Subprime or subcrime? The criminal dimension of the financial crises: an astonishing denial of reality

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Subprime loans were the cause of the greatest financial and subsequently economic crisis since 1929. In the United States, for example, the social impact was immense with millions of households suffering repossessions, mass unemployment, the disappearance of savings invested in the stock market, and a jump in the poverty rate from 12.5% to 14.3% between 2007 and 2009.

Anesthetic explanations

It is therefore vital to consider the true origins of this tragedy: fundamentally, what does the term "subprime crisis" mean? All are keen to impose a happy narrative on the causes of the crisis through explanations which are either fatalistic (cycle theory), magical (a catastrophe, a cataclysm), or mollifying (market failures). Not to mention the reassuring reflections of Doctor Panglosses who claim that "*this crisis is a roughly psychological one*" (Alain Minc). These denial specialists are often those who were blind to the growing anomie in financial markets during the boom years (1980/2000). Having failed to anticipate the crisis (if they did not cause it), they have since been falling over themselves to conceal their deepest doubts, thus spelling the nearly universal collapse of academic and media expertise on both sides of the Atlantic.

However, there is another possible diagnosis that reveals the true nature of Wall Street and a new balance of power in the United States, and more broadly the increasing autonomy of players on the globalized financial market. In order to understand the hidden roots of this crisis, we need to think outside the box imposed by propriety. The subprime crisis was a systemic fraud.1 More than just a metaphor, a criminological approach reveals the existence of a series of genuine frauds which, rather than simply being accidents, were in fact symptoms of a system that had become anomic. Ultimately, American finance has become a vast crime scene. Few financial crises have had such a clear criminal dimension or critical mass of frauds.2 As always, published opinion—belonging to the elite with access to the media—is in a hurry to demonize any such troubling viewpoints by resorting to easy fear-mongering: Conspiracy theories, scapegoats, distractions, populism. Using crime to explain a macroeconomic phenomenon may seem derisory, anecdotal, even naïve. However, it is vital for anyone wishing to explore the roots of a crisis caