcement for the "common welfare," especially that of the West (Levi, 2007). Whether the locus of concern (rather than panic) was properly on obscure Caribbean and South Pacific islands, plus a set of noncore nations from Nigeria to Russia, rather than upon the mainstream financial services providers like Switzerland, the United Kingdom, and the United States (Shaxson, 2011) is an intriguing issue. However, offshore finance centers are not core tabloid news items in the way that muggers are.

THE ECONOMIC CRISIS AND ITS IMPACT ON LEVELS OF FRAUD

Some frauds whose commission long preceded the crisis have been brought into victim and/or public consciousness as a result of the credit squeeze; some "organized criminals" may be drawn into greater confidence in making fraud participation offers to insiders or blackmailing them because of the latter's inability to repay debts and because they believe that people are more corruptible at times of economic stress; some fraud opportunities linked to workplaces will be reduced because if people motivated to defraud have lost their jobs, they can no longer commit internal frauds; but in other cases, temptations are greater because of the desire not to lose lifestyle and social status. Using a fraud typology (drawn from Levi, 2008b) of preplanned fraud, intermediate fraud (starts off honest and consciously turns to fraud), and slippery-slope fraud (tells lies to continue trading in unrealistic hope that things will turn around), there have been both extra and reduced risks of motivation, opportunity, and capable guardianship. The net effect of these changes is difficult to determine, and most fraud data – other than plastic card fraud – are too dependent on changing probabilities of recognition, reporting, and recording to enable confident inferences about trends to be drawn. It seems plausible that more slippery-slope insolvency frauds occur in times of recession, as some company directors and professionals seek to preserve income and wealth from the economic consequences of the downturn. However, there is no evidence that the GFC has had or is likely to have a major impact on increasing the cost of fraud or levels of fraud overall in the areas about which we have the best knowledge: Australia, the United Kingdom, and the United States.

Some apparently trivial points are worth stressing. To the extent that crimes are *occupational*, one must have an occupation in order to commit them: thus, though motivation to offend may rise during economic crises, opportunities to defraud may fall. To illustrate this, we might examine the extent to which fraudulent chief executives and dot-com bubble chiefs were able to allocate to the company expenditures that, in fact, were largely or wholly personal. (This also applies to kleptocratic dictators in developing countries, whose coffers may become larger because of the increased desperation of sales divisions of international corporations; though this may be counteracted by the increased activism of prosecutors noted recently in the United Kingdom as well as the United States). Accountants, bankers, and lawyers cannot readily manipulate clients' accounts or set up trust and other corporate secrecy vehicles if they no longer work, though they (and anyone else) can make up *imaginary* firms and may have a pretext for corporate instructions to firms. If others have confidence in them, such entrepreneurs can develop new businesses that may generate new manipulative possibilities, but this would usually take longer at times of recession. At a lower status level of white-collar crimes, staff in call centers (whether physically located in the Western jurisdiction or in India/Bangladesh) cannot so easily copy and extract personal data of account holders if they are no longer employed in the call centers. If still employed, they may be more tempted to defraud if they consider that they may shortly become unemployed and/or that the company will show no loyalty toward them. (Though their *ability to offend* may be reduced by physical opportunity controls such as the absence of USB and CD drives on computers and rapid integrity checks.) Under such circumstances, *voluntary* compliance via procedural legitimacy becomes much harder to achieve. (Financial and social pressures to offend may also be affected positively or negatively by fear of redundancy and peer group pressures, though *threats* from organized crime groups may not be related to economic crises.)

Rises in card-not-present payment card frauds are partly the product of increased opportunities and partly displacement from the introduction of Chip and PIN in payment cards outside the United States: they have little relationship to economic crises, though first party frauds (by otherwise legitimate cardholders) may be more common because of financial pressures. The rise in visible mortgage frauds (Carswell & Bachtel, 2009) and consumer/investment scams has energized the regulatory process, assisted by forensic linking software developments that make it easier proactively to search out connections between banking and insurance fraud networks. Since Ponzi investment pyramids rely on a high rate of incoming investments to sustain payouts, a fall in the rate of *increase* of investments or a *reduction* in the rate of reinvestment of imaginary profits causes them to collapse earlier.

CONCLUDING COMMENTS

Concern, even anger, at the inappropriate sales of insurance, mortgages, pensions, and other financial services products – which have the *potential* for demonizing the commonplace behavior of many elite financial institutions – has been defused by regulators' willingness to treat them as issues for compensation (restorative justice) rather than for punishment (retributive justice), and by politicians' efforts to downplay the (im)moral component of the issues in favor of economic management.[5] In contrast to the visceral language of moral panics and its focus on "just worlds," the unemotive rationalist discourse of risk management has also been embedded in police rhetoric and *modi operandi*. In the particular case of fraud policing, those risks mainly relate to future harm and to perceptions of it among those publics deemed to be most salient. After careful legal vetting, parts of the media – for example, in the United Kingdom, periodic *Panorama* and other television programs about corruption among senior figures in the International Olympic Committee, FIFA, and the Premier League, and books/websites about this (Bower, 2007; Jennings, 1996, 2000, 2007, http://www.transparencyinsport.org/) – may seek to stimulate action by informing the public and creating political pressure for change. However, there is no research or other evidence of public anger about these socially marginal phenomena: perhaps despite the controversial award in 2010 of the next two World Cups to Russia and Qatar, the public are cynical and resigned to what Al Capone once termed "the legitimate rackets." Furthermore, major police and prosecutor operations against elite institutions or even against corruption in sport carry serious risks of media and political criticism for "publicity-seeking" incompetence if they are not aimed at consensually agreed egregious misconduct and fail to end in conviction.[6] On the other hand, identity theft generates more hostility and consensus, touching sensitive nerves about personal invasion and financial incapacitation in our mass credit-card dependent society.

The cost of doing something about fraud is largely privatized, and though governments can pass legislation, forcing firms to exercise much greater governance of fraud risks or "bankers' bonuses" on a *national* basis runs the risk that financial services firms with low "sunk capital" can simply move offshore (e.g., from the United Kingdom to the Irish Republic, the Channel Islands, or Switzerland; or from the United States to the Bahamas, Bermuda, or London), losing "multiplier effect jobs" upon which the economy depends, even where the corporations themselves pay as little tax as their avoidance mechanisms allow. So "the financial City" is a key player in the "consensus" needed to generate moral panics and to translate them into effective controls.

"Real" criminals are those who do not provide us with any services that we define as "productive" and – especially in a Fox News dominated world – this ties us to most corporations and corporate actors. Especially when using the anonymizing medium of a corporation, and with the greater potential for claiming (correctly or not) that they did not intend harm, this chameleon quality makes it harder to categorize and damn them without ambiguity. Hence the relaxed moral panic-free character of movie representations of fraud networks and individuals from *The Sting* to *Catch Me if You Can*; though there are notable movies such as *The China Syndrome, Silkwood, The Insider, The Whistleblower, The Most Dangerous Man in America: Daniel Ellsberg and the Pentagon Papers*, and *Enron: The Smartest Guys in the Room*, which express fears about the dark powers of corporations and governments. It might seem more appropriate then to view white-collar criminals and fraudsters as "folk devils in disguise." The criminalization of "conventional" criminals can well be seen as the moral boundary maintenance of *society*, but the occasional folk-devilling of high status criminals can also be cathartic insofar as it not only attempts maintenance of the moral boundaries of society, but also the moral boundaries of the *self* by stigmatizing and criminalizing those who, far from being "not like us," are too much "like us" to enable us to feel comfortable. As the former CEO of Citigroup, Chuck Prince, observed (before his resignation under pressure in November 2007, as Citigroup mortgage losses mounted) (*Financial Times*, July 9, 2007): "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing." Alternatively, as *The Doors* expressed it, "When the music's over, turn out the lights."

NOTES

1. The issue of a hierarchy of folk devils has not been dealt with systematically in the literature, which – except in the more "culture of control" -influenced work – tends to treat folk devilment as a binary rather than linear status. But it will surprise few readers that banks are lower down the media and political demonology list than "Islamic terrorists" or even "East European" or "West African" fraud gangs.

2. See, for example, http://www.youtube.com/watch?v=n0XIF84AtYg; http://www.youtube.com/watch?v=U73dfpQ4YGg; http://www.youtube.com/watch?v=0GGV3GGHD2Q&feature=related.

3. The small charity Corner House was particularly active in the BAE case, the much larger anticorruption moral entrepreneurial NGO Transparency International being inhibited by its rule that it does not take on individual cases.

4. What the longer-term economic and political effects are of this UK's *national* folk devil status remain to be seen, but the public image of double standards has made the UK's genuine efforts to deal with corruption in developing countries less credible and legitimate (author interviews with officials, NGOs, and private sector consultants, 2007, 2008).

5. One important difference between many white-collar crimes committed by ongoing corporations and other forms of crime is that these corporations may often be *able* to compensate victims, whereas typical offenders' savings and income flows are too modest to do this.

6. Getting police attention becomes part of the risk-based approach of those parts of the private sector and public bodies that want the police to carry out arrests, enable and expedite transnational formal controls, etc., in order to put an end to the predations of particular individuals or groups and/or to generate the greater (hopefully deterrent) publicity that accompanies the drama of criminal proceedings. So without seeing the police as the *initiators* and *overall managers* of this risk management in business (the mistake made by Ericson & Heggarty, 1997 and neglected by Williams, 2005), they are asked to play a significant role and they do exercise independent judgment in deciding which risks to prioritize.

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CORPORATE CRIME AND CRISIS: CAUSATION SCENARIOS

Wim Huisman

ABSTRACT

This chapter examines four possible relationships between the credit crunch and corporate crime. A first relation is that cases of accounting fraud have contributed to the causes of the crisis. Because of these accounting scandals, the trust in large corporations and the financial sector possibly eroded. A second possible relation is the reverse: the crisis leads to more corporate crime. As a result of the crisis, companies run into financial difficulties. In their despair, they possibly cut costs by not complying with business regulations, or they may try to gain illegal profit through fraud. The third relation is the criminalization of more unethical corporate behavior. The moral outrage regarding the behavior of banks and insurance companies that contributed to the crisis might lead to an increased labeling of "risky" or "greedy" behavior of corporate executives as criminal. This results in more legal regulation. The fourth and final relation is that these amplification effects will lead to the discovery of more corporate crime.

INTRODUCTION

In the Netherlands, criminologists studying corporate crime were accused of remaining silent in the public debate on the causes of the economic crisis

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that has hit the world since 2008 (Huisman, 2009). Critics apparently assumed that corporate criminal behavior lay at the root of the crisis. On an international level, criminology cannot be criticized for a lack of interest in the economic crisis, considering recent articles (Braithwaite, 2009; Dorn, 2009) and special journal issues (Black, 2010; Shover & Grabosky, 2010), such as this volume of *Sociology of Crime, Law and Deviance*.

The aim of this chapter is to explore the possible relationships between the economic crisis and corporate crime. Four different possible causal scenarios will be discussed: (1) the economic crisis is (partially) caused by instances of corporate crime; (2) the economic crisis produces instances of corporate criminality; (3) the crisis causes criminalization of entrepreneurial behavior; and (4) because of the crisis more corporate crime can be detected.

While this contribution refers to "the economic crisis," in reality, the crisis consists of various crises of which one led to the other in a domino-like manner. The first crisis was sparked by a subprime mortgage crisis in the United States. This led to the credit crunch or financial crisis: banks could no longer fulfill (or advance) the financial obligations that were connected to the high-risk derivates of these subprime mortgages. Since banks had become wary of providing loans to businesses because of their own financial problems, the economic "motor" ground to a halt due to lack of financial lubricant. This led to a general economic crisis in which businesses could no longer invest due to lack of capital. In addition, suppliers went bankrupt. Increasing unemployment caused a decline in public purchasing power as well as a decrease in consumer confidence in making large purchases.

Corporate crime is a specific form of crime studied by criminologists. The object of criminology includes conduct that can be qualified as illegal as well as the reactions to this conduct from society. This reaction also involves the labeling of behavior as criminal – criminalization. A good understanding of crime therefore not only requires knowledge about the causes of the behavior labeled illegal but also an understanding of the processes that lead to the criminalization of this behavior. After all, crime – and particularly white-collar crime – is a social construction (Nelken, 1994). The possible relationships between the financial/economic crisis and corporate crime can therefore include illegal behavior as well as the reactions to harmful business behavior that contributed to the crisis. The scenarios will be explored using studies on corporate crime, official inquiries after the crisis and reports in the media. Besides the obvious examples of actions and reactions occurring in the United States, this contribution will also provide examples from the United Kingdom and the Netherlands. For as Braithwaite (2010) rightfully stated, the "global financial crisis" actually is a "North Atlantic" financial crisis, as countries with a high exposure through the derivates market to US housing mortgages suffered the most.

CORPORATE CRIME CAUSES THE CRISIS

In the National Public Survey on White-Collar Crime, conducted by the National White-Collar Crime consortium in the United States, 70% of the respondents believed that white-collar crime has contributed to the economic crisis (Huff, Desilets, & Kane, 2010). The question is then what type of white-collar crime. Both accounting fraud and fraud in the mortgage industry have been linked to the economic crisis.

Accounting Fraud

The large accounting fraud scandals that occurred at the start of the millennium have often been linked to the current economic crisis. ''Accounting control fraud epidemics can cause bubbles to hyperinflate – producing crisis'' (Black, 2010). This relation is often made implicitly; it is not clear how fraud contributed to the crisis.

There may have been a causal relationship. The financial damage of the ENRON, WORLDCOM, TYCON, AHOLD, and PARMALAT cases and more recently Bernard Madoff's fraud was enormous. ENRON is the best documented example (Fusaro & Miller, 2002; Henderson, Oakes, & Smith, 2009). The value of ENRON shares plummeted from $90.56 in mid-2000 to 25 dollar cents in the fall of 2001 after the revelation of the accounting fraud. The company – and therefore the stockholder(s) – lost $60 billion of market value. In addition, $2 billion of the superannuation funds of ENRON employees vanished into thin air and thousands lost their jobs. As a result of the ENRON scandal ''Arthur Anderson,'' the oldest and one of the largest accountancy firms in the world, went bankrupt and caused another 26,00 people to lose their jobs. In addition to the direct damage for stockholders and employees, these types of ''domino-effects'' are seen in all big fraud cases: suppliers and buyers get into trouble and public purchasing power decreases.

Such a causal relationship between grave instances of crime and the credit crunch is not very likely. While the damage caused by the large accounting frauds was substantial and banks were harmed, these cases did not cause the banks' large financial problems or their unwillingness to provide loans.

There are two other possible relationships between large accounting fraud and the credit crunch. First, there can be an indirect relationship. In essence, the credit crunch boils down to a lack of trust, which causes credit providers to be unwilling to take risks. Trust is the bedrock of the economy: when market parties do not trust their partners to fulfill their obligations, no transactions will occur. This lack of trust could be a consequence of the large fraud cases that influenced belief in integrity and reliability of the business world and the financial system.

According to van de Bunt (1992), the loss of trust in organizations and institutions on which society increasingly depends causes social disintegration and is the prime harmful consequence of organizational crime. This notion is quite abstract and hard to measure. Two examples can clarify the cost of lack of trust. The US economists Karpoff, Scott, and Martin (2008) analyzed 384 bankruptcies of stock exchange companies. He concluded that main depreciation is caused by reputation damage. While the value decrease in stock accounts for 24% of the value depreciation of the company and the costs of fines or court cases are only a small percentage of this decrease, reputation damage is "the big hammer": about 67% of the total costs of accounting fraud.

A second example is the costs that companies have to make in order to comply with the increased number of rules that were issued after the first big accounting fraud cases. The draconian Sarbanes–Oxley Act (SOx), which applies to all companies quoted on the US stock exchange, is the best-known example. The size and scale of these compliance-costs can be shown by the case of the downfall of the Dutch ABN AMRO bank, as described by journalist Jeroen Smit (2009). In 2003, the US FED established that ABN AMRO did not comply with the rules about internal supervision. The bank could not explain who the interested parties were for transactions via the bank's offices in Dubai and New York, financed by eastern European legal entities. Furthermore, CEO Rijkman Groening ordered the destruction of a concept version of the internal report about these transactions. This was a clear violation of the new SOx law. The Securities and Exchange Commission (SEC) considered starting a criminal procedure against the bank. The bank was sentenced to a penalty of $75 million, one of the largest fines ever imposed by the SEC. Further criminal prosecution was precluded by a settlement of $365 million. Possibly, the most harmful blow for the ABN AMRO was the "cease and desist order" imposed on the bank. This prevented the bank to buy or sell banks in the United States which trapped ABN in this important market. This happened while the bank was actively searching for a takeover or merger candidate in order to prevent a hostile takeover. To this same end it was very important that the share price would go up, but this was impossible because of increasing costs for the bank, mostly as a result of investments in compliance procedures. The cost of the compliance rules therefore contributed to a situation in which the bank became the victim of a hostile takeover by the consortium of Royal Bank of Scotland, Santander, and Fortis. Partly because of this takeover, Fortis collapsed during the crisis and Royal Bank of Scotland had to be rescued by the British government.

A second possible relationship between the crisis and accounting fraud is that essentially there is a spurious relationship between the two that can be explained by a third factor influencing both. According to Pheijffer and Hoogenboom (2009), creative accounting is the symbol of moral decay in the business world and the current crisis. The line between legal and illegal behavior is often very thin. In some cases (like ENRON and AHOLD) criminal misrepresentation of regulators and investors and in other cases (like Freddy Mack and Fannie Mae) risky transactions and fabricated reports – creative compliance – seem to fall right within the borders of the law. Behavior at both ends of the legal line fits, according to Pheijffer and Hoogenboom, in a corporate culture in which overconfidence, pride, risky behavior, and mundane greed play a big role and have prevailed in the previous 15 years. Attention within the top of the business world for compliance, corporate governance and corporate social responsibility has increased sharply since the 1990s, partly as a consequence of insider trading scandals in the late 1980s. However, this attention seems to be a thin varnish. Renowned criminologist Braithwaite (2009, p. 449) joins this idea in his polemic piece on how to deal with bankers complicit to the crisis: "The bonus culture has already created a wave of crime in the suites [...]."

Cools (2005) compared 25 corporations, active on the stock exchange, which went bankrupt after accounting fraud scandals with a control group of 25 companies who did not. Cools thinks the main causes are a combination of overstrained and unrealistic targets for profit or turnover-increase, coupled with exorbitant personal bonuses and de facto absent internal control because of narcissistic CEOs. This analysis seems to fit for the financial institutions that were discredited in the current credit crunch, such as AIG, Lehman Brothers, ABN AMRO, and Royal Bank of Scotland.

As a result of the large accounting frauds, many people wonder why the legal searchlight is not aimed at the banks (Braithwaite, 2009). To fulfill high targets and acquire the necessary capital, high ENRON officials invented an ingenious system in which the costs were stored at legal entities custom made for this purpose (special purpose entities, SPEs). These SPEs were kept out of the books, while artificial profits were created by selling ENRON resources for exorbitant prices to these SPEs. Various banks knew about these practices, and sometimes actively participated in the SPEs: JP Morgan, Citigroup, Credit Suisse, First Boston, Merril Lynch, Deutsche Bank, Barclays, Lehman Brothers, and Bank of America (O'Brian, 2009). Also the irresponsible risks that were taken by banks in the accommodation of mortgages, which was the catalyst of the credit crunch, are increasingly qualified as unethical and possibly criminal.

Mortgage Fraud

Another suggested causal link between corporate crime and the global financial crisis is the alleged widespread mortgage fraud in the United States. According to Nguyen and Pontell (2010), the subprime mortgage crisis is the result of a combination of unethical predatory lending practices and downright fraud. Selling loans with attractive introductory terms that become high-costs loans in the long term to people who cannot afford such loans becomes fraud when those granting the loan intentionally misstate financial information to qualify the borrower to such a loan. In Southern California, the epicenter of subprime mortgages, approximately 56% of the loans were originated by 15 large lenders, among which New Century Financial Corporation (Abate, 2009). According to a BasePoint Analytics analysis (2007: in Braithwaite, 2010) of 3 million loans, 70% of early payment defaults contained fraudulent misrepresentation on their original loan applications.

While the banks tried to blame the borrowers for providing false information on their income and assets, corporate actors such as lenders, brokers, and the banks engaged in irresponsible, unethical, and perhaps even criminal behavior. According to Nguyen and Pontell (2010), the lead in mortgage fraud tends to be taken by mortgage origination personnel rather than by borrowers. The subprime loans, which were packaged and sold worldwide by the banks, provided the "toxic assets" that poisoned the international banking system through a complex structuring of derivates and other financial instruments.

In the United States, the Federal Bureau of Investigation (FBI) started an investigation into the Lehman Brothers to see whether the rendering of mortgages involved criminal acts. If this was the case, this would be the most direct connection between the credit crunch and organizational crime: conduct of financial institutions and their directors contributing to the credit crunch would be qualified as criminal. Partially, this would be post hoc criminalization, which will be discussed below. First, the next section describes the reversed relationship between the credit crisis and corporate crime.

THE CRISIS CAUSES CORPORATE CRIME

Expert opinions differ on the question whether economic recession will lead to an increase in crime nevertheless such predictions can be found in many countries. ''Every recession since the late '50s has been associated with an increase in crime and, in particular, property crime and robbery, which would be most responsive to changes in economic conditions,'' announced Richard Rosenfeld, a sociologist at the University of Missouri-St. Louis to the *New York Times* (Hauser, 2008). Lecturer in crime prevention and criminal investigation, Klerks, told a Dutch newspaper that the economic crisis increased crime rates: ''People who lose their job and income also lose their bond with society. They are more willing to do illegal things to get money'' (Van Leeuwen, 2009). In the United Kingdom KPMG (2010) sent out a similar warning: the crisis would lead to more fraud. Braithwaite continued the argument cited earlier in this chapter as follows: ''The bonus culture has already created a wave of crime in the suites; in future decades, it may create a new wave of crime in the streets as children grow up in families that experience long-term unemployment and homelessness'' (Braithwaite, 2009, p. 449).

These predictions are not yet based on empirical evidence but are supported by one of the most important criminological theories used to explain crime. Strain theory explains that subordinated groups in society try to react to the culturally defined goal of acquiring wealth by using alternative and possibly illegal means. This theory has also been applied to corporate crime (Cohen, 1995; Passas, 1990). When corporations do not manage to reach the goal of profit maximization as dictated by the capitalist economy by legal means, they will start using illegal means, especially when the lines between legitimate and illegitimate conduct are blurred. This theory seems to provide a good explanation for large accounting frauds: all corporations were active in globalizing and very competitive markets with a shared notion that scaling-up and increase in turnover were necessary to survive. To make this happen, they formulated ambitious targets. When it seemed impossible to attain these targets, the temptation to feign this growth by ''cooking'' the books became stronger.

According to Coleman (1987, 1995), the business community is dominated by a "culture of competition" that can be a strong motivator for white-collar crime. However, it is not the capitalistic strive for personal gain that is the main incentive for criminal behavior, but rather the fear of losing what has already been attained in the hunt for social wealth.

Based on these theoretical notions, it may reasonably be expected that the economic crisis will lead to an increase in corporate crime. The crisis causes the reduction in legal means to attain economic goals or prevent loss of wealth. The temptation to save on costs by not adhering to legal regulations (for security of environment, etc.) or by acquiring income through illegal means can be very strong.

It remains to be seen whether the crisis will affect the culturally dominant goal of profit maximization and its resulting risk-taking and greed. In the financial world, there seems to be a trend toward departure from the idea that financial institutions should only provide for the interests of the stockholders and should therefore maximize profits as soon as possible. For instance in the Netherlands, the Advisory Commission on the Future of Banks stresses the need for a more conservative culture in which the long-term benefits for the client should prevail and replace the focus on shareholder value (Adviescommissie Toekomst Banken, 2009). However, it is not yet clear whether these calls for a change of corporate culture in the financial sector will prevent abuse and fraud, or that this recent trend is mere "window dressing" as a response to blaming the banks for the economic crisis. Braithwaite (2009, p. 440) remarked that Asian banks, although also hit by the crisis, did not resort to irresponsible risky behavior like their American and European colleagues. He explains this phenomenon by referring to the financial crisis in Asia in 1997, also caused by financial greed, which provided lessons for this crisis. This made Asian banks "more conservative, prudent, and accountable."

THE CRISIS CAUSES CRIMINALIZATION OF BUSINESS CONDUCT

Corporate crime not only increases by economic crisis but also by criminalization of existing business conduct. As stated before, criminality is a social construction. In their analysis of the social construction of fraud, Brants and Brants (1991) make a distinction between two forms of social construction. Informal criminalization is the societal or social construction of certain behavior as criminal. Formal criminalization is the legal definition of certain behavior as criminal, expressed by way of statutes and sanctioning by judicial authorities. These definitions do not necessarily overlap. Not everything that is legally criminal is also considered criminal by society and vice versa.

Discrepancies between informal and formal criminalization are very prevalent in the field of corporate crime. Violations of the rules directed to corporations are often seen as not really criminal and often harmful business conduct does not constitute a criminal offence. Formal and informal criminalization of corporate behavior changes over time. There are clear criminalization processes regarding corporate conduct.[1] Public outrage after large scandals and affairs, media attention, political commotion, regulations, and enforcement policy all play an important self-amplifying role in this process. Brants and Brants show how fraud was criminalized in the Netherlands in the 1980s, partially as a result of publicity and political commotion about labor subcontractor practices and criminal cases against a well-known bank, the pension fund of civil servants, and the subsequent changes in legislation. In the 1990s, a similar criminalization process developed about insiders trading, manipulation of exchange rates, and other stock market practices ("stock fraud") culminating in the police raid of the Dutch stock market in Amsterdam (the "Clickfonds case") and new legislation and the establishment of the Authority Financial Markets (Van de Bunt & Huisman, 2007). After cases like ENRON in the United States and AHOLD in the Netherlands, the same process can be identified in accounting fraud.

Formal and informal criminalization influences each other in two scenarios. Criminal law theory preaches that criminal law is a codification of the prevailing current social and moral principles. In this scenario, the formal definition of a crime follows the informal definition: something is legally prohibited because society does no longer consider such behavior to be permissible. However, in the field of economic crime this relation is reversed. Formal criminalization is often used as an instrument to bring about change in behavior. By introducing the penalization of certain conduct, the legislator hopes that businesses or branches of industry catch on to the immorality of certain conduct.

Should we expect the credit crunch to lead to criminalization of risky behavior in the financial sector? And if so, through which scenario would this change occur? Messages in the media regarding public indignation about the conduct of banks and insurance companies and the exorbitant bonus culture indicate a new social intolerance for these practices. The National Public Survey on White-Collar Crime shows that the economic crisis has done much to frame white-collar crime as a chronic social problem (Huff et al., 2010).

Things have also changed within the financial sector. According to Stephen Green (2008), CEO of the HSBC Bank, the solution to this crisis starts with accepting the moral dimension of the crisis. Now that the public and politicians show their indignation and the financial sector acknowledges its own blame, Ministries of Finance, central banks, and financial regulators have warmed up for tougher regulation and closer monitoring. Moreover, according to the principle of the amplification spiral, new legislation will lead to further criminalization and more violation.

As expected, the credit crunch has led to increasingly demanding rules and regulations for high-risk financial products. In 2010, President Obama of the United States signed the Wall Street and Consumer Protection Act. The new regulations are viewed by many analysts as the most sweeping reforms to hit the financial industry in more than half a century. This is ‘‘reform that will prevent the kind of shadowy deals that led to this crisis’’ Obama remarked. Furthermore, the 2009 Mortgage Reform and Anti-Predatory Lending Act created new restrictions on lending activities and increased standards regarding consumer protection, notification, and disclosure in the loan origination process. The UK government plans to dismantle the Financial Services Authority (FSA), the current UK integrated regulator of firms and markets, and the UK's tripartite system of regulation. Prudential supervision will be transferred to a new body under the Bank of England. The other functions of the FSA will be organized within a new Consumer Protection and Markets Authority, which will also tackle serious economic crime (http://www.hm-treasury.gov.uk/consult_financial_regulation.htm). In the Netherlands, following up on the reports of an Advisory Commission on the Future of Banks and a Parliamentary Committee of Inquiry on the causes of the financial crisis, a recommended code of conduct for banks received a legal foundation. Banks have the legal obligation to disclose compliance with the code in their annual account (Adviescommissie Toekomst Banken, 2009; Parlementaire Commissie Financieel Stelsel, 2010). A special commission monitors the compliance with the code.

Several academics are raising awareness of forms of corporate crime that do not constitute a legal violation, for instance, because this conduct does comply to the letter, but not to the spirit of the law, or because the industrial lobby manages to keep the conduct out of legislation, or because corporations, physically or ‘‘fiscally,’’ move to tax havens or developing countries with a comfortable regulation policy. In addition, because of the moral ambiguity that typifies white-collar crime (Nelken, 1994), it is often difficult to distinguish corporate crime from ordinary business transactions. Furthermore, regarding the acts that led to the subprime mortgage crisis, there is a thin line between actual crime (mortgage fraud) and unethical or risky practices (predatory lending) that were, in most cases, legal (Nguyen & Pontell, 2010). Passas (2004) speaks of "crimes without rule breaking" and McBarnet (2006) calls this type of corporate crime "whiter than white-collar crime." As a result of this focus, they contribute to informal criminalization and possibly also to formal criminalization. Speaking about the credit crunch Braithwaite (2009, p. 439) notes: "Yet, when it comes to a financial crisis, criminologists join the assumption that strengthening regulation, conceived in the expanded-criminal-law-powers paradigm, is the priority." He adds to this by saying that bankers who behave irresponsibly should be eliminated by "reversed permit granting": denying them the right to fulfill a function in the financial sector.

Levi (2009) doubts whether raised awareness and indignation will be enough to criminalize future financially irresponsible behavior. This requires a "moral panic," he argues, but white-collar crime rarely invokes moral panic, for several reasons. Even when a large number of people are harmed by white-collar crime, "normal" crime will always appear to be more threatening. Furthermore, politicians do not benefit from "moral panic." In contrast to moral outrage about conventional criminality, politicians want to control public unrest while managing the economic crisis. Therefore, risk management is considered more important than criminalization. According to Pontell (2005), such public policies "whitewash white-collar crime." Dominant neoliberal thinking about corporate governance trivializes the notion of fraud and provides accounts of the causes of the crisis that hide the significant role of material fraud in the financial crisis. Dorn (2009) adds that "The recent development of a sense of public outrage over bankers, bonuses and 'hand-outs,' and the beginnings of criminal prosecution for only the most egregious frauds are interesting as the "flip side" of the preceding tendency to "whitewash" corporate excesses."

Banker Bashing

According to Levi, a distinction should be made between criminalization of behavior and criminalization of people who portray this behavior. Fear and indignation are not enough for "moral panic": this requires a target for anger and outrage. According to Levi "moral panics require folk devils." The absence of identifiable perpetrators inhibits criminalization of financial misconduct.

Levi explains this with two arguments. First, those who caused the financial crisis are not social outsiders. Bankers and insurance officers do not fit into the common "criminal" image. Second, the anonymity of the large bureaucratic organizations inhibits personal stigmatization. The criminal operating through the medium of a corporation typically is only folk-devilled when he '[…] "frightens the horses" by engaging in some extreme business practice. The latter may or may not be presently legal but because it is made explicit, causes a popular resentment that then translates the "normally implicit" into something reprehensible; for example, risk becomes negligence, innovation becomes greed, and so on' (Levi, 2009).

With the exposure of his seemingly successful hedge fund as a Ponzi scheme, perhaps the dealings of Bernard Madoff fit such "extreme business practice." However, it is his qualification as a fraud that confirms the exception: pretending to be a respectable businessman, the villain is unmasked as a crook and is therefore an outsider; not like "us" law abiding citizens.

The moral translation of commercial risks and bonuses that had become normalized within the business world into irresponsibility and profiteering are very clear reactions to the credit crunch. Politicians and financial regulators in the affected countries point at banks and bankers as those most guilty. According to former UK Prime Minister Gordon Brown, bankers had "lost sight of basic British values." And the Chair of the British Financial Services Authority Lord Turner qualified the conduct of the banks as "anti-social." Critics in the United States blamed President Obama for maintaining a populist "blame-the-bankers" campaign. In a interview for the CBS television program "60 Minutes" President Obama was clear on who had caused the crisis: "I did not run for office to be helping out a bunch of fat cat bankers on Wall Street. […] You guys are drawing down $10, $20 million bonuses after America went through the worst economic year that it's gone through in – in decades, and you guys caused the problem" (*The Wall Street Journal*, 2009).

Blaming the banks as institutions of the crisis is still different from holding individual bankers responsible. Groups of angry customers challenge the bureaucratic anonymity in their craving to find those responsible. Several executives of large financial institutions have been targeted. "They've been hauled before Congress, deposed and fired, lost vast fortunes, and been the targets of populist rage" (Gross, 2009). This was illustrated by the photo published in many newspapers, in which AIG CEO Edward Liddy had to account for the commission of the US Senate. In the background, above Liddy's head, a protestor holds up a sign saying "Jail."

Personal shaming was also seen in Britain and the United States, where bankers had to appear before parliamentary and congressional committees.

In the United Kingdom, Sir Fred Goodwin, former CEO of Royal Bank of Scotland, is the embodiment of all that is apparently wrong in the financial sector and which has caused the financial crisis. He is seen as responsible for the disastrous acquisition of the Dutch ABN AMRO bank and the resulting rescue operation of the government – with British taxpayers money. "Politicians blamed banks, banks blamed regulators, and everyone blamed Sir Fred Goodwin" (*PRWeek*, 2010). Anger was especially raised when Goodwin insisted receiving an agreed pension of 775.000 pounds sterling at the age of 50. It was even suggested that his knighthood be revoked since this had been given for his past contribution to the financial sector.

One step further than the above are the calls to prosecute individual bankers. Former Prime Minister Haarde of Iceland is the first political leader in the world to be criminally prosecuted for his failing economic policy during the crisis. Atli Gislason, the chair of the committee, argued for the prosecution stated in an interview "I have strong indications that there was a lot of criminal activity within the banks from the beginning of 2008 leading up to their collapse; criminal acts were committed." The former executives of the banks named Kaupting Bank, Glitnir Bank, and Landsbanki who issued credit for a total of €66 billion are currently awaiting prosecution. The loans were "if not illegal, completely unethical," the new Prime Minister Sigurdardottir stated (Valdimarsson, 2010). In January 2011, the former executives of Landsbanki were arrested for the alleged crimes that led to the downfall of the bank (*BBC News*, 2011).

In his days as opposition leader of the British Conservative Party, David Cameron called for an intensified investigation of possible illegal conduct of bankers. In the television program Sky News he said: "I think that we need to look at the behaviour of banks and bankers and, where people have behaved inappropriately, that needs to be identified and if anyone has behaved criminally, in my view, there is a role for the criminal law and I don't understand why in this country the regulatory authorities seem to be doing so little to investigate it, whereas in America they're doing quite a lot"(Porter, 2009). The Manhattan US Attorney's Office is still looking into whether investment banks and bankers committed criminal securities fraud in connection with their mortgage trading. A settlement was reached with Goldman Sachs, dropping further criminal charges. The FBI has more than 2,100 corporate and securities fraud investigations open, many with losses exceeding $100 million, and several with losses topping $1 billion, according to the Justice Department (Catan & Scannel, 2010). However, as Black

(2010) points out, there are no criminal cases and few enforcement actions against the senior officers of the large subprime mortgage specialty lenders.

It remains to be seen whether these attempts at personal criminalization will succeed. According to Levi (2009), attempts to stigmatize respected entrepreneurs as white-collar criminals are often unsuccessful and end "not with a bang but with a whimper," not uncommonly because of lawsuits that drag on for years.

Detrimental to this personal shaming and criminalization are the concerns that are raised in the media and in politics about the consequences of this "banker bashing." Worries exist for the economic effects of getting tough on banks and bankers. For instance, London is supposed to have lost its status as the world's unrivalled financial capital after demands for curbs on bonuses and tougher regulation of the city. The results of the influential Global Financial Centers Index would justify the fear that "banker bashing" has tarnished the reputation of international financial capital (Prunn, 2010).

It is also feared that the limitation of bonuses and tougher regulation would lead to a financial "brain drain" to other countries. It is interesting that this same argument was used in other countries for the large bonuses that were allegedly needed to attract financial talent (Smit, 2009). Otherwise this talent would remain in London. The same argument was used in the city: without large bonuses, top talent would move to other financial centers. The foretold exodus of bankers because of tougher regulation and lower bonuses never occurred (Murphy, 2010).

According to Levi (2009), this fear of counterproductive effects will restrain attempts at folk-deviling bankers and the criminalization of their conduct. The consequences of uncontrolled criminalization are far too serious for the economy to permit "indulgence in the bread and circuses ritual" of banker bashing. Instead, key actors with power will attempt normalization strategies in order to manage "the problem." In this vein, a gentlemen's agreement was settled in the Netherlands, between the financial sector and the Ministry of Finance, in which the sector committed itself to a sustainable and moderate reward policy. The emphasis is on the restoration of trust. A sustainable rewarding policy ought to prevent the excesses that erode this trust. With this agreement, the financial sector dissociates itself from the rewards and bonus systems that instigate irresponsible risk-taking and a disproportionate orientation on the short-term shareholder value. Variable rewards should contribute to long-term corporate goals, instead of giving perverse incentives.

Furthermore, to pillory bankers would be to draw attention from the more structural causes of the financial crisis. "The economic crisis is too complicated to explain to most readers. Collateralized debt obligations and credit default swaps don't sell papers. Flogging bankers in public, by contrast, is a sport that everybody can enjoy'' (*The Economist*, 2009).

Such backlashes against stigmatization also come from the banks. In response to the public anger, bankers have confessed guilt and promised improvement in public hearings and media appearances. This has led to reports in which improvement measures and self-regulation are announced such as the report of the Dutch Advisory Commission on the Future of Banks chaired by former banker Cees Maas, which has the telling title ''To Restore Trust'' and in which a code of conduct for banks was introduced. This code aims at strengthening corporate governance, risk management, and rewarding policies. The commission's report was applauded and was translated into law. In the United Kingdom, a similar commission was put to work chaired by banker Sir David Walker. The responses to their report show that they did not succeed in silencing the critique: the recommendations are perceived to be not sufficiently far-reaching and practically nonenforceable (Allen, 2010).

Bank reaction was not always apologetic – some went on the offensive, for instance, by ''blaming the victim.'' Richard D. Parsons of Citigroup stated, ''The loans wouldn't have been there in the first place if American home buyers, driven by what The Weekly Standard calls immediate gratification without personal responsibility, hadn't overstepped their bounds'' (Zombeck, 2010). One step further is the neutralization technique of the ''condemnation of the condemners'' (Maruna & Copes, 2005). In a letter to the Dutch financial daily *het Financieele Dagblad*, the chair of the Dutch Society of Banks Boele Staal critically responds to the remark of the Dutch Authority Financial Markets on the failure to bring about a culture change in the financial sector (Staal, 2009). According to Staal, the position of the Authority Financial Market is an example of how it ought not to be. Politicians responded to the vague critique ''without minding the facts, and with the usual Pavlov reaction of ''being sick and tired.'' Especially because restoring trust takes more time than making it disappear, Staal criticizes the tone and language in the dialogue with the media and politics. Politics and regulators do not care for imaging and therefore do not contribute to the restoration of trust, Staal complains.

These responses neutralize the responsibility of bankers and shift these partly to customers, regulators, and politics. In this way, the distinction between perpetration and victimization becomes blurred and stigmatization fails. ''The creation of 'folk devils' works best when a simple juxtaposition of good victims and evil perpetrators can be made'' (Levi, 2009, p. 14). Public and politics blame the banks, banks return the blame and all arrive at joint responsibility, as is literally stated in the Dutch gentlemen's agreement. The labeling of bankers as social outsiders, as occurs with regular offenders to expel them from the conventional moral order, is not successful. Instead of "folk devils" bankers are more like "Faustian devils who, when revealed as large-scale lawbreakers, being central to the social structure, are also threat to our *moral* selves" (Levi, 2009, p. 18).

THE CRISIS UNCOVERS CORPORATE CRIME

The final possible relation is that the credit crunch and the economic recession make crime more apparent. The prime example for this relation is the investment fraud of Bernard Madoff. Madoff ran a pyramid scheme disguised as a high-return investment fund for over 20 years concerning $65 billion from more than 4,800 clients. Madoff's reputation was spotless. Among other things he was the director of the IT stock market NASDAQ. Because of this established trust, together with a selective admission policy, Madoff's clients consisted of renowned investment funds and banks. Madoff did not invest the money of his clients; instead he used it to live his luxury life and to pay dividends to earlier clients to keep up the appearance of a reputable investment fund. Because of the economic crisis, there were not enough new clients, causing Madoff to be unable to fulfill his obligations and ultimately the outing of his scheme (Lenzer, 2008). More recently a similar case came out: the company of the billionaire Stanford developed liquidity problems because of the crisis. In this way it became clear that the investments that the company sold were essentially worthless, causing the FBI to arrest the Texan (Stecklow, 2009).

In addition to these "accidental" revelations, there is another mechanism that can lead to the discovery of corporate crime. When there is indeed an amplification spiral, this means not only that behavior at the root of the credit crunch would be criminalized but also that the increased attention and increased enforcement priorities would lead to the discovery of more mishaps. According to Regulatory Bulletin 37–54 of the US Department of Treasury, the FBI is investigating about 2100 mortgage fraud cases, a 400 percent increase from before the crisis.

READING TEA-LEAVES

The presented possible relationships between the current financial crisis, economic recession, and the phenomenon of corporate crime are obviously, for a large part, the result of the proverbial reading of tea-leaves. However, although the provided scenarios lack a sound empirical basis, they do fit within criminological theories and studies of corporate crime. Studies on corporate crime can provide lessons, like the parallels that are found with previous financial crises and the criminalization processes of other forms of corporate crime. Pontell and Geis (2010), Nguyen and Pontell (2010), and Black (2010) draw comparisons between the savings and loans debacle in the 1980s and the current crisis and stress that lessons should have been learned. ''Both financial crisis involved deregulatory policies that loosened financial restrictions, provided inadequate oversight, and required no accountability'' (Nguyen & Pontell, 2010). However, first and foremost, empirical research for testing these hypothetical causal relations is necessary. Not wanting to overestimate the influence of academic criminologists, such research on the behavior causing the financial crisis conducted by criminologists might nevertheless further contribute to the criminalization of this behavior. It is telling, however, that the irresponsible and greedy behavior of bankers and insurers that allegedly caused the credit crunch has not yet yielded a ''catchy'' term, like ''accounting fraud'' and ''mortgage fraud.'' Perhaps when terms like ''credit fraud'' or ''crisis crime'' are all the rage, only then may one speak of real criminalization.

NOTE

1. At the same time there are decriminalization processes, such as the legal decriminalization of price-fixing and formation of cartels from a crime to an administrative offence as well as the discussion about regulation pressure of businesses and the abolition of rules for this reason (see Van de Bunt & Huisman, 2007).

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ILLEGALLY BACKDATED STOCK OPTIONS

David Shichor, Henry N. Pontell and Gilbert Geis

ABSTRACT

The illegal backdating of stock options has been studied by economists and lawyers, but totally neglected by criminologists. We examine three cases in order to convey a sense of how backdating has played out in practice, and consider the results of empirical research that has been published on the subject. Traditional legal analyses, mostly by law students, have detailed the statutory history and standing of the law regarding stock options. Economic writings focus almost exclusively on structural features that may correlate with outcomes. The failure of financial writers to carefully distinguish between criminal and noncriminal backdating is in part a consequence of the limited theoretical interpretations in their field beyond cost–benefit analysis and rational choice calculations. Criminologists, while having a plethora of theoretical constructs that might be applied to backdating, generally have no training to allow them to comprehend the arcane elements of economic criminal behavior. We conclude that more multidisciplinary attention is necessary to overcome the current pigeonholing of research approaches that limits both understanding of illegally backdated stock options and effective policies designed to prevent it.

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INTRODUCTION

In December 1939, at a joint meeting in Philadelphia of the American Sociological Society and the American Economic Society, Edwin H. Sutherland, president of the sociological society, introduced the term "white-collar crime." In the second sentence of his speech Sutherland pinpointed what he claimed were the cross-disciplinary deficiencies of both groups. "[T]he economists are well acquainted with business methods but not accustomed to consider them from the point of view of crime," Sutherland said, adding that "many sociologists are well acquainted with crime but not accustomed to consider it as expressed in business" (Sutherland, 1940).

Sutherland might well have added a third intellectual endeavor – law – to the mix. He could have quoted the observation endorsed by Supreme Court justice Louis Brandeis a few years before his own address that "a lawyer who has not studied economics and sociology is very apt to become a public enemy" (Brandeis, 1934). Two writers later would elaborate on these positions. David Riesman of Harvard, trained in both sociology and law, noted that "lawyers are very apt to be scornful of the findings of social science" and suggested that a main reason was that the social sciences tend to introduce novel insights and uncertainty into the comparatively rigid legal system, thereby representing something of a threat to legal practitioners (Riesman, 1957). Looking at the matter from a legal perspective, A. Delafield Smith charged that the social sciences had shown "a grievous absence of understanding of the law's objectives, a resulting failure to apply legal methods, and little awareness of the contributions of legal philosophy to social objectives" (Smith, 1955).

It is in terms of these foregoing considerations that we will focus on a particular behavior – the illegal backdating of stock options – that has been reasonably well studied by economists, diligently dissected by lawyers, and totally neglected by criminologists. We will largely concentrate on ingredients of the offense itself before, toward the end of the chapter, addressing the question of why there exists so striking a disparity in disciplinary attention to the behavior and what we regard as the failure of scholars to provide a full-fledged view of the illegal activity.

We will briefly examine three cases in order to convey a sense of how backdating has played out in practice. Then we will look at the results of empirical research that has been published on the subject. The aim is to determine what has been learned, what has been overlooked, who in terms of disciplinary affiliation has done most of the research on the subject and what implications all this has for a comprehensive understanding of stock option backdating. That accomplished, the next task will be to see if the observations by Brandeis, Reisman, and Smith and in particular Sutherland's 1939 claim of the gap between economists and sociologists/criminologists is reflected in the literature on stock option backdating and, if so, why this is so.

STOCK OPTIONS

From the viewpoint of the powers-that-be in publicly traded corporations, a satisfactory scenario would unfold like this. The company lures a highly regarded man or woman to serve as its CEO by offering a decent but not exorbitant salary (and the likelihood of an equivalent-level bonus payout). Attached to the offer is an option to purchase a sizeable amount of stock in the company five years hence at the same price that prevails when the executive signs up – known as the "exercise price" or the "strike price." If at the end of the five-year period the company has prospered through acumen, luck, or because of other conditions that occurred during the tenure of the new executive, her or his shares may now be worth much more than when they were first awarded to the new CEO. He or she may cash out or hold the stock in anticipation of further increases or a more favorable capital gains tax climate.

Stock options were found to constitute one-half to two-thirds of CEOs' pay packages in the early 2000s (Dash, 2008). Companies also offered such options to nonexecutive personnel, indicating that they often did so to equalize pay among personnel hired in different economic climes. Walker suggests that perhaps this was done as a means of "providing cover for executives to grant themselves valuable backdated options" (Walker, 2007).

Until passage of the Sarbanes–Oxley Act in 2002 the awarding of stock options did not have to be disclosed until the end of the fiscal year in which the transactions occurred. Section 403 of Sarbanes–Oxley Act required that the options have to be reported to the Securities and Exchange Commission (SEC) within two days of their granting (Rouse, 2007). The new rule brought about a decline in backdating, but it is believed that many companies simply have disregarded the mandate (Saul, 2006).

Providing stock options to corporate executives as part of their compensation package became a widespread practice during the "dot.com" boom of the 1990s. The appeal of this arrangement is that the company can avoid a higher original outlay of funds at the hiring stage by postponing payment to a later date, when its bankroll hopefully has been enhanced.

This is a particularly attractive pathway for cash-challenged startup companies (Jayaratnam, 2007) and those in the high-tech industry (Carter & Lynch, 2001). A downside is that key personnel who eagerly anticipate the arrival of the time when they can sell their stock options may be inclined to resort to highly risky and sometimes illegal tactics to increase the company's short-term earnings at the expense of more solid and more sensible dealings that do not pay off so rapidly.

It is often said by those advocating stock options that they supposedly are useful in "more closely aligning the interests of shareholders and managers" (Cox, 2006; see also McClendon, 2004), a highly dubious proposition first undercut in the classic study by Berle and Means (1932). A pair of writers suggested that "[a] suitable compensation package for executives is important since it enables the executives to focus on the interests of the business" (Adam & Schwartz, 2009). Putting aside the question of what constitutes a "suitable compensation package" it is difficult to believe that the difference between the obscenely exorbitant salaries and bonuses that executives have been garnering and more reasonable earnings would have a pronounced effect, indeed any effect, on their work performance.

Frankel (1999) writes critically of "America's corporate 'democracy' in which citizen-stockholders are allowed to 'elect' slates of handpicked directors, and although celebrated as 'owners' are forced to accept policies decreed at the top." Bear Stearns, a company that had to be purchased by the Bank of America in order to stay afloat during the economic meltdown, offers an example of an eviscerated board of directors. Board meetings at Bear Stearns were so scripted that minutes often were written out in advance and directors were asked to read from prepared comments (Cohan, 2009). Besides, boards of directors, for their part, notoriously are made up of persons who themselves are likely to benefit from the level of the prevailing compensation arrangements in the business world.

A scenario that is said to characterize a good deal of irregular stock option backdating is presented in a portrait of a meeting of the directors of a fictitious entity – Banana Computer, Inc. – whose board is already frazzled by an array of reports, forecasts, and similar corporate information:

> The chairman is aware that the time is drawing to a close and that all the external directors have flights to catch. However, there is still the matter of this quarter's stock option grant. The grant has to be approved by the board. At the last moment, and just before adjournment, the chairman of the executive compensation committee passes around a memo detailing the next option grant. The directors do not read the memo, ask questions, or hesitate for a moment before unanimously approving the grant. The directors depart and everyone arrives at the airport on time. (Nowicki, 2008)

This portrayal may be something of a caricature but most caricatures have embedded within them a gem of truth. And it hardly seems arguable that contrary to Cox's (2006) rosy position, it is more likely that corporate decisions are "more closely associated with the self-interest of directors than shareholders' concerns" and that common initiatives aimed at aligning the interests of the shareholders and managers are ineffective (Henry, 2005, p. 129). Another writer indicates that in his view an expectation that stock options will enhance executives' desire to serve the best interests of shareholders is a "prescription for disaster" (Bruhl, 2003).

The disconnect between the rationale that lucrative stock option deals motivate executive performance was indicated when Cablevision Systems provided stock options to its deceased vice chairman, and backdated them to a date before his demise. This led a law professor to declare dryly that the firm apparently was trying to "incentivize a corpse." The company also had awarded backdated options to outside compensation advisors who were not its employees (Grant, Bandler, & Forelle, 2006).

Stock option arrangements in recent times have been bedeviled by situations that were likely unanticipated when the stock grants were arranged: these are situations in which when the time approaches that the stock in the option may be redeemed it is worth less than it was at the date that it was granted. One way to deal with this discomforting eventuality is to alter to a fictional date the time when the stock was awarded. Such an action is perfectly permissible if the arrangement is reported to stockholders and it is properly reflected in the company's earnings report. If this is not done, the backdating is a criminal offense. The rationale for this distinction between informing stockholders or not doing so is eccentric. In neither instance are shareholders likely to attend to the matter, much less to object to it unless it is particularly egregious.

In most states the law does not require stockholder approval of option backdating, only notification, and boards of directors rarely seek endorsement by those who presumably own the company (Arya & Sun, 2004). An attempt to make a computer company seek shareholder approval for its proxy proposal regarding redating stock options failed when the SEC declared that the options were no more than ordinary business and did not need shareholder endorsement. But in 1998 when the Wisconsin Investment Board sought to have General Datacom Industries adopt a bylaw requiring stockholder approval of repriced options the SEC now declared that "the widespread public debate concerning option repricing and the increased recognition that the issues raised important policy issues" dictated that such a vote be held. At the company's annual meeting the proposed bylaw was adopted by a 52 percent favorable vote (Thomas & Martin, 1998).

The recent upsurge of interest in the illegal backdating of stock options is an offshoot of the attention and outrage that developed in regard to the compensation packages awarded to corporate executives. Early on, financier Warren Buffett criticized the extraordinary amounts of money allocated by corporate compensation committees to upper-level employees. "Too many of these people have in recent years behaved badly at the office, fudging numbers and drawing obscene pay for mediocre business achievements," Buffett declared: "[They] simply followed the career path of Mae West: 'I was Snow White but I drifted'" (Buffett, 2002). As the economic meltdown hit home, most Americans came to share Buffett's judgment about the compensation of corporate executives. It was noted that from the 1990s to the early 2000s executive pay increased from about 100 times that of the average worker to an estimated 350–570 times higher (Harris, 2009). Included in the exorbitant pay packages of executives are perks such as tax breaks, use of private jets, country club memberships, and similar goodies (Friedrichs, 2009). For the company, there is a possible tax advantage. While an individual's compensation exceeding one million dollars is not tax deductible, a stock option is not calculated into that total. And since 1993, federal tax law has deemed option grants tax deductible if the price of the option is not less than the market price of the stock at the date the grant was made (Bernile & Jarrell, 2009).

In numerous instances executive compensation grew while thousands of workers were laid off by companies that were losing million of dollars. In 2007, for example, the CEO of the CBS television network received $18.5 million in cash bonuses atop his $5.3 million salary and more than $12.5 million in stock options. This pay package was 28 percent higher than what he had gotten the previous year. During the same period, the company's net income declined by 24 percent and it had to cancel several programs and lay off more than 160 employees (James, 2008).

PROTYPICAL CASES

The Brocade Communications Systems

The first criminally prosecuted case of stock option backdating took place on July 20, 2006 and involved two executives of the Brocade Communications Systems Corporation in San Jose, CA, the world's largest provider of switches for storage of corporate data. The accused were Gregory Reyes, Brocade's former chief executive, and Stephanie Jensen, the company's former vice president of Human Resources. The SEC also filed civil charges against Reyes and Jensen and against Antonio Canova, the company's onetime chief financial officer. They were accused of illegally backdating stock options and thereby concealing millions of dollars in expenses from shareholders and significantly overvaluing the company's income. So flagrant had been the practice that in one instance they backdated stock options to two employees that bore a date prior to the time when the individuals had been hired to work for Brocade. The backdating was deemed necessary when Brocade stock dipped from a high of 133.77 to a low of 34.00.

In January 2007, Reyes, after seven days of jury deliberations, was found guilty of 10 felonies and received a 21-month prison sentence and a $15 million fine. Two months later Jensen was given a four-month jail term and fined $1.25 million. For his part, Canova was barred for three years from doing any accounting work that had to be presented to the SEC.

Brocade settled the civil suit against it by agreeing to pay a seven-million dollar penalty and settled a class action suit by stockholders with a $160 million payment. It retrieved some $12.5 million from Reyes. On appeal, however, Reyes' conviction was overturned. During the trial, he had claimed that the finance department was well aware of the backdating and that he presumed that the department was seeing to it that the transaction was carried out in accord with the law. The prosecutor in his summary address to the jury said that the finance department was not cognizant of the deal and reminded the jury that not one witness had so testified. But the FBI had interviewed several members of the finance department who maintained, even though they could have been prosecuted for saying so, that they were informed of the backdating. The prosecutor knew this, but misled the jury. Jensen, joined with Reyes in the appeal and had her sentence reduced from four months to 60 days because the court ruled that the trial judge had misinterpreted the obstruction of justice segment of the federal sentencing guidelines (*United States v. Reyes*, 2009).

On retrial in 2009 Reyes again was convicted, this time of nine counts. He was acquitted of the tenth, a charge of conspiracy. Reyes' attorneys adopted the risky tactic of calling no witnesses, relying totally on a long summation that tried to persuade the jury that their client thought that his behavior was permissible, that it was a common practice in the industry, and that the government had not satisfactorily proven its case beyond a reasonable doubt (*United States v. Reyes*, 2010). Reyes again was found guilty but his prison sentence was reduced from 21 to 18 months.

Converse Technology

The stock option backdating fraud perpetrated by three officers of Converse Technology, a firm located in Woodbury, Long Island, New York, is much more open-and-shut, illustrating how backdating can be employed as a fraudulent operation to enrich its perpetrators. There was no hint of a gray area in this instance: it was all black and blatant – and clearly criminal.

Converse executives designated persons who did not exist as recipients of stock options, and placed the money paid out to these ghosts into a secret slush fund, which on the whim of a secretary was filed as "I.M. Fantom" based on her recent viewing of a performance of *Phantom of the Opera*. The fund was used to reward Israeli-born Jacob (Kobi) Alexander, the company's founder as well as other employees with backdated stock options. The FBI filed charges against Alexander for the scheme. The SEC calculated that the cost to the company on a single option grant was $130 million. Charges were also filed against William Sorin, the Converse lawyer, and David Kreinberg, its CFO.

In a scheme that lasted from 1991 to 2002, Alexander would determine a favorable grant date when the stock price was low and then obtain the endorsement of a befuddled compensation committee. After the fraud was uncovered, Converse had to restate its earnings for half a decade (Chambers, 2008, pp. 261–264).

Alexander at first denied backdating options, but a *Wall Street Journal* analysis determined that the odds of the grant dates that he had chosen falling as they did by chance were about one in a billion. Alexander then caved in and sought to justify his actions by claiming that everyone was doing the same thing (the typical plaint of a motorist caught speeding on a freeway). Kreinberg copped civil and criminal pleas in late 2006 in which he agreed to pay almost $2.4 million in a disgorgement fine, and admit guilt to criminal charges. William Sorin was sentenced to a year and a day in prison. Alexander fled with his wife and three children to Namibia in Africa and attempted to conceal his wealth by transferring $40 million to accounts in Israel. He won a court fight in April 2010 when a Namibia judge declared that the country's Extradition Act decreed that a person must be kept in custody while proceedings to determine if he or she will be extradited are underway. Out on bail, Alexander has been courting Namibia by munificent gifts for education and other philanthropic endeavors. In 2010, Namibia refused to extradite Alexander to the United States, and in November of the same year Alexander agreed to pay nearly $54 million to settle shareholder suits and a civil penalty imposed by the SEC (Kaplan, 2010).

Broadcom

A major manufacturer of computer chips, Broadcom, according to the SEC, kept "books and records that falsely and inaccurately reflected, among other things, the date of option grants, the company's stock-based compensation expenses, the company's operating results, and at least one employee's hiring date" (Reckard, Christensen, & Elliot, 2008, p. A21). When the fraudulent report was uncovered, the company's restatement of its financial position showed an additional $2.2 billion in payouts.

In his opening statement at the Broadcom trial, the prosecutor insisted that this was not a case about accounting but a case about lying. The defense relied on the fact that there were no witnesses to testify that the defendants – former CEO William Ruehle, current CEO Henry T. Samueli, and the cofounder Henry Nicolas III – knowingly lied about the backdating. The defense also maintained that at the time that the backdating had taken place it was a common understanding that the practice was not illegal – after all, hundreds of companies were believed to have done the same thing.

Elements of deception by the prosecution undermined the government's case. David Dull, the Broadcom general counsel, said that he was told by the prosecutor that if he changed what he had told the SEC about the innocence of the Broadcom executives he would be given a "soft cross," that is, handled gingerly by the federal attorney. If not, he was likely to be charged with perjury. The result was that the case was thrown out of court by the judge who ruled that the prosecutors had "intimidated and improperly influenced" witnesses.

Taken together, the Brocade and Broadcom cases illustrate the barriers to effective prosecution of an alleged white-collar crime of stock option backdating, most importantly the need to demonstrate criminal intent beyond a reasonable doubt. This requirement was the fundamental reason why, among many similar scenarios, Martha Stewart was charged with conspiracy, obstruction of justice, and lying to investigators – the easier charges to prove – rather than the insider trading that had most fundamentally gotten her into trouble with the criminal law (Hemingway, 2007).

EMPIRICAL FINDINGS

Brocade was a prototypical case of stock option backdating. The scholarly literature has concentrated not on such single events but on aggregate financial correlates of stock option backdating and their implications. An early study learned that the price of the stock involved in backdating shot up during the 50-day period after the backdating took place. The author presumed that insider information was at work here, that the company knew of events that likely would enhance the value of its shares and opportunistically chose a date that would maximize the value of the backdated options (Yermack, 1997; see also Aboody & Kasznik, 2000; Chauvin & Shenoy, 2001; Lie, 2005). The last two reports just cited found that a company's stock price was abnormally low immediately before the grants were made but climbed higher soon thereafter. Lie (2005) suspected that the dates were all set retroactively. In this respect options backdating can be interpreted as a form of ''collective embezzlement'' (Calavita & Pontell, 1991) or ''control fraud'' (Black, 2005) in which executives defraud shareholders through illegally converting corporate resources for their own benefit. On a more macro-level, research indicates that stock repricing is best understood as a firm-specific activity, in that it occurs when a particular company's stock has gone south, despite healthier conditions in the industry and in the market in general (Brenner, Sundaram, & Yermack, 2000).

It is not precisely clear how much stock option backdating occurs. A widely cited study by two business professors reported that between 1996 and 2005 more than 2,000 companies had revised the dates on original stock options in order to sweeten executive pay. They examined the records of 39,888 stock grants and concluded that 13.6 percent of these were backdated or otherwise manipulated (Heron & Lie, 2007). The writers believe that in most cases this activity violated the law because it did not fulfill the conditions necessary to legitimize backdating, such as notifying shareholders.

More recently, Edelson and Whisenant (2009) sought to learn the effect of backdating on a company's performance. Overall they concluded that for every one company that discloses backdating there are two that do not do so. Edelson and Whisenant focused on 42 firms that had disclosed backdating and 92 that they believed had engaged in the practice but did not disclose it. They found that for both groups the company's financial position deteriorated after the backdating, and even more so for the nondisclosers than the disclosers. When illegal backdating is discovered and it becomes public knowledge, a study of 110 companies determined that firms' stock price showed declines that ranged between 20 and 50 percent (Bernile, Jarrell, & Mulcahey, 2006).

The estimated loss to shareholders based on a study of 48 companies was said to be about 8 percent. Put another way the practice cost firms $500 million each with the average gain to individual executives being $600,000. The same study pinpointed a complementary practice of "forward dating"; that is, altering the date of the stock option to a later time when it was hoped the stock value would have increased (Narayanan, Schipani, & Seyhun, 2007).

What is striking about our consideration of illegal stock option backdating and the extensive literature that considers it is the absence of any sense of condemnation of the behavior either as criminal or immoral in economics, finance, and law expositions. Adam & Schwartz (2009) in their 13-page essay on stock option backdating never once use the word "crime"; rather they blandly note that there is a difference between legal and illegal stock option backdating. Imagine, if you will, calling burglary and rape "illegal acts" rather than designating them as crimes.

CONCLUSION

We return now to the observation by Sutherland about the insularity of economics and sociology/criminology as academic disciplines that have white-collar crime as part of their intellectual domain as well as the sentiments of several prominent writers concerning the firewall that exists between law and the social sciences.

How does our review of the backdating of stock options coincide with these statements? Does the research suggest a disciplinary rapprochement and the emergence of a multidisciplinary approach to a subject whose ramifications contain significant elements that fall within the boundaries of traditional scholarly disciplines and enterprises? Or do the indictments expressed in our opening paragraphs remain regnant? The latter position is clearly reflected by our review of stock option backdating. Other criminal acts may be scrutinized with more collaborative work and greater crossing of traditional boundaries, but this self-evidently has not been true for the behavior upon which we focused.

The most significant finding of our inquiry is that virtually all of the scholarly consideration of stock option backdating has been carried out by researchers in economics, business, and closely related fields. Traditional legal analyses, mostly by law students, have detailed the statutory history and standing of the law regarding stock options. The primary focus of legal scholarship has been, as commonly is the case, on appellate court decisions that provide judicial interpretation of elements of the statute.

The economic writings on stock option backdating focus almost exclusively on structural features that may correlate with outcomes; for example, the relationship between the behavior and the price of the company's stock and earnings before and after the backdating of the options occurs. The research reflects the advice of a prominent organizational scholar who encouraged the study of corporate law-breaking through empirical inquiries that he found "especially attractive because the indicators cited can be readily computed or accessed without gaining entry into the firms themselves" (Szwajkowski, 1985, p. 566). The scholarly literature on stock option backdating indicates that virtually all researchers have adopted the view that it is preferable to sit in front of computers in air-conditioned offices and manipulate available data rather than to seek to penetrate the world in which the behavior is carried out or to locate those who were involved in the behavior to try to determine how they saw things.

In terms of scientific logic a serious shortcoming of the published work is that it should be necessary to demonstrate that the indices correlated with illegal backdating are meaningful to the persons who allegedly are responding to them. Many years ago Robinson (1950) noted what he labeled the "ecological fallacy." He illustrated the concept by pointing out that scholars correlate census tract data with behavior by persons residing in the tracts. Overlooked is the fact that the aggregate tract data might be off base in regard to individuals whose behavior is being studied.

The sophisticated article output on stock option backdating in the financial journals would not pass muster for acceptance by first or second tier sociological/criminological periodicals because it lacks a theoretical wrap. The implicit assumption is that the behaviors were triggered by cost-benefit analyses or rational choice calculations but no compelling evidence is offered to support these or other theoretical positions.

The failure of financial writers to attend carefully to a distinction between crime and noncrime in acts such as stock option backdating is in part a consequence of the limited theoretical interpretations in their field beyond cost-benefit analysis and rational choice calculations, neither of which is readily proven by more than speculative assumptions. For economic scholars the law's characterization and the penalties that can accompany it are but another of the factors in a subjective behavioral equation. They ignore Braithwaite's important observation that "it is the fact that the criminal chooses to engage in the behavior knowing that it can be so labeled that distinguishes criminal choice from other choices. It is the defiant nature of the choice that distinguishes it from other choices" (Braithwaite, 1989, p. 2). A federal judge further noted when asked to determine where the blame lay in the Bank of America's failure to notify stockholders asked to endorse its merger with Merrill Lynch that Merrill was carrying a considerable undisclosed debt that was the result of large bonuses it had promised executives. ''If crimes are committed they are committed by people, they are not committed by some free-floating entity,'' the judge declared. ''The companies … don't operate on automatic pilot. There are individuals that make decisions – and some make the right decisions and some make the wrong decisions. If the decisions they make break the law, they are the ones who are responsible'' (Popper, 2010, p. B2).

The total negligence of stock option backdating in the sociological/criminological literature is a function of several conditions. For one thing, the general subject of white-collar crime is something of an outlier in the two fields. In an op-ed piece for the American Society of Criminology newsletter, the present writers scolded the membership for its failure to attend to the crimes that played so prominent a part in the devastating economic meltdown that began in 2008 and which remains the major concern of the public today (Shichor, Pontell, & Geis, 2010).

Criminologists have available a plethora of theoretical constructs (Cullen & Wilcox, 2011), many of which can be used to pretend to interpret the etiology of stock option backdating. But they have no training to allow them to comprehend the arcane elements of economic criminal behavior that results in legal actions.

The kind of work necessary for a full-fledged comprehensive understanding of stock option backdating requires a book-length monograph. An article providing detailed information concerning offenses and offenders would not likely be able to locate a home in any of the prestige journals in the discipline; they heavily favor research that offers complex statistical analyses. It would prove especially worthwhile for a Ph.D. student to do a dissertation on a topic such as stock option backdating or for such work to be carried out by a scholar who has tenure and prefers to make a contribution that has something more than a short shelf life.

Sociologist Donald Cressey pioneered the kind of undertaking necessary to come to grips with as complex a phenomenon as illegal stock option backdating. Cressey (1953) interviewed 133 persons in penal institutions who had been incarcerated for the crime of embezzlement or cognate forms of trust violation. Unless and until such demanding work is done and done well, we will produce but a very partial view of behaviors such as stock option backdating. To do better we must somehow overcome the pigeonholing of research approaches as the exclusive domain of one or another traditional discipline and see human actions as behaviors that cry out for multidisciplinary attention.

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THE CRIMINAL CONSEQUENCES OF CHANGES IN NEIGHBORHOOD STRUCTURE DUE TO HOME FORECLOSURE: A THEORETICAL DISCUSSION

Paul (Lish) Harris

ABSTRACT

Almost every city in America has felt the effects of the current home foreclosure crisis. It has been reported that 94 of the top 100 metropolitan areas reported an increase in home foreclosures in 2008. Yet, some of the varying costs of this ongoing crisis are relatively unknown. This chapter offers a theoretical examination of the influence an increase in vacant homes due to home foreclosure may have on criminal behavior. It does so by first discussing the breadth of the home foreclosure crisis. Next, the chapter covers strain, social disorganization, and disorder theories and addresses their explanations of the potential criminal consequences of vacant homes due to home foreclosure. Then, the chapter discusses if these classic theories actually apply to this crisis. This is done by introducing the concept of suburban insulation. Finally, the conclusion links the key concepts and ideas from the aforementioned theories and how they best relate to this current phenomenon.

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INTRODUCTION

The unprecedented breadth of the current home foreclosure crisis has made it a frequently discussed topic across America. In fact, few cities can claim they have been unaffected by it as 94 of the nation's 100 largest metropolitan areas witnessed an increase in home foreclosures in 2008. Such an upswing in home foreclosure has left many wondering what consequences may appear in the wake of the largest crisis of this kind in American history. This chapter offers theoretical discussions addressing the reasoning behind potential criminal consequences of home foreclosure.

Criminal consequences of home foreclosure can encapsulate a myriad of deviant behaviors and the way these behaviors can be connected to this particular crisis is varied. There has been attention given to the lending practices of banks and their involvement, whether complicit or not, in the implosion of the housing market. Additionally, individual homeowners have, in some cases, developed unsound and even deviant spending habits that may have contributed to the increase in home foreclosure. This chapter, however, examines the potential influence foreclosed homes may have on crime in a given neighborhood. More specifically, will an increase in home foreclosures in a community lead to an increase in crime? But before we embark on a theoretical discussion, we must take a closer look at the home foreclosure crisis itself.

THE HOME FORECLOSURE CRISIS

In their defining of the American Dream, Messner and Rosenfeld (2001) identified homeownership as vital to the pursuit of material success. For many, the pinnacle of their purchasing and, thus, material success is reached when purchasing a home. In short, homeownership is a central part to achieving the American Dream.

To help increase the number of homeowners and, for many, facilitate the realization of the American Dream, financial institutions began subprime lending. This is when banking institutions provide credit to borrowers that have been deemed high-risk because of loan delinquency, loan default, or an inadequate debt history. The practice of making little or no down payment is also common in subprime lending. Over the last decade this practice grew enormously. From 1994 to 2005, subprime lending grew from $35 billion to $665 billion, respectively (Immergluck, 2008; Schloemer, Li, Ernst, & Keest, 2006).

The homeownership boom not only provided many people with low incomes, limited assets, and troubled credit histories with substantial loans but also inflated the overall price of housing. As housing prices began to drop in 2006 and 2007, mortgage delinquencies shot up. By 2006, subprime mortgage defaults had already doubled from previous years and loans made in 2006 were at a significantly higher risk to default than those from earlier years (AEW Research, 2007).

The rate of foreclosure continued to grow. More were recorded in the first half of 2007 than they were in the second half of 2006 (Immergluck, 2008). By the end of the year, there had been 2.2 million foreclosures nationwide, up 75% from 2006 (Forbes Magazine, 2008).

The number of home foreclosures continued to climb through 2008. According to RealtyTrac, the foreclosure rate provider for MSN, Yahoo, and *The Wall Street Journal*, the number of home foreclosures in 2008 was up 81% in total properties from 2007 and up 225% in total properties from 2006. In fact, 49 of 50 states and 94 of the nation's 100 largest metropolitan areas witnessed an increase in home foreclosures in 2008. In 2008, there were a total of 3,157,806 foreclosure filings (these include default notices, auction sale notices, and bank repossessions) on 2,330,483 total properties. This is a national average of slightly under 1 foreclosure per 50 households. In 2009, the number of properties receiving foreclosure filings increased again to a total of around 2,800,000.

It is important to keep in mind that this happened even with a governmental plan that was called, "more ambitious and expensive than many housing analysts had expected" (Andrews, 2009). Ultimately, the spread of home foreclosures has left financial institutions that backed these subprime mortgages void of any value. Through this dynamic process, the activity of subprime mortgage lenders is shown to have a direct link to the problem of high foreclosure rates (Immergluck & Smith, 2006).

As mentioned earlier, the distribution of subprime borrowers and, thus, the bulk of home foreclosures are not randomly distributed. They are centralized in middle-class neighborhoods (Wilson & Paulson, 2008). In fact, these concentrated areas saturated with subprime mortgages are 10 to 20 times more likely to experience foreclosure (Apgar & Duda, 2004; Immergluck, 2008; Immergluck & Smith, 2006). Put another way, neighborhoods who were not experiencing high levels of disadvantage are now at much greater risk to experience high rates of rapid foreclosure, the subsequent economic woes that accompany such foreclosure, and these neighborhoods are spatially concentrated.

Additionally, the effects of foreclosure are not limited to the family who loses their home. Although this is one of the largest consequences of home foreclosure, many residents of the same neighborhood who do not lose their home also suffer because of plummeting property values. A 2001 study by Temple University concluded that an abandoned house on a block reduced the value of other properties on the block by an average of $6,720. A 2008 report by the Federal Housing Finance Agency's House Price Index showed housing prices in America fell an average of 9.6% when adjusted for inflation, the highest price drop in the 18-year history of the government's survey. This means that a resident of a neighborhood experiencing a high number of foreclosure stands to lose tens of thousands of dollars even if they keep their home.

During his September 2007 testimony in front of the House Committee on Financial Service, Federal Reserve Chairman Ben Bernanke said:

> The consequences of default may be severe for homeowners, who face the possibility of foreclosure, the loss of accumulated home equity, and reduced access to credit. In addition, clusters of foreclosures can lead to declines in the values of nearby properties and do great damage to neighborhoods. (Reuters, 2007)

It is evident the home foreclosure crisis has greatly affected the housing market and the economy as a whole. Nonetheless, these large-scale, dramatic shifts are not the end of its influence, as noted by Chairman Bernanke's statement that "great damage" can be experienced in these neighborhoods. I will now discuss a few theoretical frameworks that help explain the potential influence, or lack thereof, of a rise in home foreclosures on one of these outcomes: crime.

THEORETICAL DISCUSSIONS

Throughout the history of the study of crime, changes in social environments and structures have been examined to see how they influence behavior. Some of these environmental and structural changes have occurred during the shift from feudalism to capitalism and the evolutions spurned by industrialization and later deindustrialization. All of these ecological transformations have compelled social scientists to examine and explain the effects these shifts have had on crime (Durkheim, 1897; Massey & Denton, 1993; Shaw & McKay, 1942; Wilson, 1987, 1996).

The ideas derived from the study of these changes have provided a plethora of conceptual explanations of the relationship between variations in community structure and crime rates. Two of these explanations can be found in the frameworks set forth by social disorganization and social disorder theories. Each of these theories focuses on dysfunction within a community; however, each approach has a distinct definition of either disorganization or disorder. Other explanations of the relationship between variations in community structure and crime rates are not based on changes in community structure per se, but are rooted in peoples' reactions to the various situations they encounter in their lives. And although all of these theoretical explanations provide compelling arguments about the potential relationships between variations in community structure and crime rates, some researchers have questioned their contemporary validity (Liska, 1987; Putnam, 2000). Needless to say, there are numerous ways to theoretically engage the current home foreclosure crisis.

STRAIN THEORIES

Like so many criminological theories, strain theory has its roots in the works of Emile Durkheim (1897). Durkheim described anomie, a concept that is vital to strain, as the result of a breakdown of societal controls. In an age marked by large variations in community structure, the age of industrialization experienced rapidly changing controls as life shifted from rural, feudal societies to urban, industrial societies; Durkheim noted anomie was the subsequent feeling of normlessness. Moreover, Durkheim had a Hobbesian outlook on human nature in the sense that he saw society as providing the cap to keep insatiable human desires in check. Without such, these desires would be unregulated and crime and deviance would ensue.

In addition to the concept of anomie, Durkheim helped illustrate what established societal norms. He saw norms to be the results of the greater collective consciousness, which is the totality of beliefs and sentiments common to the average man in society. He saw crime or unconventionality as an offense to the collective consciousness. The idea that there are legitimate and illegitimate manners of behavior manifested in society is also important to the development of strain.

Mertonian Strain

In 1938, Merton first articulated what came to be known as strain theory. He built a theory of crime causation on the ideas Durkheim established. Merton noted that American society planted the seed of potential criminality in the American population as it perpetuated the idea that everyone could be monetarily successful. In this sense, he differed from Durkheim who saw society as a mechanism of control. Thus, Merton saw criminal behavior as a result of the disjunction between aspirations for success and expectations to achieve success. In other words, everyone aspires to be successful and is told that they can be, but in reality the available opportunities for success reflected in the social structure are not infinite, nor are they available to all. Because of this, it is not actually possible for everyone to be monetarily successful. This leads some to engage in irregular, nonconforming, and sometimes criminal conduct in order to accumulate wealth because they are exposed to elevated levels of strain. This means groups who experience high levels of destabilized economic conditions, such as those created by the spread of home foreclosures, may be more likely to engage in deviant behavior when compared to those who have an economic advantage and access to legitimately beneficial economic opportunities. Merton's notions were substantiated and expanded on by others (Cloward & Ohlin, 1960; Cohen, 1955).

Later, in 1968, Merton revisited his idea of strain and further described its process. He saw strain/anomie and crime as having a reciprocal relationship. As strain/anomie increased, people would look for illegitimate ways to achieve success and as they were successful in utilizing unconventional means for achieving success, more strain/anomie would be introduced into society.

To sum up the main points of strain theory, groups who experience increases in strain like that caused by economic destabilization are more prone to deviant behavior. Parker and McCall (1999) note there is an established connection between blocked economic opportunities and crime, as economic instability provides fertile ground for strain and subsequent conflict. Many other studies have confirmed this link between economic inequality and crime (Blau & Blau, 1982; Chamlin, 1989; Loftin & Hill, 1974; Krivo & Peterson, 1996; Messner, 1983; Sampson, 1986).

Agnew's New Interpretation of Strain

One of the impediments to the idea proposed in Mertonian strain theory was the apparent inability for it to appropriately describe participation in all types of crime, especially violent crime. In a response to these critiques, Agnew articulated general strain theory (GST) (Agnew, 1992). The fundamental notion of GST is, when individuals are treated badly and subsequently experience strain, they may become angered or frustrated and participate in crime. In order to account for participation in all types of crime, Agnew made the decision to widen the focus of strain to refer to negative treatment by others. Ultimately, this leads to the inclusion of many more sources of strain than those proposed by Merton (1938, 1968) and others (Cloward & Ohlin 1960; Cohen, 1955; Greenberg, 1977).

In addition to the primary source of strain for Mertonian strain theory, which is when one is prevented from achieving positively valued goals, GST incorporates relationships in which others present the individual with noxious or negative stimuli. Thus, the negative relationships Agnew identifies in GST are

> … the actual or anticipated failure to achieve positively valued goals … the actual or anticipated removal of positively valued stimuli, and … the actual or anticipated presentation of negative stimuli. (Agnew, 1992, p. 59)

The first type of strain described by Agnew (1992), the failure to achieve positively valued goals, can take many shapes. This strain can be produced by the failure to achieve financial success, autonomy, or status and respect. Research suggests people who confront this type of strain are more likely to participate in criminal behavior (Anderson, 1994; Agnew 1984, 1994, 1997; Agnew, Cullen, Burton, Evans, & Dunaway, 1996; Burton & Dunaway, 1994; Greenberg, 1977; Jankowski, 1995; MacLeod, 1987; Majors & Billson, 1992; Messerschmidt, 1993; Moffitt, 1993, 1997; Padilla, 1992; Sullivan, 1989; Tittle, 1995).

The next source of strain, the loss of positively valued stimuli, also encompasses many things. This may involve the loss of everything from a spouse or loved one to the loss or theft of a valuable possession. Lastly, the presentation of negative stimuli includes things like verbal insults and physical assaults. A number of studies have found criminal behavior to be associated with these final two sources of strain as they have manifested themselves as child abuse and neglect; criminal victimization; negative relationships with parents, friends, or peers; neighborhood problems; homelessness; and a wide variety of other stress producing events like unemployment and familial disruption (Agnew, 1985, 1992, 1997; Agnew & Brezina, 1997; Agnew & White, 1992; Brezina, 1998; Hagan & McCarthy, 1997; Hoffmann & Cerbone, 1997; Hoffmann & Miller, 1998; Hoffmann & Su, 1997; Landau, 1998; Mazerolle & Piquero, 1997, 1998; Paternoster & Mazerolle, 1994).

Yet, in the end, the negative relationships that act as sources of strain are whatever individuals identify them to be (Agnew, 1992; Berkowitz, 1982). This can be seen in the wide array of tests of GST Agnew has identified as objective measures of strain (Agnew, 2001). Some of these are whether an individual has been assaulted or had something stolen from them; whether their parents have divorced; whether they cannot afford to buy the clothes or other items they desire; whether they have enough money; whether they have problems at school or work; or whether their neighborhood has problems like vandalism, drug use, assaults, and robberies. Ultimately, Agnew states that, "… individuals may experience hundreds of different types of strain" (Agnew, 2001, p. 162).

Through a test of the elements of GST, Agnew and White (1992) were able to identify five sources of strain to have a significant, positive influence on criminal behavior. Particularly, they noted that relationships with one's family, school, or neighborhood are the most significant sources of strain. For example, they found those who reported they were afraid to walk in their neighborhood because they perceived it to be unsafe were more likely to participate in deviant behavior. Furthermore, research by Paternoster and Mazerolle (1994) produced similar results. They found that communities characterized with social problems like crime and physical deterioration manufactured considerable amounts of strain that influenced the residents of these areas to commit significantly more deviant acts than those living in more stable neighborhoods.

However, distinct negative relationships can vary in the amount of strain they produce and may differentially influence rates of criminal behavior. That is to say that some sources of strain are greater than others. For instance, living in a crime-ridden, disordered community and having an untenable relationship with a coworker may both be sources of strain, but the amount of strain these relationships produce may not be the same. This variation in the amount of strain produced by these relationships is due to factors such as the size, recency, duration, and frequency of the adverse relationship or event. This means that major life events and contact involving major social environments such as those with family, school, or neighborhood are more consequential in their manufacturing of strain and have subsequently been recognized as prime examples of potentially adverse relationships (Agnew, 1992; Avison & Turner, 1988; Thoits, 1983).

If one experiences any type of negative relationship, emotional reactions such as anger, disappointment, depression, fear, and frustration can manifest themselves and increase the likelihood of participation in criminal behavior (Kemper, 1978; Morgan & Ross, 1988; Simons, Chen, Stewart, & Brody, 2003). Agnew (1992), however, states that anger and frustration are the main emotions that noxious relationships lead to. These negative emotions lead to pressure for corrective action that may be exhibited in criminal behavior through trying to escape, avoid, manage, or terminate the negative relationship, among other things. For example, people who lose something they value may become angry and seek revenge. This may lead to theft or violence.

Brezina (1996) shows that criminal behavior is a more efficient outlet than conventional behavior for the negative emotions that result from negative relationships. This lends support to the idea that having these strains increases the likelihood that one participates in deviant behavior because it is an effective outlet for them. In short, GST expects negative relationships with others to have a positive effect on delinquency through the negative emotions they cause, such as anger, and sees this to be particularly true of negative relationships that are serious and do not offer plentiful alternatives to delinquent coping. Several studies indicate that negative emotions generated from sources of strain explain part of the influence of strain on crime (Agnew, 1985; Brezina, 1998; Mazerolle & Piquero, 1997).

The negative emotions caused by strain can result in a number of ways. As discussed earlier, direct contact with negative, not positive or neutral, relationships that act as sources of strain is one cause (Thaxton & Agnew, 2004). However, strain can be experienced even if an individual does not have direct contact with the strain producing entity. Agnew (2002) states that strains can be vicarious or anticipated, but those who feel strain must be aware of the cause or people who have been affected by it. Also, vicarious strains tend to be more serious when they are rooted in expectation and reality (Agnew, 1992; Bandura, 1973; Zillman, 1979). This means that an individual or group does not need to have a negative relationship to feel strain, but that they only need to be aware of the cause of it or be close to an individual that is experiencing it.

Connecting the Dots

Strain theory provides some interesting insight into the potential influence of home foreclosures on crime. Those experiencing the effects of home foreclosure should be considered more "economically disadvantaged" than they had been previous to the loss of their home. In the Mertonian sense, they will feel increased levels of strain due to the loss of their home or, for those living in neighborhoods saturated with foreclosures, the loss on their investment. Nonetheless, Mertonian strain deals with the placement of one in the social structure and their access to opportunities for financial success (Merton, 1938). If owning a home is truly a desired measure of success, individuals who lost their home would, in all likelihood, have a tougher time obtaining the financial backing needed to become a homeowner again. This difficulty could equate to the type of blocked opportunity Merton theorized would lead to future criminal activity.

Although Mertonian strain can be useful in examining the home foreclosure crisis' effect on crime, GST seems to provide even more help. According to GST, losing a home would certainly qualify as a significant source of strain, as it directly affects one's neighborhood (Agnew & White, 1992). And not only would it be a significant source, but it would also be considerable in the amount of strain it produces because the loss is of great size (Agnew, 1992). Most importantly, losing a home due to foreclosure would introduce all three types of negative relationships discussed by Agnew as it would be the failure to achieve a positive goal (homeownership), the removal of positively valued stimuli (the loss of the home itself), and the presentation of negative stimuli (having to move, being without a home, the stigma of losing your home, etc.). According to GST, these negative relationships would greatly increase feelings of stress, anger, and frustration and would lead to increased participation in criminal behavior.

Lastly, GST suggests strain can be experienced vicariously (Agnew, 2002). This means the strain produced by the home foreclosure crisis is not endemic to those who have lost a home, but can be experienced by individuals who perceive who perceives themselves to be at risk to lose their home or endure a loss of value on their home. This idea is particularly prevalent for those individuals who have not lost their homes, but live in neighborhoods with a high number of home foreclosures.

Both versions of strain theory have offered explanations for the reactions people may have to the home foreclosure crisis. Next, we will look at two different theories that examine the effects variation in community structure can have on crime.

SOCIAL DISORGANIZATION THEORY

As mentioned earlier, a central point to Durkheim's (1897) argument outlined in his conception of anomie is that rapid social change positively influences crime due to the evaporation of social controls. Around the turn of the 20th century, the city of Chicago experienced an extraordinary breakdown of controls due to the incredible influx of immigrants and other individuals yearning to move to the city and partake of the fruits of industrialization. Researchers at the University of Chicago were witnessing the creation of an extremely large city and took note of some of the changes that were occurring.

Park and Burgess (1925) were ecologists who saw the city as a developing ecosystem. Their scientific backgrounds lead them to develop a design of the city that consisted of concentric rings emanating out from the center. They arrived at this design by tracking the amount of crime happening by city area. As they mapped the frequency of criminal acts they noticed a pattern; the majority of crime was happening in what they labeled as transitional neighborhoods who were closest to the industrial center of the city. They stated that these areas were subject to invasion, domination, and succession from the city center. Their observation that the frequency of crime was spatially patterned set the table for future Chicago School researchers to expand their ideas.

In 1942, Shaw and McKay further developed social disorganization theory. They identified three elements germane to high-crime areas: their physical status, economic status, and population composition. Physical status refers to the number of condemned or vacant buildings in the area. It also touches on the population change that takes place in order to vacate previously occupied buildings. The element of economic status is composed of measures indicative of the economic conditions of a community, such as percentage of families on welfare, the median rate for renting property, and the percentage of families who owned their home. Lastly, population composition deals with the level of foreign-born or minority residents in a community. These characteristics were indicators of social disorganization, which means areas rife with these elements are less able to enact social control on the residents of the neighborhood by monitoring local youths, having local friendship networks, and participating in local civic service organizations, all of which resulted in higher levels of crime.

This theory was a change from past crime causation theories because it saw human behavior as a result of characteristics of a neighborhood, not the residents living there. Shaw and McKay came to this conclusion because they noted that as groups of immigrants moved out of cheap transitional housing and into concentric zones further from the city center, being replaced in the transitional areas by another group of immigrants, crime rates in the transitional areas remained stable and the rates in the areas where the immigrants had moved did not increase. This means that crime was not following people as they moved, but was stable in the transitional area. Because of this observation, Shaw and McKay concluded the aforementioned characteristics of social disorganization lead to the development of a subculture that persisted in the transitional areas even after the residents left. To restate their argument, they saw social disorganization resulting in the inability to affectualize proper social controls that ultimately lead to the development of a criminal subculture and a stable, high-crime rate in these transitional neighborhoods.

As the decades passed, social disorganization fell out of favor with many criminologists. The shift to more individual level theories in response to countercultural or conflict theories dominated much of the 1960s and 1970s and into the 1980s. The incredible population boom the Chicago school researchers experience died as suburbanization became a reality and urban sprawl became commonplace. However, Kornhauser (1978) reinterpreted social disorganization theory by arguing that delinquency emerges in areas where community institutions and relationships have broken down, thus disabling their ability to maintain effective social controls. Without effective social controls, neighborhoods become disorganized, which Kornhauser (1978) viewed as the crux of this theory. Ultimately, disorganization leads communities to be more conducive to criminal behavior.

Kornhauser (1978) describes and finds empirical support for a model that focuses on community control. Her primary argument is that impoverished people, who live in racially and ethnically heterogeneous areas, and who are residentially mobile, will experience difficulty in establishing and sustaining the normal, necessary relationships through which neighborhood residents usually achieve their shared desires and goals. Kasarda and Janowitz (1974), Bursik (1988), and Bursik and Grasmick (1993) noted that social disorganization did not directly affect crime rates, but that it indirectly affected them through its effect on local friendship, kinship, and acquaintanceship network ties. In the end, without the capacity to realize common aspirations, these areas become more favorable for criminal activity.

Yet even after these contributions to the understanding of the causal argument of social disorganization theory, many considered there to be a considerable lack of good empirical tests of the theory. Sampson and Groves (1989) were able to provide a comprehensive test of the theory. They tested the effects of racial and ethnic heterogeneity, residential mobility, concentrated disadvantage, familial disruption, and urbanization on local friendship networks, the supervision and monitoring of local youths, and the participation in local civic service organizations. This, in turn, was tested to see if it affected rates of crime. The results of this study supported the basic argument of social disorganization theory and set the stage for a resurgence in interest and empirical tests of this theory, and other research has continued to develop these ideas and show empirical support for social disorganization theory (Parker & McCall, 1999; Petee & Kowalski, 1993; Sampson, 1991; Sampson & Groves, 1989; Smith & Brewer, 1992; Smith & Jarjoura, 1988).

Collective Efficacy

Sampson, Raudenbush, and Earls (1997) elaborated on the construct through which social disorganization affects crime by addressing the function of informal social control in curtailing neighborhood violence. He states, in order for residents to sustain public order or realize other specific tasks, there must be a feeling of mutual trust and solidarity throughout the neighborhood. However, unlike the construct of network ties described above, this particular measure of social organization does not necessarily depend on strong associations (Sampson, 2006). Furthermore, collective efficacy brings the normative idea of social cohesion together with the concept of shared expectations for control that are brought to pass through social action. In short, collective efficacy is the social cohesion among neighbors paired with their intervening on behalf of maintaining community social order. This means that if a neighborhood displays collective efficacy, rates of criminal behavior should be significantly reduced.

As noted earlier, collective efficacy does not necessarily require that your neighbor be your friend. It is, however, based on repeated interactions with fellow community members, activating the relationship (Sampson, 2006). This interaction-based activation will help stimulate social action because there will be an expectation of future contact. Also, repeated contact with fellow community members will produce shared norms and expectations about the future that exists independent of friendship and kinship networks. These shared expectations for control will increase necessary behavioral interventions (Bandura, 1997). Thus, there will be shared beliefs about the ideal state of the community coupled with a mutual feeling of activism on the part of the residents. Therefore, "social networks foster the conditions under which collective efficacy may flourish, but they are not sufficient for the exercise of control" (Sampson, 2006, p. 153).

Research has shown collective efficacy to be associated with lower crime rates (Kubrin & Weitzer, 2003; Morenoff, Sampson, & Raudenbush, 2001; Pratt & Cullen, 2005; Sampson et al., 1997; Sampson, Morenoff, & Earls, 1999; Sampson, Morenoff, & Gannon-Rowley, 2002). In their 1997 study examining the effect of collective efficacy on violent crime rates in 343 Chicago neighborhoods, Sampson et al. found this association to be true after controlling for concentrated disadvantage, residential stability, immigrant concentration, age, sex, socioeconomic status, race/ethnicity, homeownership, indicators of dense personal ties, the density of local organizations, and prior neighborhood violence. Ultimately they found that a two standard deviation increase in collective efficacy was found to reduce the number of expected homicides by 26%.

In addition to this finding, other research supports the notion that collective action does not require dense personal ties in a neighborhood (McNulty & Bellair, 2003; Morenoff et al., 2001; Sampson et al., 1999). Given the seemingly endless line of obstacles facing modern communities, it seems increasingly difficult to overcome them by relying principally on individuals. Thus, the density of local organization and volunteer association has been shown to increase levels of collective efficacy (Morenoff et al., 2001).

The overall accumulation of knowledge about social disorganization theory is extensive. As I previously discussed, the theory has been developed in many ways. However, Pratt and Cullen (2005) offer a meta-analysis of the empirical validity of the basic social disorganization argument. They reviewed 213 empirical studies of the theory and found empirical support for the effects of racial and ethnic heterogeneity, residential mobility, concentrated disadvantage, familial disruption, and urbanization on crime. A review as vast as this offers a solid summation of the knowledge accumulated about this theory. It has been tested considerably and has garnered overall support for the causal argument it makes.

Connecting the Dots

The home foreclosure crisis has introduced new changes into neighborhood structure, and social disorganization theory addresses many of these changes. As Shaw and McKay (1942) noted, the physical status of a community is vital to the overall welfare of the neighborhood. Not only does it matter if there are vacant buildings in a neighborhood but also the number of people moving in and out of these vacant homes is important. In areas with high levels of home foreclosure, vacant buildings will become more commonplace. Additionally, people will be moving out of the neighborhood, but it is unknown how quickly other people will move in, if at all. This type of empty space and population turnover will affect the well-being of communal network ties and the repeated interactions needed for the creation of collective efficacy (Sampson, 2006). Without an intimate connection with neighbors or even an expectation for future contact, the communal ability to uphold informal social control will be significantly diminished. According to social disorganization theory, this will lead to higher levels of criminal behavior.

As discussed previously, the home foreclosure crisis has also introduced economic changes to communities. These economic changes will affect the relationships people have within their communities. As people become more stressed due to their financial situation, they become less likely to positively interact with their neighbors. This lack of communication will inhibit the capacity of the neighborhood to maintain social control.

In short, research has shown that appropriate conditions for social disorganization, like the lack of collective efficacy, are often made worse by spatial and economic changes (Parker & McCall, 1999). Thus, social disorganization theory suggests that drastic changes to community structures brought on by the home foreclosure crisis will negatively affect communities. These change brought on by sweeping, spatially concentrated home foreclosures, will greatly impact the advancement of sustained, intergroup associations necessary for the development and maintenance of communal social control, ultimately resulting in an increase in criminal behavior.

DISORDER THEORIES

Much like social disorganization theory, disorder theories focus on deteriorating neighborhood conditions. However, disorder theories do differ from social disorganization theory. Where social disorganization theory emphasizes the detrimental effects factors like residential mobility and familial disruption can have on a neighborhood's ability to maintain effective levels of social control, disorder theories are concerned with the effects literal physical dilapidation has on the perception and maintenance of control within a community. Therefore, these theories highlight the repercussions of literal manifestations of neighborhood decline.

Wilson and Kelling (1982) state that, "… at the community level, disorder and crime are usually inextricably linked, in a kind of developmental sequence" (p. 2). In order to better understand this connection, one must first identify those things that make up disorder. In his 1990 study, Skogan identified behaviors and physical signs that constituted disorder. First, Skogan noted the behaviors residents listed as disorderly. The most frequently identified behaviors include public drinking, public intoxication, loitering youths, corner gangs, drug use, loud neighbors, harassment on the streets, panhandling, and prostitution. These behaviors related to physical signs of disorder such as vandalism to public spaces, graffiti, noticeable increases of trash in public spaces, and run-down, vacant buildings.

These signs of disorder can result from neglect, natural disasters, economic crises, or deviant behavior, but its continued presence is a sign that nobody in the community cares that such behavior is transpiring. According to disorder theories, the presence of vandalism and neglect sends a clear signal that communal civility and esteem are relatively unimportant. Ultimately, these signs of disorder do not discourage further unruly and often criminal behavior from taking place in physically ailing communities. Consequently, disorder and crime are linked as they influence the occurrence of one another, in a reciprocal relationship.

In addition to the connection between disorder and crime, Wilson and Kelling (1982) also describe a link between disorder and feeling unsafe. If a resident of a community notices broken windows, graffiti, unkempt buildings and homes, or other signs of neglect and vandalism, they must confront the fact that this environment is, at some point, uncontrolled or uncontrollable. In other words, the area is unsupervised or unattended long enough so the acts leading to the observed signs of disorder can be successfully perpetrated. Indications of destructive and often criminal behavior in neighborhoods and communities are strongly related to the fear of crime (Biederman, Johnson, McIntyre, & Weir, 1967; Kelling & Coles, 1996). This means residents who notice these signs of disorder and decline will feel fearful of crime and unsafe in their neighborhoods or communities. In response to feelings of fear and unrest, residents avoid contact with others, undermining any communal social control or cohesion. According to Skogan (1990):

> For residents, disorder and crime lead first of all to withdrawal from the community. Daily experiences with disorderly conditions creates anxiety; the prospect heightens fear … Such withdrawal tends to reduce the supervision of youths, undermines any general sense of mutual responsibility among area residents, and weakens informal social control. Withdrawal also undermines participation in neighborhood affairs, presaging a general decline in the community's organizational and political capacity. (p. 13)

This means that disorder is not only conducive to increased levels of criminal behavior but also engenders feelings of fear and anxiety that lead to the dissolution of necessary communal social controls.

It may seem like this process of "broken windows" describes a slow progression of neighborhood deterioration. However, Wilson and Kelling (1982) describe this process as one that can take place rapidly: "A stable neighborhood of families who care for their homes, mind each other's children, and confidently frown on unwanted intruders can change, in a few years or even a few months, to an inhospitable and frightening jungle" (p. 3). The speed of this change speaks to the immediate influence of varying signs of disorder. Schuerman and Kobrin (1986) found that communities can make the significant change from low-crime to high-crime areas in less than a decade. Hence, if the first sign of decline is neglected, the spiral of decay will quickly follow leading to higher rates of criminal behavior, feelings of insecurity, and deteriorating levels of social control in the neighborhood or community.

This is not to say that all neighborhoods or communities that experience change will spiral into disorder. According to Skogan (1990), complex social systems are not static. The fact that neighborhoods are complex means that they are always experiencing some systemic shifts. However, when they fail to reproduce themselves, instability sets in. Therefore, disturbances in neighborhood renewal inhibit the area from reproducing itself properly. This causes dramatic shifts that lead to communal instability.

According to disorder theories, numerous features can trigger that disruption. For example, all neighborhoods experience families moving in and out, the aging of homes, and the consequences of a fluctuating market. Yet if all of these factors do not change dramatically, stability reigns. It is when a significantly higher number of people move out than move in or when homes are not renewed and repaired that signs of decline become present. When the price to rent or buy a home becomes inappropriate for the quality of the building and the prevailing social class of the area, disorder begins to set in.

Another factor leading to disturbances in neighborhood reproduction is disinvestment by mortgage lending institutions (Skogan, 1990). When lending institutions change their practices, all of the factors mentioned above can be affected. Loans may become harder to get, which means people may not be able to move in to vacant properties or repairs and renovations may not be made on aging homes. This can lead to rising levels of disorder and crime, which then have a reciprocal negative impact on the housing market and the institutions connected to it.

Once a community has experienced disinvestment by mortgage lending institutions, among other things, and has begun to show signs of disorder, it becomes increasingly difficult for the neighborhood to regain its sense of stability. Skogan (1990) notes that area disorder discourages trust in one's neighbors, involvement in local social activities, and informal cooperative action. This results in an impairment of the interaction and cooperation necessary for residents in declining neighborhoods and communities to solve their problems. In short, these elements that result from disorder make it so the neighborhood can no longer reproduce itself in a healthy manner. Because of this, midcourse corrections are exceedingly complicated to make and the process of decline evolves into a spiral of decay.

Disorder theories, like social disorganization theory, are concerned with the dissolution of necessary communal mechanisms that help maintain social control. However, they emphasize the ramifications of physical disorder on a neighborhood's or community's capacity to do so. Once physical signs of decay are present, fear of crime among residents will increase as will the amount of criminal behavior. These factors will continue to compound one another resulting in a rapidly declining area.

Connecting the Dots

It is obvious one of the results of home foreclosure is vacant homes. Seemingly, this fits well with one of the signs Skogan (1990) identified in his study. However, the loss of a home due to home foreclosure does not necessarily mean that it will become run-down, becoming a symbol of neighborhood decay. Although this may happen, it seems disorder theories apply best to moderately disordered communities that have very high levels of home foreclosure. It is in these areas where an increase in vacant homes will allow already existing signs of disorder to become even more widespread. If these signs of decay spread to the newly vacant homes and feelings of uneasiness and fear rise in response to them, important communal communication and networking can be damaged (Wilson & Kelling, 1982). According to disorder theories, crime rates will respond by increasing.

In addition to physical signs of disorder, these theories address the need of community reproduction. In order for a neighborhood to remain stable, it must not experience any drastic changes in the number of residents or the housing market. Areas saturated with home foreclosures will not be able to replicate the conditions prior to the home foreclosure crisis. This will also introduce more instability and disorder in the neighborhood, contributing to the expected increase in crime.

Lastly, Skogan (1990) specifically addressed disinvestment by lending institutions. In his mind, disinvestment can exacerbate spirals of decay. Because of the practice of subprime lending that leads to the home foreclosure crisis, lending institutions have become more strict about whom they give lines of credit. In short, disinvestment by mortgage lending institutions leads to neighborhood decline, which then influences a lending institutions decision to invest in the community at a later date. Ultimately, this disinvestment contributes to instability and further decline.

DO THESE THEORIES REALLY APPLY?

Despite the implicative arguments centered around the ideas of economic destabilization, social disorganization, and community disorder, there are also compelling points of view that may lead one to believe the home foreclosure crisis may *not* affect levels of crime. First, both strain and social disorganization theory stem from schools of thought that looked to explain the alleged disproportionate participation in crime by the transitional or lower class. Yet, the current home foreclosure crisis is not disproportionately affecting the lower class, but those occupants of middle-class, suburban neighborhoods. This particular fact raises a critical issue with the application of these theories.

Suburban Insulation

The social and economic processes that pertain to contemporary life are much different than they were in the 1930s and 1940s. The emergence of a sizeable middle class, urban sprawl and suburbanization, and gentrification has altered the social and physical world that acted as the anchor for these theoretical explanations. In his book *Bowling Alone*, Putnam (2000) discusses how suburbanization has been a catalyst for increasing the disconnection between people and for the deterioration of mainstays in various social structures. Nonetheless, these socially isolated suburban neighborhoods have lower crime rates than inner-city neighborhoods, which begs the question, do intimate social ties and networks matter as much in contemporary suburban neighborhoods as social disorganization theorists claim they do? In short, how well does this model apply to modern neighborhood structure? (Liska, 1987)

Furthermore, Mertonian strain theorists' argument is centered in the concept of economic deprivation. The economic ramifications of losing a home are no small matter, but they may not thrust middle-class families into the type of economic withdrawal that characterizes the class of deprivation often associated with and used to measure strain. Because of their preforeclosure-crisis class standing, families who are disproportionately suffering from the rise in home foreclosures may be partially isolated from the expected effects of economic loses, especially those families who are left in the high foreclosure areas.

In closing, it is important to note that home foreclosures are not a variable that has been linked with either strain or social disorganization previously. Although compelling arguments can be made that they potentially affect levels of strain (both that of Merton and Agnew) and the ability to build and maintain necessary levels of social control and collective efficacy, they may not be closely associated enough with any of these theoretical factors to increase crime through the means they describe. Thus, it is logical to conclude that the rise in home foreclosures may or may *not* affect crime.

CONCLUSION

As discussed earlier, the current home foreclosure crisis has greatly destabilized the national economy and has severely impacted certain middle-class or revitalized neighborhoods. Researchers have noted homeownership to be one of the primary sources of wealth in America (Krivo & Kaufman, 2004; Shapiro, 2004). In addition, home foreclosures not only involve a loss of accumulated wealth in the form of home equity but also have been shown to limit families' access to decent, stable housing after losing their home (McCarthy, Van Zandt, & Rohe, 2001). In other words, home foreclosures represent American families losing one of their main sources of accumulated wealth and a great limitation on their chance at future opportunities to invest in a home. Merton (1938) would see this as a legitimate source of strain and, as has been discussed, strain leads to higher rates of crime.

The rise in home foreclosures has not only destabilized the economy but has also disorganized communities. As was said earlier, the geographic distribution of home foreclosures is not random, but spatially concentrated. In addition, researchers note the foreclosure crisis is expediting the normally long, slow process of neighborhood decline. This means middle-class areas that were not formerly destitute are rapidly becoming moderately disadvantaged, and studies show these areas to be affected by structural instability at greater rates than highly disadvantaged areas.

Key elements of social disorganization and disorder theories, like high rates of residential mobility, instability, and vacant homes, are influenced by home foreclosures, weaken social controls, and create disturbances among institutions. This negatively affects the capacity of a neighborhood to develop and maintain intergroup associations because networks are interrupted by residents moving or becoming fearful of their communities. In fact, disorganized and depleted areas tend to have less connections and access to people and institutions that can help reduce crime (Logan & Molotch, 1987; Velez, 2001; Velez, Krivo, & Peterson, 2003). Ultimately, social control cannot be sustained, which leads to higher rates of crime. Conversely, research shows homeownership, a primary victim of home foreclosure, to be positively related to collective efficacy, as one has a financial and thus vested interest in the welfare of the community (Sampson et al., 1997). To reiterate, without such, participation in crime increases.

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EMPLOYMENT, UNEMPLOYMENT, AND RATES OF INTIMATE PARTNER VIOLENCE: EVIDENCE FROM THE NATIONAL CRIME VICTIM SURVEYS

Richard R. Peterson

ABSTRACT

Although the news media have speculated that the current recession has increased rates of intimate partner violence, there is no reliable evidence supporting that claim. Moreover, no well-designed studies have examined the impact of prior recessions. This chapter considers whether rising employment during a period of economic growth reduces intimate partner violence. The findings on the effect of economic growth are used to assess the likely impact of economic decline on rates of intimate partner violence. Using data from the National Crime Victim Surveys, the analyses examine both macro-level trends and individual-level effects. At the macro-level, men's and women's unemployment rates were only weakly related to rates of intimate partner violence. The individual-level results show that rising rates of employment during a period of economic growth were not responsible for producing declines in intimate partner

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violence. Taken together, these findings suggest that the current recession will not increase rates of intimate partner violence against women.

INTRODUCTION

Has the recent economic crisis caused an increase in rates of intimate partner violence in the United States? Many reports in the news media suggest that it has (e.g., Buford, 2009; Franke-Ruta, 2010). The media has reported increases in domestic violence calls to the police and in calls to domestic violence hotlines, as well as increases in use of domestic violence shelters in many jurisdictions (e.g., Jenkins, 2009; Higgins, 2009). However, these reported increases are not sufficient to support the claim that the recession has increased intimate partner violence. For example, increased use of shelters may occur not because intimate partner violence has increased but because friends and family are financially unable to provide temporary housing during a recession. Furthermore, local reports of higher rates of intimate partner violence are not collected systematically, and the media are much less likely to write about localities where rates of intimate partner violence have declined or remained stable. Finally, little evidence is available linking local increases to the effects of the recession.

National data do not yet indicate that intimate partner violence has increased since the recession began. The Bureau of Justice Statistics found no increase between 2007 and 2009 in rates of intimate partner violence reported in the National Crime Victim Survey (NCVS) (Catalano, Smith, Snyder, & Rand, 2009; Truman & Rand, 2010).

Questions about the impact of the recession remain, however. A lagged increase may occur in 2010 or later, or rates of intimate partner violence may increase in regions or localities hit particularly hard by the recession. Addressing these lingering questions about whether the current recession will increase rates of intimate partner violence is difficult. Surprisingly, history provides little guidance because no well-designed studies have examined the impact of prior recessions on rates of intimate partner violence in the United States.

In the absence of research on prior recessions, this chapter reviews relevant studies that address the connections between employment, unemployment, and intimate partner violence. It then argues that we may be able to learn something about the likely impact of the recession on intimate partner violence by studying the impact of economic *growth* on rates of intimate partner violence. The analyses examine whether rising employment during a period of economic growth reduces intimate partner violence, and the findings are used to assess the likely impact of the recession on rates of intimate partner violence.

REVIEW OF THE LITERATURE

Most research on the connection between recessions and crime rates has found that recessions increase rates of property crime but do not increase rates of violent crime that lack an economic motive (Cook, 2010). Prior research has not directly examined the effect of a recession on macro-level rates of intimate partner violence. However, there is individual-level research about the effects of financial hardship and unemployment on the likelihood of intimate partner violence. This research consistently demonstrates that rates of intimate partner violence are higher among low-income couples (Renzetti, 2009; Salari & Baldwin, 2002) and among the unemployed (Benson & Fox, 2004). These findings suggest that a recession, by increasing unemployment or financial hardship, might increase intimate partner violence.

Benson, Fox, DeMaris, and Van Wyk (2003) argue that employment, rather than income, is the key factor associated with intimate partner violence. This review therefore focuses on the relationship between employment status and intimate partner violence. Research has examined three hypotheses about the impact of male employment, female employment, and the joint employment status of both partners (Macmillan & Gartner, 1999; Resko, 2007). Two of the hypotheses suggest that women's employment has a protective effect. The resource deprivation hypothesis asserts that unemployment of either or both partners increases financial stress, which may, in turn, put a strain on the relationship and increase the likelihood of intimate partner violence. The dependency hypothesis asserts that women who are not employed are at increased risk of intimate partner violence because they often lack the independent resources to either leave an abusive relationship or make a credible threat to leave if the abuse does not stop. Unemployment may also increase their isolation and reduce their social support. The third hypothesis suggests that women's employment may increase their risk of experiencing intimate partner violence. Specifically, the backlash hypothesis asserts that a woman's employment increases her risk of intimate partner violence if her male partner is not employed because he may use violence to reestablish a dominant masculine role. Among men who exert coercive control in their relationships, the vulnerability associated with unemployment may increase their need for power and control. Men who lose their jobs may become abusive, increase the frequency and severity of abuse, and/or engage in new types of economic abuse involving control over money.

Macmillan and Gartner (1999) designed a study to test all three hypotheses. First, they examined the effects of the male and female partner's employment status, without considering their employment status jointly. They found weak support for the resource deprivation hypothesis: male unemployment, but not female unemployment, increased the risk of intimate partner violence. When they considered the joint effects of male and female partners' employment status, they found that women's employment lowered their risk of intimate partner violence when the male partner was employed. However, women's employment increased their risk of intimate partner violence when the male partner was unemployed. They argue that this finding is consistent with the backlash hypothesis. It also appears to support the dependency hypothesis because when their partners are employed, unemployed women are at greater risk of intimate partner violence than employed women.

Subsequent studies testing these hypotheses have produced mixed results. Benson and Fox (2004) found that male unemployment increased women's risk of intimate partner violence, which is consistent with the resource deprivation hypothesis. However, since they did not consider the effect of female unemployment, it is not possible to determine whether their finding is also consistent with the backlash hypothesis. Similarly, Resko (2007) found that male unemployment increased a female partner's risk of intimate partner violence; however, she conducted additional analyses of the joint effects of male and female unemployment to test the backlash hypothesis. When males were unemployed for more weeks than their female partners, the likelihood of intimate partner violence was lower. Resko argues that her finding supports the dependency hypothesis while contradicting the backlash hypothesis because men who were unemployed for longer periods than their female partners were *less* likely to commit intimate partner violence. Riger and Staggs (2004) found that getting a job increased a woman's risk of intimate partner violence, while stopping work decreased it. They argue that this finding supports the backlash hypothesis; however, this support is weak since the analysis did not include measures of the partner's employment status.

In summary, research suggests that employment and unemployment affect rates of intimate partner violence. Studies examining the independent effects of male and female unemployment find that male unemployment or job instability increases intimate partner violence (Benson & Fox, 2004; Resko, 2007), as predicted by the resource deprivation hypothesis. Studies examining the effect of female employment find that when a woman is employed more steadily than her male partner (Resko, 2007) or when both partners are employed (Macmillan & Gartner, 1999), the male partner is less likely to commit intimate partner violence against the woman. This suggests that women's employment has protective effects, as predicted by both the resource deprivation and dependency hypotheses. In one study, when the male partner was unemployed, employed women experienced more intimate partner violence (Macmillan & Gartner, 1999), as predicted by the backlash hypothesis, whereas in another study, when the male partner had more job instability than his female partner, she experienced less intimate partner violence (Resko, 2007), contradicting the backlash hypothesis. Overall, then, there is support for the resource deprivation hypothesis and the dependency hypothesis, while results for the backlash hypothesis are mixed.

One other study is worth mentioning in this review because it examined trends in intimate partner violence during a period of economic growth. Farmer and Tiefenthaler (2003), in an analysis similar to the one presented in this chapter, examined a model predicting the likelihood of intimate partner violence against women using data from the 1990s. When they excluded household income from the model, women's employment reduced the likelihood of intimate partner violence. They speculated (although they did not directly test) that the increase in women's employment rate during the 1990s accounted for a portion of the decline in intimate partner violence between 1993 and 1998. They concluded that increased economic prosperity, as reflected in either household income or women's employment, was one of the key factors accounting for a decline in intimate partner violence during the 1990s. This finding suggests the possibility that an opposite effect may occur: a recession may increase rates of intimate partner violence.

The current study builds on Farmer and Tiefenthaler's (2003) study of the effect of economic prosperity on intimate partner violence by focusing on employment, rather than household income, and by examining the joint impact of husbands' and wives' employment status, to test hypotheses regarding the effects of employment on intimate partner violence. It also incorporates additional years of data that became available after Farmer and Tiefenthaler conducted their study. Most importantly, the current study directly tests whether women's rising employment during the 1990s accounted for declining rates of intimate partner violence against women.

RESEARCH PLAN AND METHODOLOGY

This chapter presents new research examining the connections between employment, unemployment, and intimate partner violence, focusing on both offenders and victims. Given the multiple ways that rising unemployment and the recession may affect rates of intimate partner violence, how can we assess whether this recession will increase rates of intimate partner violence? There aren't any close parallels to the current recession in history, at least not during a time period when we have reliable data on rates of intimate partner violence. An alternative approach is to examine a period during which there was economic growth.

There are two reasons that examining the effect of economic growth on rates of intimate partner violence may be useful in understanding the impact of the recession. First, studying the effects of economic growth will show whether improved employment opportunities reduce intimate partner violence. If so, then it seems plausible that declining employment opportunities in a recession may increase intimate partner violence. For example, if having a job reduces dependency and enables an intimate partner to leave an abusive relationship, unemployment may make it difficult to leave and may prolong the abuse. Similarly, if employment reduces financial hardship and the likelihood of abuse, unemployment may increase deprivation and stress in the relationship and lead to an increase in abuse. The second reason for examining the impact of economic growth is to see what impact an improving economy might have on rates of intimate partner violence as the United States comes out of the recession.

The analyses in this chapter use data from the NCVS from 1993 to 2005. The NCVS collects annual data on crime in the United States by interviewing a nationally representative sample of persons aged 12 and over. The survey determines whether respondents were victims of crime and, if so, gathers detailed information about crime incidents. The NCVS redesigned the survey questions in 1992 to encourage respondents to remember and to report incidents of domestic violence and sex crimes, whether or not they reported these incidents to the police (Cantor & Lynch, 2005). The NCVS is the only national survey that includes annual data on trends in intimate partner violence victimization in the United States.

The NCVS definition of violence includes nonlethal criminal acts of physical and sexual violence – behavior that is considered illegal and that would be subject to criminal penalties if proven in court. The data presented here are limited to intimate partner violence, which includes violence between partners who are married, cohabiting or dating, or formerly married, cohabiting or dating.

The NCVS has a variety of limitations, several of which are particularly relevant for this study. First, the measure of intimate partner violence excludes several types of crime, such as theft and stalking, as well as many aspects of psychological abuse and control that are not criminal. Nevertheless, it allows us to see how employment affects the aspects of intimate partner violence that are included in the definition. Second, the NCVS data only indicate whether the respondent is employed or not employed. They do not indicate whether a respondent who is not employed is available for and actively looking for work, information that would be needed to classify him or her as unemployed. To address this limitation, I incorporate national unemployment data from other sources for the macro-level analyses. For individual-level analyses, I look at employment (rather than *un*employment) status. Third, the NCVS includes information about the employment status of their partners only for women who are married. For separated, divorced, and never married women, the NCVS only has a measure of their own employment – not their partner's. Because of this, I conducted the individual-level analyses using two subsamples. One includes only unmarried women (never married, separated, divorced, or widowed) and examines the effect of their own employment on intimate partner violence; the other includes only married women and examines the impact of both spouses' employment. In spite of these limitations of the NCVS data, the analyses will contribute to our understanding of the dynamics of employment and intimate partner violence.

ANALYSIS

The analysis looks at both macro-level trends and at individual-level effects of employment and unemployment on intimate partner violence.

Macro-Level Trends

Fig. 1 presents NCVS data on rates of intimate partner violence incidents from 1993, the first full year of the NCVS redesign, until 2005, the last full year before a change in methodology affected the continuity of estimates (Rand & Catalano, 2007). The rates shown here reflect the annual number of intimate partner violence incidents per 1,000 persons. Incidents of intimate partner violence declined significantly for women from 1993 to 2000 and more slowly thereafter. Men's victimization rates were stable and

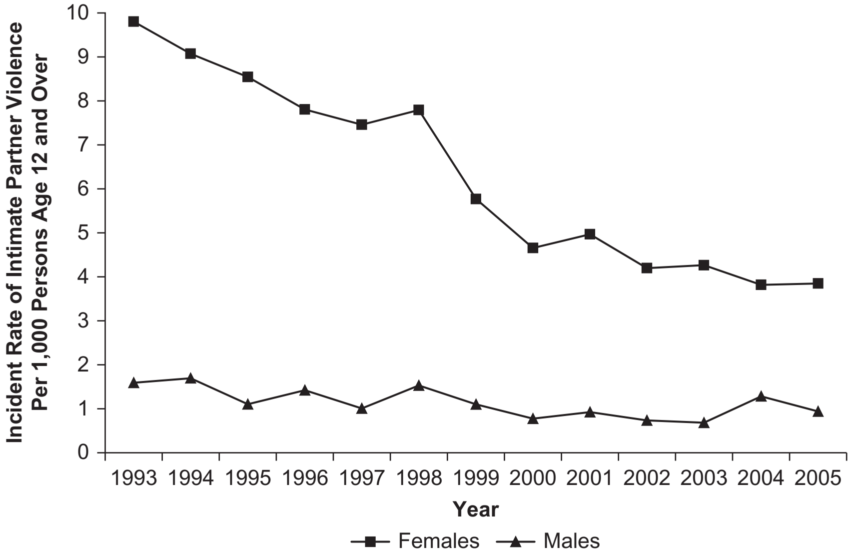

Fig. 1. Intimate Partner Violence Incident Rates, 1993–2005.

much lower, so I will focus on women's rates for the remainder of the chapter.

To take a closer look at the connection between employment and intimate partner violence, I looked at a person-based rate of intimate partner violence, that is, whether women experienced *any* intimate partner violence during the survey year, and focused on women age 18–64, the prime working years (see Fig. 2). The rate of intimate partner violence is lower in Fig. 2 than in Fig. 1 because it measures whether women experienced any intimate partner violence during the year, rather than the total number of incidents they experienced. Nevertheless, the trend is the same – showing a decline from 1993 to 2000 and leveling off thereafter. Taken together, the two charts show that the decline in intimate partner violence was due to a decline in both the number of women ever experiencing it (as shown in Fig. 2) and the total number of incidents women experienced (as shown in Fig. 1).

The period from 1993 to 2000, during which women's rates of intimate partner violence declined, was a period during which the U.S. economy came out of a recession and experienced significant growth. Fig. 3 overlays data on the unemployment rate obtained from the Bureau of Labor Statistics. It shows that from 1993 to 2000 both intimate partner violence

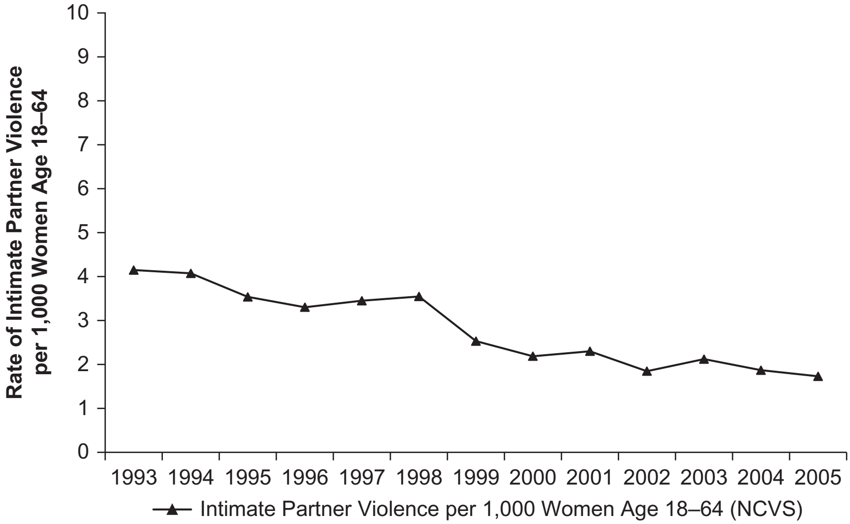

Fig. 2. Intimate Partner Violence per 1,000 Women Age 18–64.

and the unemployment rates of men and women declined. From 2000 to 2003, both men's and women's unemployment rates increased; after 2003, the rates began to decline. Although unemployment increased after 2000, the rate of intimate partner violence did not increase – from 2000 to 2005, the rate remained relatively stable.

These macro-level trends are interesting to consider, and they suggest that at least between 1993 and 2000, there may have been a connection between declining unemployment rates and declining rates of intimate partner violence against women. However, many other changes were occurring during the 1990s, and correlation is not causation. Moreover, the patterns from 2000 to 2005 show that increasing unemployment was not associated with an increase in intimate partner violence during this period. This casts considerable doubt on the hypothesis that rising unemployment increases rates of intimate partner violence.

Individual-Level Effects

To examine the individual-level effects of employment, I pooled the NCVS data from 1993 to 2000, the years of the major decline in intimate partner

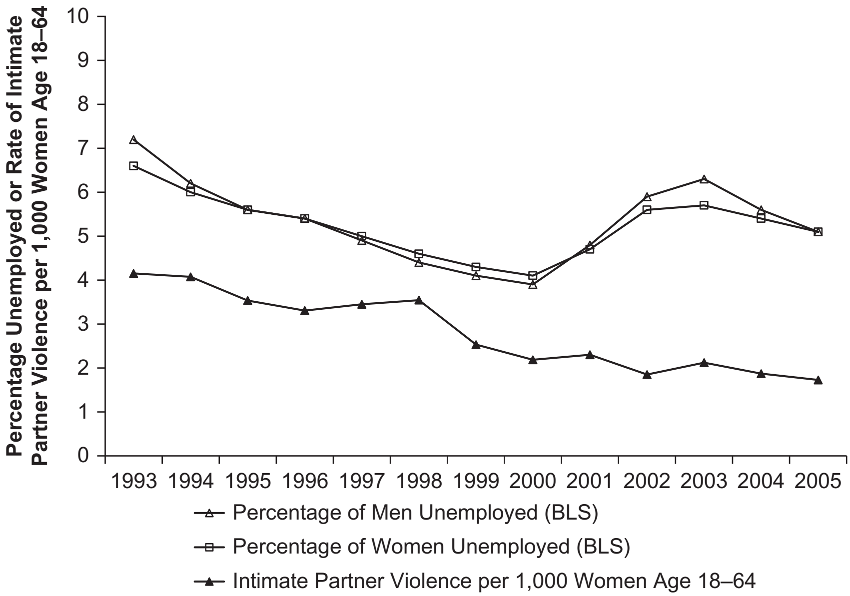

Fig. 3. Male and Female Unemployment Rates and Intimate Partner Violence per 1,000 Women Age 18–64.

violence, and looked at two subsamples of women age 18–64 at the time of the survey: unmarried women and married women. There are 293,330 observations in the unmarried subsample and 419,908 in the married subsample. Each observation includes data for one woman for one calendar year of the survey. Because the NCVS interviews households repeatedly over a two and a half year period, the observations in each subsample include women who were interviewed more than once (Bureau of Justice Statistics, 2007; Farmer & Tiefenthaler, 2003).

For each subsample, I have estimated logistic regression models that predict the likelihood that a woman in the survey experienced intimate partner violence during the calendar year. To represent the time trend, the models include "year of survey" as a predictor variable. The analysis of the unmarried subsample examines the effect of an unmarried woman's own employment status on the likelihood that her partner committed intimate partner violence against her. For the unmarried subsample, I did not analyze information about the partner's employment status because the survey does not collect information about the partners of unmarried individuals. The analysis of the married subsample examines the joint effect of both partners' employment status on the likelihood that the husband committed intimate partner violence against the wife.

Subsample 1: Unmarried Women Age 18–64

The analyses of the first subsample of unmarried women age 18–64 address two questions:

1. Are unmarried women who are employed less likely to experience intimate partner violence than unmarried women who are not employed?
2. Do rising rates of employment for unmarried women (from 67% in 1993 to 72% in 2000, data not shown) account for the decline in rates of intimate partner violence over that period?

This analysis enables us to consider at least one of the mechanisms by which employment may affect rates of intimate partner violence, specifically whether a woman's employment is a protective factor that reduces her likelihood of experiencing intimate partner violence. If employment has a protective effect, this would lend support to both the resource deprivation and dependency hypotheses.

The model predicting the likelihood of intimate partner violence controls for the effects of a number of variables: marital status (never married vs. widowed vs. divorced or separated), whether the respondent lives alone, whether she has any children under age 12, age, ethnicity, education, and length of time living at current address (see Table 1).[1] Table A1 provides means and standard deviations for the variables. The analysis is weighted using weights provided by NCVS for each observation.

Model 1A (column 1, Table 1) shows results for a model that includes all the variables except for employment status. Odds ratios show the effect of each variable. Odds ratios greater than 1 indicate a greater risk for intimate partner violence, while odds ratios less than 1 indicate a lower risk of intimate partner violence. As expected, the odds ratio for "year of survey" is statistically significant and shows that the likelihood of intimate partner violence decreased over time, confirming that rates of intimate partner violence declined for unmarried women from 1993 to 2000.

In Model 1B (column 2, Table 1), the employment variable is added, measuring whether a woman is currently employed. Compared to some of the other variables, its effect is relatively weak. Nevertheless, the results indicate that employed unmarried women are less likely to experience intimate partner violence than unmarried women who are not employed, even after controlling for a variety of other predictive factors. This finding answers the first

Table 1. Logistic Regression Models Predicting Likelihood of Intimate Partner Violence Among Unmarried Women Age 18–64 (NCVS, 1993–2000, $N = 293{,}330$).

Independent Variables	Model 1A Odds Ratio	Model 1B Odds Ratio
Year of survey	0.944***	0.947***
Employed at time of survey	[*Excluded*]	0.794***
Marital status (*reference category: never married*)		
Widowed	0.590*	0.577*
Divorced or separated	3.167***	3.197***
Lives alone	1.505***	1.514***
Any children in household under age 12	2.932***	2.879***
Age (*reference category: age 25–34*)		
Age 18–19	1.625***	1.565***
Age 20–24	1.342***	1.324***
Age 35–49	0.690***	0.690***
Age 50–64	0.151***	0.145***
Ethnicity (*reference category: non-Hispanic white*)		
Non-Hispanic black	0.724***	0.714***
Hispanic	0.526***	0.520***
Non-Hispanic other	0.546***	0.530***
Education (*reference category: high school graduate*)		
Less than high school	0.983	0.940
Less than 4 years college	0.781***	0.792***
College graduate	0.503***	0.516***
Post-graduate	0.503***	0.515***
Length of time living at current address (*reference category: less than 1 year*)		
1–2 years	0.451***	0.453***
3–5 years	0.328***	0.330***
6–10 years	0.395***	0.397***
11–20 years	0.373***	0.375***
21 or more years	0.255***	0.256***
Nagelkerke R^2	0.12***	0.12***

Note: Models use weighted data, and include variables to control for interview conditions that might affect survey responses (variables not shown; see discussion in note 1).
*Statistically significant at $p < 0.05$.
***Statistically significant at $p < 0.001$.

question: yes, an unmarried woman's employment is a protective factor that reduces her likelihood of experiencing intimate partner violence. The analysis is unable to determine whether the protective effect of women's employment comes from reducing resource deprivation, reducing dependency, or both.

The analysis also addresses whether employment accounts for the decline in intimate partner violence. Did unmarried women's rising rate of employment over time explain away the declining trend in intimate partner violence, as represented by the "year of survey" variable? If we compare the odds ratios for "year of survey" in Models 1A and 1B, we can see that adding employment to Model 1B hardly changed the effect of the time trend (the odds ratio for "year of survey" was 0.944 in Model 1A and 0.947 in Model 1B). This suggests that the decline in intimate partner violence among unmarried women during the 1990s was not due to rising rates of employment. Intimate partner violence declined for unmarried women who were not employed, as well as for unmarried women who were employed.

The models for unmarried women also include other interesting findings. The odds that separated or divorced women will experience intimate partner violence are over three times greater than for never married women. Similarly, unmarried women who have children in their household under the age of 12 are at higher risk of intimate partner violence than those who do not have young children. Younger women, non-Hispanic white women, those with a high school education or less, those who live alone, and those who have lived at their current address less than one year all have a higher risk of intimate partner violence.

Subsample 2: Married Women Age 18–64

The analyses of the second subsample of married women age 18–64 address two questions:

1. What is the joint impact of husbands' and wives' employment status on the likelihood that the husband will commit intimate partner violence against the wife?
2. Do rising rates of employment for married women, from 59% in 1993 to 62% in 2000, account for the decline in intimate partner violence over that period?

Model 2A (column 1, Table 2) shows results for a weighted model that includes all variables except for employment status.[2] Table A2 provides means and standard deviations for the variables. Similar to the results for unmarried women, the effect of "year of survey" is statistically significant and shows that intimate partner violence declined for married women between 1993 and 2000.

Model 2B (column 2, Table 2) shows the results of adding employment to the model. The employment variable measures the joint employment status of the wife and her husband. Compared to married couples where both

Table 2. Logistic Regression Models Predicting Likelihood of Intimate Partner Violence Among Married Women Age 18–64 (NCVS, 1993–2000, $N = 419{,}908$).

Independent Variables	Model 2A Odds Ratio	Model 2B Odds Ratio
Year of survey	0.950*	0.949*
Employment status of husband and wife	[*Excluded*]	
(*reference category: both husband and wife employed*)		
Husband employed, wife not employed		0.997
Wife employed, husband not employed		1.572*
Neither spouse employed		0.928
Husband's employment status missing		1.266
Any children in household under age 12	1.474**	1.487**
Age (*reference category: age 25–34*)		
Age 18–24	1.512*	1.515*
Age 35–49	0.828	0.825
Age 50–64	0.495**	0.489**
Ethnicity (*reference category: non-Hispanic white*)		
Non-Hispanic black	1.282	1.254
Hispanic	0.672	0.672
Non-Hispanic other	0.286*	0.285*
Education (*reference category: high school graduate*)		
Less than high school	1.678**	1.682**
Less than 4 years college	1.188	1.195
College graduate	0.711	0.719
Post-graduate	0.691	0.699
Length of time living at current address (*reference category: less than 1 year*)		
1–2 years	0.582**	0.580**
3–5 years	0.532**	0.530**
6–10 years	0.387***	0.385***
11–20 years	0.304***	0.301***
21 or more years	0.250***	0.247***
Nagelkerke R^2	0.05***	0.05***

Note: Models use weighted data, and include variables to control for interview conditions that might affect survey responses (variables not shown; see discussion in note 2).
*Statistically significant at $p < 0.05$.
**Statistically significant at $p < 0.01$.
***Statistically significant at $p < 0.001$.

spouses were employed, the risk of intimate partner violence was significantly greater among couples where the wife was employed and the husband was not employed. This finding supports the backlash hypothesis: for some men, not being employed while having a wife who is employed increases their use of intimate partner violence as an expression of power and control (MacMillan & Gartner, 1999).

Women in marriages where the husband was employed and the wife was not employed had rates of intimate partner violence similar to women in marriages where both spouses were employed. The difference between these two groups of married women was small and not statistically significant. This finding is puzzling and seems somewhat inconsistent with the findings for unmarried women in Model 1B, where women's employment appeared to be a protective factor. To explore this further, I reestimated Model 2B ignoring husband's employment status and using only a measure of the woman's employment status (data not shown), which is the same measure used in the analysis of unmarried women in Model 1B. In the reestimated model, married women's employment status had no statistically significant effect on their likelihood of experiencing intimate partner violence (data not shown). This suggests that being employed did not have a protective effect for married women. Moreover, the earlier finding supporting the backlash hypothesis suggests that married women's employment puts them at greater risk of intimate partner violence when their husbands are not employed.

The second question addressed in this analysis is whether rising rates of employment over time accounted for the decline between 1993 and 2000 in intimate partner violence committed by husbands against their wives. As shown in Table 2, the odds ratio for the time trend hardly changed between Model 2A, which did not control for employment, and Model 2B, which did. This suggests that intimate partner violence declined for all married women, regardless of the employment of the husband or the wife.

Findings for the effects of other variables in the models were generally similar to those reported earlier for unmarried women. Younger women, those living with children under the age of 12, those with less than a high school education, and those who have lived at their current address less than one year are at higher risk of intimate partner violence.

The analyses presented in this chapter examined the connections between employment, unemployment, and intimate partner violence using data from the NCVS; however, the implications of the findings are limited in several ways. First, the macro-level analysis examined data on only one recession (2001–2003). The increase in unemployment during that recession may not have been sufficiently large or of sufficient duration to affect rates of intimate partner violence. Furthermore, that recession may have had atypical effects because it affected so many highly skilled employees (Lauritsen & Heimer, 2010).

Second, more sophisticated individual-level analyses are needed that incorporate trends in other factors, such as availability of emergency shelters and other victim services, enforcement of laws against domestic violence, offender characteristics, drug and alcohol abuse, etc. The ability of employment to account for trends in intimate partner violence may become clear only when the effects of these other factors are considered.

Third, the individual-level analyses considered only the effects of current employment status. A more comprehensive analysis is needed to examine the impact of measures of employment history, number of hours worked, employment stability, earnings, or other measures of the recession (e.g., the Consumer Pessimism Index discussed in Lauritsen & Heimer, 2010).

Fourth, the analysis has not accounted for the possibility that men's acts of intimate partner violence reduce women's employment rates by keeping them out of the labor market, which might explain some of the patterns reported here (Renzetti, 2009). Although prior research has not found evidence of this (Dugan & Mattingly, 2005; Riger & Staggs, 2004), it was not explicitly tested here.

Finally, additional analysis of the NCVS data would be useful, such as measuring more precisely the timing of employment and intimate partner violence, adjusting the weights for design effects (Dugan & Apel, 2003: note 8), and examining the effects of other characteristics of the husband and wife, such as education and age.

Although additional research is needed, the analyses presented here have provided new insights into the connections among employment, unemployment, and intimate partner violence.

CONCLUSION

There are numerous mechanisms by which employment and unemployment, and by extension the current recession, might affect rates of intimate partner violence. There might be effects on the likelihood and frequency of abuse by potential offenders, on the ability of potential victims to leave the relationship, and on the ability of government and service organizations to provide assistance for victims. Yet, there are no reliable studies available showing how a prior recession affected rates of intimate partner violence. Recent national data show that the current recession has not increased rates of intimate partner violence, although there may be lagged or regional effects not yet detected. To address whether the recession is likely to increase rates of intimate partner violence, this chapter explored the connections between employment and intimate partner violence.

At the macro-level, the data presented in this chapter show that both men's and women's unemployment rates were only weakly related to rates of intimate partner violence. When unemployment was declining during the 1990s, intimate partner violence was also declining. However, when unemployment rates increased after 2000, rates of intimate partner violence remained stable. These data show that the recession of 2001–2003 did not result in an increase in intimate partner violence, casting doubt on the claim that the current recession is increasing intimate partner violence.

At the individual level, this chapter examined data to determine (a) if women's employment is a protective factor, either because it reduces resource deprivation and/or dependency, (b) if there is evidence for the backlash hypothesis, that is, that employed women are more likely to experience intimate partner violence when their partners are unemployed versus employed, and (c) if women's rising employment explained the decline in intimate partner violence during the 1990s. The findings suggest that women's employment was protective for unmarried women but not for married women. The analysis was unable to determine if unmarried women's employment was protective because it reduced deprivation and/or because it reduced dependency.

The findings for married women supported the backlash hypothesis. Among married couples where the wife was employed, the likelihood of intimate partner violence was higher when her husband was not employed than when he was employed. The results addressing whether rising employment rates accounted for the decline in intimate partner violence were clear. For both unmarried and married women, rising employment rates did not account for the decline in intimate partner violence during the 1990s.

The latter finding contradicts the conclusion reported in Farmer and Tiefenthaler's (2003) study. However, unlike the current study, Farmer and Tiefenthaler based their conclusion on speculation, not on a direct test of whether rising rates of employment among women accounted for the decline in intimate partner violence. The current study found that whether or not employment was included in the model, the declining trend in rates of intimate partner violence against women during the 1990s remained the same. This finding provides stronger evidence about the lack of a connection between employment and trends in intimate partner violence.

What predictions can we make, then, for rates of intimate partner violence in the current recession? First, the macro-level analyses show that the relationship between rates of unemployment and intimate partner violence was weak. Second, the individual-level analyses show that rising rates of women's employment were not a significant factor accounting for the decline in intimate partner violence among either unmarried or married women. During the 1990s when women's employment rose significantly and intimate partner violence declined significantly, employment did not account for the decline in intimate partner violence. Taken together, these findings suggest that the recession will not increase the likelihood of intimate partner violence against women.

One factor not taken into account in this analysis is whether rising male or female unemployment affects marital status. If male and/or female unemployment cause unmarried couples to postpone marriage and other factors remain constant, the number of unmarried couples may increase. This may increase rates of intimate partner violence against women, since unmarried partners have higher rates than married partners. Similarly, male unemployment may increase the likelihood that married couples will separate and/or divorce. This also may increase intimate partner violence, since, as we saw in the first individual-level model, divorce and separation are associated with a considerably higher likelihood of intimate partner violence. Alternatively, rising unemployment among married women might have the opposite effect: lower rates of separation and divorce, and a reduced likelihood of intimate partner violence. Clearly, much remains to be learned about the dynamics of employment, unemployment, marital status, and intimate partner violence.

Similarly, the recession may affect other factors identified in the individual-level models that could produce changes in rates of intimate partner violence. For example, foreclosures may increase housing instability among couples, and the models show that women living at their current address for less than one year are at higher risk of intimate partner violence. The recession may have a variety of other effects, positive and negative, direct and indirect, making it difficult to anticipate its effects (Cook, 2010). This means that a discussion of "the" effect of the recession on rates of intimate partner violence summarizes the net impact of numerous interactive effects, many of which are not well understood.

Overall, the findings presented here provide little support for the claim that the current recession will increase rates of intimate partner violence against women. This is consistent with the more general research finding that recessions are not associated with increases in violent crime that does not have an economic motive (Cook, 2010). The current findings do, however, suggest that employed wives whose husbands are unemployed face a higher risk of intimate partner violence. In the current recession, most of the job losses have occurred among men (Rampell, 2009). This may increase the size of the high-risk group of married employed women whose husbands are unemployed.

In several years, when comprehensive data on intimate partner violence during the current economic crisis become available, researchers will have their first opportunity to study whether and how the recession had long-term effects on rates of intimate partner violence. New studies will examine the multiple pathways by which changes in men's and women's employment and unemployment during a recession affect the likelihood of intimate partner violence against women. These studies will provide valuable information to address questions about the likely impact of the next recession on intimate partner violence. Until then, the best prediction based on the limited evidence available now is that the recession is unlikely to increase intimate partner violence against women.

NOTES

1. The models also control for several interview conditions that might affect survey responses (data not shown): whether the interview was conducted by telephone (75%) or in person (25%); whether anyone was present at the time of a personal interview (this occurred in 15% of all interviews); whether the interview was "unbounded" (11% of the interviews; see Dugan & Apel, 2003 for an explanation of this term), and whether a proxy answered questions for the respondent (2% of the interviews).
2. Note that the models for married women dropped two variables that were included in the models for unmarried women: marital status, and whether the woman lives alone. The models in Table 2, like those in Table 1, also control for interview conditions that might affect survey responses (data not shown): whether the interview was conducted by telephone (79%) or in person (21%); whether anyone was present at the time of a personal interview (14% of all interviews); and whether the interview was unbounded (6%). Proxy interviews of married women were rare; an estimate of their impact was unstable and therefore excluded from the models in Table 2.

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APPENDIX

Table A1. Means and Standard Deviations for Unmarried Women Age 18–64 (NCVS, 1993–2000, $N = 293{,}330$).

Variable Name	Mean	Standard Deviation
Any intimate partner violence	0.007	0.08
Year of survey	1996.48	2.28
Employed at time of survey	0.70	0.46
Marital status		
Never married	0.57	0.49
Widowed	0.08	0.26
Divorced or separated	0.35	0.48
Lives alone	0.24	0.43
Any children in household under age 12	0.29	0.45
Age		
Age 18–19	0.10	0.30
Age 20–24	0.19	0.39
Age 25–34	0.24	0.42
Age 35–49	0.29	0.45
Age 50–64	0.18	0.39
Ethnicity		
Non-Hispanic white	0.65	0.48
Non-Hispanic black	0.21	0.41
Hispanic	0.10	0.30
Non-Hispanic other	0.04	0.19
Education		
Less than high school	0.14	0.34
High school graduate	0.37	0.48
Less than 4 years college	0.28	0.45
College graduate	0.13	0.34
Post-graduate	0.08	0.27
Length of time living at current address		
Less than 1 year	0.24	0.43
1–2 years	0.20	0.40
3–5 years	0.19	0.39
6–10 years	0.14	0.34
11–20 years	0.14	0.34
21 or more years	0.09	0.29

Table A2. Means and Standard Deviations for Married Women Age 18–64 (NCVS, 1993–2000, $N = 419{,}908$).

Variable Name	Mean	Standard Deviation
Any intimate partner violence	0.001	0.03
Year of survey	1996.42	2.27
Employment status of husband and wife		
Both husband and wife employed	0.44	0.50
Husband employed, wife not employed	0.21	0.41
Wife employed, husband not employed	0.05	0.23
Neither spouse employed	0.07	0.25
Husband's employment status missing	0.23	0.42
Any children in household under age 12	0.43	0.49
Age		
Age 18–24	0.05	0.22
Age 25–34	0.25	0.43
Age 35–49	0.44	0.50
Age 50–64	0.26	0.44
Ethnicity		
Non-Hispanic white	0.80	0.40
Non-Hispanic black	0.07	0.25
Hispanic	0.09	0.29
Non-Hispanic other	0.04	0.20
Education		
Less than high school	0.11	0.31
High school graduate	0.38	0.48
Less than 4 years college	0.24	0.43
College graduate	0.16	0.37
Post-graduate	0.11	0.31
Length of time living at current address		
Less than 1 year	0.12	0.32
1–2 years	0.16	0.36
3–5 years	0.21	0.41
6–10 years	0.20	0.40
11–20 years	0.18	0.39
21 or more years	0.13	0.33

THE SHOWDOWN WITH SHRINKING BUDGETS: POLICE DEPARTMENTS IN ECONOMIC DOWNTURNS

Darrell D. Irwin

ABSTRACT

This chapter describes the shortfalls in local police budgets following the economic woes experienced by police departments during the Great Recession. Providing a timeline of external events impacting police budgets, in particular, the terrorist attacks on September 11, 2001 and the Great Recession, this chapter places these events since 2000 in an economic context. In addition, multiple sources, that is, interviews with police administrators, survey data, and news media content, are used to analyze police budget cuts. Most police administrators have already cut their budgets and report their jurisdictions anticipate more effects from the economic crisis. Significant reductions in police budgets, personnel and training are discussed. Both a police administrator and academic perspective of policing in an economic crisis are included in this chapter to better understand how recent budgets cuts affect the quality of policing.

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INTRODUCTION

Policing is local, but local police budgets come from several sources, all in steep decline. This chapter describes the shortfalls in local police budgets occurring nationwide by 2010 set against the economic woes of the Great Recession. In the first decade of the 21st century, police department budgets were impacted due to external forces, particularly the terrorist attacks on September 11, 2001. Criminologist Herman Goldstein, reviewing the direction of change in police departments, wrote that they ‘‘dwell on the structure, staffing, and equipping of the police organization, with the assumption that such efforts will eventually result in an improvement in the quality of policing’’ (1990, p. 1). Improving the quality of policing is a perennial theme found in police research, but recent budget cuts have made improvements more difficult (Irwin & Willis, 2007). In the current budget crisis, police lack resources for maintaining stasis in service levels, much less making improvements. This chapter explores the opinions of police administrators regarding their budget shortfalls and balances their perspective with survey data and an analysis of news media content. The framework developed in this chapter aims to provide a greater understanding of the links between budgets and the direction of 21st century policing by reviewing recent news media articles, analyzing interviews with police managers, and analyzing nationwide survey data on police department budgets.

MAJOR TRENDS SHAPING POLICE BUDGETS BEGINNING IN 2000

Economic decline and budget difficulties followed the more sanguine 1990s. Since the 1990 publication of Herman Goldstein's book, *Problem-Orientated Policing*, many significant trends have affected the direction of police departments. Since September 11, 2001, many municipalities were more willing to spend portions of their policing budget toward fighting terrorism, and this flow of money continues today. The Office of Homeland Security restructured grants for police departments to fight terrorism and increase security, but the funding came at the expense of traditional areas of crime fighting and patrol (Cox, 2005). Table 1 recaps significant events in the past decade that have affected police budgets.

The timeline of events, listed in Table 1, is important for the study of police resource allocation. First, these events beginning with the September 11, 2001 attack record a seismic shift in policing priorities accompanied by a

Table 1. Event History Affecting Police Department Budgets, 2000–2010.

Event Timeline	Positive Effect	Negative Effect	Notes
2000 – Decade begins	Economy steady; no significant budget problems		
September 11, 2001 – Terrorist Attack		Police funding redirected toward national security	
January 24, 2003 – Department of Homeland Security established	Grants available from Department of Homeland Security	Department of Homeland Security grants centered in response to terrorist threats.	As of April 2004, approximately 85% of these grant funds had not yet been drawn down by local governments because of various bureaucratic obstacles.
Federal Budget FY 2007		President Bush proposes 79% cut to COPS program	Classified as a "deep program" cut by the Center on Budget and Policy Priorities
Great Recession begins December 2007		Survey reports 40% of police budgets decline	
Great Recession ends June 2009	Some federal stimulus money to police departments	Survey reports 51% of police budgets decline	

Source: Center on Budget and Policy Analysis and Department of Homeland Security websites; PERF PART I, 2009; PERF 2010.

reallocation of resources. Harold L. Hurtt, the police chief of Houston, TX, wrote that, "one of the concerns of some of the major city chiefs is that gangs and drugs as public safety issues have been pushed into the shadow of homeland security. The urban threat we have faced for many years still causes great harm to the quality of life of our residents" (Hurtt, 2005, pp. 27–28). Protective equipment purchases shifted from Kevlar bullet-resistant vests to robots, chem-bio suits, and hazardous materials trucks. In many police departments, the best use of Homeland Security funds has not corresponded to community policing efforts. Much of this expenditure shift occurred since 2003,

> when the Homeland Security Department was created, the government has given states and cities $22.7 billion for emergency preparedness. … Since 9/11, the IACP (International Association of Chiefs of Police) says, 99,000 people have been murdered in the USA and 1.4 million are the victims of violent crime each year. ''In terms of day-to-day crime fighting, we're far worse off than we were before 9/11,'' IACP's Ronald Ruecker says. (Hall, 2008)

Whether far worse off or just far off track, the level of spending on the fight against terrorism is hard to justify in recessionary times and pits national policy against the needs of local law enforcement.

A second major shift in expenditures came when the Bush presidency cuts, occurring first in 2001 but restored by Congress, affected Community Oriented Policing Services (COPS) funding available to state and local police departments. As reported in the *Washington Monthly*, by 2000, ''COPS had helped departments hire about 70,000 new officers (upping local police strength by 12 percent nationally), and required that all of the new cops be out on street beats. In those six years, violent crime declined by 46 percent nationally, the most sustained, dramatic decline in the last hundred years'' (Wallace-Wells, 2003). President Bush's first budget sought to cut the entire Clinton-era COPS program, although Congress was able to restore some of its funding (Wallace-Wells, 2003). COPS grants, according to criminologists, brought increased funding, although there remains no clear link to a drop in crime rates (Conklin, 2003; Eck & Maguire, 2000). While evaluations of COPS programs report increasing police professionalism, increased education levels, and shifts in police culture, criminologists John Eck and Edward Maguire did not find the changes in organizational culture of police, a compelling enough explanation for crime reduction (2000, p. 221). Other criminologist lauded the CompStat process for its management principles and use of technology to improve police accountability (Stone & Ward, 2000, p. 29). By 2007, the COPS program and grants available to departments dwindled under pressure from policymakers (Center on Budget and Policy Priorities, 2006).

A third major shift in expenditures crystalized in 2008 when the financial crisis, referred to as the Great Recession, began to impact federal, state, and local funds. By then, state and local revenue projections for spending on traditional police departments became extremely pessimistic. A content analysis, conducted during the course of this research in 2009, on coverage by daily newspapers of the effect of the recession on policing found them closely following their city's budget woes. The continuing economic woes pressured police in cities where, ''(d)espite having one of the highest crime rates in the nation, Camden, NJ, laid off nearly half its police force this week after failing to win concessions from its unions. On the other side of the country, Vallejo, CA, was filing a bankruptcy plan that proposed paying some creditors as little as a nickel or 20 cents on each dollar they are owed'' (Cooper, 2011). In sum, 2011 began with many local governments in a financial retrenchment, some even teetering on financial collapse.

The Great Recession is, perhaps, a starting point for academic research into determining what changes occur in communities and their police departments undergoing economic hardship. Going beyond primary budgetary effects, what are the implications to police departments' future recruitment and retention, operations, and staffing? In addition to budget reductions, personnel issues of attracting young people into policing, hiring freezes, low pay, and furloughs accompany budget shortfalls. For recruits and current police officers, professional development opportunities have significantly diminished during the Great Recession (see Fig. 2).

Crime rates and victimizations during economic downturns have been studied by criminologists (Ousey & Lee, 2002; Lauritsen & Heimer, 2010; Cook, 2010), but few address police departments' decreased budget allocations (Coe & Wiesel, 2001). There are several themes to police budgets that can make them difficult to succinctly explain. In their textbook on police operations, Swanson et al. condensed these themes as ''the budget as a management tool, the budget as a process and the budget as politics'' (Swanson, Territo, & Taylor, 1988, p. 457). In addition, both the city and police budgets are interrelated and comprised of operating and capital budgets. The organizational changes to policing may emerge to be as much a function of budget as they emerge as an ideology or police science. Described next are three recent surveys examining the relationship between police department budgets and police resources effecting personnel and readiness.

POLICE BUDGETS SURVEYS

The University of North Carolina Wilmington (UNCW) Police Budget Stakeholders survey is a 27-item survey exploring police budgets during this economic crisis. On October 4, 2009, the survey was distributed by John Cease, a former police chief of the Wilmington (NC) Police Department at International Association of Chiefs of Police (IACP) conference in Denver. Chief Cease piloted the surveys to his police colleagues in a standing committee of the IACP. These police chiefs' responses to the pilot survey provided a sample indicating drastic effects on police departments from decreasing budget allocations. While the results of the pilot survey indicated severe cuts to departmental operating expenses and personnel, the survey was limited due to a small sample size of 18 respondents. Additionally, police administrators who attended the IACP conference were not likely to be facing drastic budget problems as they were allowed a travel budget to attend the conference.

The intention was to broaden the survey collection to a larger sample of police chiefs in 2010 and preparations began for a larger mail survey. A search of the literature on the effects of the economic crisis in police departments revealed annual survey research on police budgets being conducted by the Police Executive Research Forum (PERF). PERF is a nonprofit Washington, DC-based professional organization of police executives that develops and publishes research on law enforcement issues (PERF, 2010, p. 29). PERF had conducted police budget studies in the 1990s as well as a July 2008 survey focused on violent crime that included a few questions on police budgets (PERF PART I, 2009). Then, in January 2009, PERF had completed collected data from a survey focused exclusively on police budgets (PERF PART II, 2009, p. 1). PERF essentially repeated its January 2009 survey in September 2010 and published those results in December 2010 in its *Critical Issues in Policing Series* report entitled "Is the Economic Downturn Fundamentally Changing How We Police?" (PERF, 2010). These two surveys, referred to in this chapter as PERF PART II 2009 and PERF 2010, provided data on budget trends from police departments in the declining economy over a two-year period. The PERF survey questionnaires and the UNCW Police Budget Stakeholders pilot survey all focused on the fundamental changes to policing associated with an economic downturn by asking nearly identical questions. Once the PERF PART II report was published, we abandoned the launch of our survey and examined results of the two PERF surveys to research policing in the Great Recession. Consequently, throughout this chapter, results from the UNCW pilot survey are mentioned to support PERF PART II 2009 and PERF 2010 findings.

Results from Surveys on Police Budgets Show Consistency

These three surveys – PERF PART II 2009 and PERF 2010 and the UNCW pilot survey – exclusively focus on the topic of police budgets. The survey collection methods differed as PERF surveyed police departments in 2009 and 2010 by mail and the UNCW survey was a convenience sample of respondents attending anIACP meeting. The number of completed surveys in the PERF PART II 2009 survey was 233, the 2010 PERF survey had 608 completed surveys, and the UNCW pilot survey had 18 completed surveys.

The 2010 PERF survey was sent to 1,311 law enforcement administrators for a response rate of 46 percent. The 2009 PERF survey was sent to 328 law enforcement agencies for a response rate of 71 percent. The UNCW survey included 3 surveys from federal officials, which were eliminated, and 15 from local or state police administrators with 53 percent of those serving jurisdictions under 50,000 in population. Only one agency reported serving fewer than 5,000 in population. On average, the participants in the UNCW sample had served 15 years as a police administrator. They either had the highest level of budget authority, represented by their response indicating, "I am responsible for executive sign off on the Department Budget, defending the budget proposal and keeping the Department within the budget" or their response indicated, "I have executive level responsibility for assembling/preparing/coordinating the Department Budget" (Irwin & Cease, 2010).

PERF Surveys on Policing in an Economic Downturn

The PERF surveys provide snapshots of police departments faced with budget reductions. Among the police departments surveyed in 2010, 51 percent ($n = 301$) reported a budget cut in fiscal year 2010. When this same question was asked in 2009, departments had reported a 6 percent increase in their budgets. Responses on the 2010 PERF survey indicated that 39 percent of police departments were preparing plans for an overall cut in their total funding for the next fiscal year (PERF, 2010). As Fig. 1 illustrates, comparing PERF survey data from one year earlier, 63 percent of departments had prepared for budget cuts (PERF PART II, 2009).

This graph illustrates where police administrators were preparing for their budgets to decrease. Given their anticipation of a budget decrease, police administrators reported in 2009 that for next year's budget they expected an average of a 6.24 percent decrease (PERF PART II, 2009). In 2010, they expected an average of 7 percent in next year's budget (PERF, 2010). Consistent with the PERF findings, the UNCW respondents reported expecting decreases in 2010 budgets averaging 6.3 percent. Altogether, on the UNCW survey 67 percent of respondents reported they expected a reduction or no change in their FY 2010 budgets. When questioned about how much their budget could have been cut without a significant curtailing of their departmental effectiveness, it was reported from 2 to 4 percent might be cut from the budget without it affecting public safety (Irwin & Cease, 2010). More severe cuts occurred in the budgets of Los Angeles and Atlanta police

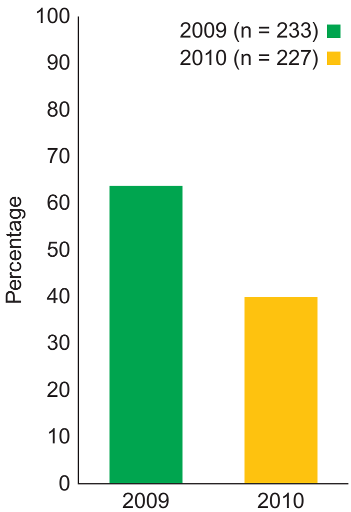

Fig. 1. PERF Survey Results of Departments That Reported Preparing for Budget Cuts.

departments that suffered 12 percent and 10 percent cut (PERF, 2010, p. 1). Forty-seven percent of the police chiefs in the PERF sample said that services in their community have declined or will decline due to budget cuts (Police Executive Research Forum Economic Summit II, 2010, slide 16).

What are the measurable effects on police departments of these budget decreases? By January 2009, 53 percent of police agencies responding to the PERF survey had implemented a hiring freeze for civilian staff, while 27 percent had done so for sworn officers (PERF, 2010, p. 1). Even though 91 percent of police chiefs believe that their last resort should be cutting sworn personnel, in this economic crisis many are finding it difficult or impossible to avoid cutting sworn officers (PERF, 2010, p. 3). The PERF survey reports an actual 3 percent decrease in police departments' sworn officers from 2009 to 2010 (PERF, 2010, p. 1).

Throughout this economic crisis, one central theme to police chiefs' comments is the loss of on-the-street crime fighting police officers (Bauer, 2009; Stateline.org, 2009; PERF, 2010). The adverse impact of fewer police officers was highlighted in PERF's 2009 *Critical Issues in Policing Series* report discussing the new challenges to police in locations suffering from the economic crisis (PERF PART I, 2009). Crime is highly dependent on opportunity, and in an economic crisis opportunities are widely found, especially in the cases such as:

> vacant homes are being burglarized for copper pipes. In Santa Ana, Calif., police said that unoccupied houses are attracting transients, gang members, and prostitutes, and are causing a general sense of neighborhood disorder. Minneapolis Mayor R.T. Rybak cited an incident in his city on September 21 in which a vacant fourplex building was destroyed by an explosion, which utility officials blamed on thieves who broke a gas line. The force of the explosion reportedly was felt a mile away. (PERF, 2009, PART I, p. 8)

Police departments have been quick to realize foreclosed properties represent fault lines where criminality occurs. In Indio, CA, with 1,500 foreclosed homes, the police worked with the city to pass an ordinance requiring a home inspection after a default notice (PERF PART I, 2009, p. 9). If a bank-owned property has been abandoned, then the lender has to register the property with the Indio Police Department and is further required to ‘‘hire a local property management company to oversee and maintain the property, and to post a sign with a 24-hour telephone number of a person who can be contacted in case of an emergency at the property’’ (PERF PART I, 2009, p. 9). The police were put in charge of code enforcement concerning abandoned buildings. Combining this notification of abandoned property with code enforcement has decreased stolen air conditioning systems and decreased general theft at these properties. California police departments had previous success with multiagency task forces combining civil enforcement and traditional law enforcement for drug suppression (Green, 1995). The partnership between police and property owner working in tandem to thwart potential crime and holding each other accountable may increase as motivated offenders, themselves facing economic crises, target abandoned properties. PERF respondents reported crime attributable to the economy produced a 39 percent increase in robberies and a 32 percent increase in burglaries where appliances and other items are taken from vacant or foreclosed homes (PERF PART II, 2009, p. 4). Thirty-nine percent of police departments surveyed agreed that foreclosures had affected their department (PERF PART I, 2009, p. 5). Irwin and Cease (2010) found that 67 percent of the IACP sample reported their jurisdiction had reduction in property taxes in the previous five years. Moreover, the combination of reduced property taxes and the ‘‘target attractiveness’’ of abandoned properties further increases police workloads (Felson, 1998).

The PERF 2010 survey found that budget cuts in 2009 to 2010 came from three areas: sworn positions, civilian positions, and overtime. Police chiefs were consistent in reporting that these three areas were where they would

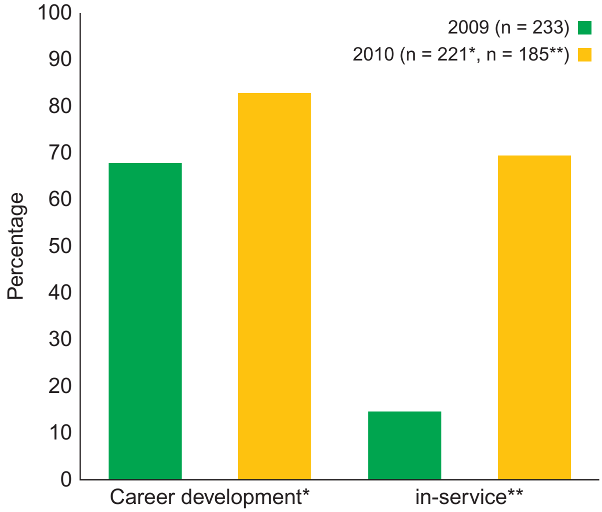

Fig. 2. PERF Survey Results of Police Training Reductions.

anticipate making their 2011 budget cuts (PERF, 2010). By cutting personnel costs from the budget, one direct effect is fewer police patrols and reduced public safety. The opinions of 91 percent of police chiefs from the 2010 PERF survey are that sworn positions should be the last thing cut (PERF, 2010, p. 3). With sworn positions being cut in departments across the country, the question of who will dictate the levels of police staffing is being raised.

Beyond personnel issues, the effect of budget cuts on police training programs cannot be overlooked. The main programs reduced or eliminated were in-service training and career development training programs. The graph in Fig. 2 illustrates the PERF survey responses of which training programs are most affected by budgets reductions.

With the elimination of budgets for essential training programs, the loss of trainers, their instructional method, and academy classes and a host of in-service training follow. These losses may alter police productivity and integrity for years to come.

The PERF Summit on Policing in the Economic Downturn

On September 30, 2010, a one-day summit held by PERF in Washington, DC brought together 120 police administrators, academics, and federal policymakers (PERF, 2010, p. 5). At the summit, these officials shared how pervasive the effects of Great Recession were on their municipalities. Those gathered at the summit described in detail the specifics of their workforce cuts, while others elaborated upon the creative ways in which their departments have had to utilize their dwindling resources. One constant theme among department chiefs facing budget cuts was the need to do more with less. Of the police administrators having already cut budgets in 2010, 59 percent responded their budgets would again decrease in 2011, and 70 percent reported their jurisdiction was currently experiencing or is expected to experience significant effects of the economic downturn (PERF, 2010, p. 1).

The perspectives of several leading academic researchers present at the summit were also the subject of discussion. The researchers, among them George Kelling who along with James Q. Wilson is credited with coining the term "broken windows" policing, believe that the departments may be victims of their previous success in reducing crime rates (Kelling & Coles, 1996; Wilson & Kelling, 1982). Kelling urged the administrators to look to factors other than the crime rates to measure success (PERF, 2010, p. 24). Academics viewed the current budget crisis differently than police officials, suggesting that the budget cuts may need to be looked at as opportunities to increase departmental efficiency and establish a model for the future of law enforcement. Amidst a discussion of the future of policing, criminologist and editor of the *Journal of Criminology and Public Policy*, Tom Blomberg lamented the repetition of history without learning from the past noting that previous recessions had produced cutbacks in law enforcement but failed in producing detailed academic studies of its effects (PERF, 2010, p. 26).

The police administrator's best defense to budget cuts is documenting that cutting expenses poses a legitimate risk to public and officer safety. But crime rates have been steadily dropping since the 1970s. A lack of resources could pose a legitimate concern, however Coe and Wiesel's research on budget strategies reports promising crime rate reductions may actually backfire (2001, p. 720). In their study police chiefs cautioned that improving policing actually led to increased crime rates because unreported crime surfaces (Coe & Wiesel, 2001, p. 720).

At the PERF summit, George Kelling elevated the need for police in current situations like enforcement of immigration laws or public order, even in an environment of declining crime. Kelling said, "We need to tout the multiple values that police serve and market those, not merely as legitimate, but as extraordinarily important issues in a democratic society" (PERF, 2010, p. 24). He noted that protecting justice or the individual rights of citizens would serve as well as crime control functions in eliciting public support (PERF, 2010, p. 24). Kelling provides a grounded view of the true worth of police in a democratic society, yet a more pervasive social construction of police comes from the media (Surette, 2007).

MEDIA COVERAGE OF POLICING DURING THE GREAT RECESSION

Examining media content from the one-year period of 2009 news articles found police departments nationwide were experiencing their tightest fiscal restraints in many years. A Minneapolis Public Radio story gave the example of "twenty Minneapolis Police officers graduated from the academy on Thursday (December 24, 2009) and the new officers will hit the streets this weekend. But by the end of next week, they'll be out of work because police department will lay off the officers because it can't afford to pay their salaries" (Williams, 2009). Many police academy stories received negative media coverage such as the story that the Pennsylvania State Police simply did not have the budget for a cadet class at all in 2010 (Stateline.org, 2009). The range of incidents which the media linked to police budgets included sheriff's cars repossessed in Illinois, buyouts of sheriff's deputies' contracts in Texas, and the retraining of Cincinnati desk sergeants for street patrols (Reynolds, 2009; KSAT-TV, 2009; McKee, 2009).

At the beginning of the 21st century, police departments had public support for increased positions and budgets. But real changes came about in the Great Recession. Departments now reexamine their strongest programs. The examples of traffic safety over two periods – one in relatively healthy budget times and the other in the current budget decline – can illustrate current budget upheavals. Police Chief Jerry Bloechle compared several years of deaths in his community, Largo, FL. Largo had 15 homicides compared to 77 motor vehicle deaths. By allocating resources toward increasing safety awareness and installing safety devices along with improving conditions at dangerous intersections, Largo witnessed a steep drop in its motor vehicle deaths (Coe & Wiesel, 2001, p. 721). By 2009, the head of Alabama's Department of Public Safety pleaded with state legislators not to cut his budget. The police, according to Col. Chris Murphy, had reduced fatality rates on state roads by 35 percent or twice the national average. Murphy said the cuts to his department would lead to reductions in service and fewer state police (Stateline.org, 2009). Successful programs are not exempt from being eliminated in difficult budget times.

By necessitating new cost-savings measures, the budget crisis defined policing strategies. The unique demands of policing crime do not disappear when budgets decline. As seen in the examples from three mid-sized city departments, justifications for crime fighting strategies in tougher fiscal times vary. In Wellford, SC, the strategy narrowed as the mayor banned police chasing suspects on foot because of workman's compensation costs (Cato, 2009). In Champaign, IL, the strategy expanded to mandating problem-solving policing because it would keep the police in neighborhoods where crime was found and reduce costs (Bauer, 2009). Champaign's Police Chief R. T. Finney said, "This is when the police really need to be on the streets with our citizens, solving crime problems in a proactive, shared method" (Bauer, 2009). The Colorado Springs Police Department seemingly reversed Champaign's strategy, as their spokesperson indicated "we're going to be much more reactive than proactive" because of personnel losses in the economic crisis (St. Louise-Sanchez, 2009). Further research is needed to compare how current budgetary pressures affect policing strategies.

A CASE STUDY IN BUDGET PLANNING

One of the challenges in police administration is guiding the budget through the budget cycle while keeping the priorities of the department intact. In many jurisdictions, this process involves a presentation of the police budget by the city manager to the City Council for eventual approval. Conducting an in-depth interview with a police chief from a metro city in the Carolinas allowed a look inside the budget process. As the police chief for the past two years of this metro city, he discussed the changes to his departmental budget process saying, "Nowadays you don't get a budget of how you want to do business, you get a budget of how somebody else wants you to do business. Regardless of what your goal is, this is how much you have, and that's it" (Irwin & Cease, 2010).

In the case of this city, an administrative budget analyst, a police captain with executive-level responsibility, assembles and coordinates the department budget. According to the captain, the initial planning phase provides a better understanding of the budgetary constraints on the department. The department relies on the prior year's blueprint outlining the annual activities and workplace goals and setting department priorities. Employing fluid strategic planning begins at the division level where each captain brings their plan forward eventually developing into a division budget. At this point, the captain remarked, "it's all sent to the designated captain to pull together for the chief's pen and review. In this budget cycle certain items, by far most important was overtime, were eliminated and an attempt was made to preserve jobs and safety" (Irwin & Cease, 2010). The chief signs the first version of the budget that then is sent to the city's review committee consisting of the assistant city managers and the city manager.

A Bureaucratic Hurdle

In the budget cycle for FY 2009, the city manager had appointed a City Council member who vetted the budget item by item and, according to the captain, "browbeat all the city department heads" (Irwin & Cease, 2010). In meetings with the City Council member occurring in the middle of the budget process, department heads were told what to expect and what was expected of them. The captain reported the process was tedious, arbitrary, and punitive. The reaction to the extra series of meetings was negative and the extra meetings were not repeated the following year. Two major budget items, one from salaries and wages and one from capital outlay, have been eliminated from the department's FY 2010 budget of $24.9 million. The departments' 270 personnel, from patrol to chief, have had a 48-hour furlough imposed on them. That represents a 2.31 percent reduction in salaries and reduced their previous 10 paid holidays to 4 holidays, preserving Martin Luther King Memorial and Thanksgiving and Christmas days. The department's entire capital outlay budget, usually a three-year equipment purchase cycle, was eliminated. The city previously paid all health care costs and last year ended it with employees now sharing costs. Police officers are able to retire after 25 years with full state retirement. The police department eliminated merit increases of 3 percent and cost of living increases of 3 percent.

The metro Carolina department has seen the budget downturn impact recruiting and retention. Along with the previously discussed cuts, other reductions included police uniforms, equipment replacement, and the repair budget. The latter is a common technique to postpone new purchases and extend current equipment. Without a maintenance program, the department will have to expedite replacement when the budget recovers. Calling status quo difficult, the captain said, "the world keeps passing you by if you're standing still." On police morale, the captain said the chief has extended his "praise and gratitude for the job his officers do." Overall, in times of fiscal austerity the police chief's good will may help shore up the effects of demoralizing budget cuts.

FINDINGS

On the UNCW pilot survey, police departments routinely report 2 to 4 percent budget reductions and it was learned that the metro Carolina department expects a 5 percent budget reduction. Police budgets are expected to remain soft in the near future. Data from the survey shows almost all jurisdictions have faced a revenue decline. For example, ad valorem taxes in one jurisdiction had dropped 7 percent and unemployment has risen in many cities. Locale-specific reasons mentioned for declining revenues included a state capital's tax base that rarely expands because government buildings are tax exempt, the closing of an automobile factory, and government mismanagement of money. The economic fallout of a recession with shuttered workplaces, an eroding tax base, and lowered investment returns has now caused cities to reduce, sometimes severely, funding to police departments. Current expectations of dwindling resources for personnel and training programs plague police departments. Just as the earlier push to engage police in fighting terrorism changed their budgets, the Great Recession poses a great challenge to policing budgets.

CONCLUSION

Taken together, independent data collections by PERF and researchers at the UNCW, informal interviews with police administrators and content analysis of news articles substantiate a significant decline in the budgets of police departments across the country. What this research suggests is this budget shortfall will continue for years to come, and it will affect the structure of police departments. The PERF data finds that police administrators universally speak of operating with fewer personnel with increased duties and a lack of training. The evidence points to long-term consequences because the elimination of police services will ultimately reduce police effectiveness. There is a need for further studies on the influence of economic factors on police departments in cities facing prolonged recessionary times.

In September 2010, PERF gathered police administrators along with academics together at its Critical Issues in Policing summit. Looking toward a productive partnership with police departments, academic scholars focused on developing models for increased efficiency (PERF, 2010, p. 27). In part, this focus can assist police departments to improve strategies. Still shared goals between academics and police administrators are unlikely, given the interrelation of crime rates and strategies. Police using a CompStat model of crime reduction, where commanders are accountable for area crime rates, may not accept the suggestion put forward by academics to measure success by using other factors and not crime rates. Crime rate suppression through CompStat meetings and "hot spot" policing is widely accepted as the norm within policing today, and any change to that standard is subject to bureaucratic resistance (Rosenfeld, Fornango, & Baumer, 2005; Sherman, Gartin, & Buerger, 1989). Police administrators are focused on the budget battles with city managers and state legislatures in order to retain police officers and not lose control of crime. It might be surmised as police administrators find themselves under siege in a showdown with shrinking budgets they will be paying increasing attention to the "politics" of their budget sooner than new law enforcement models.

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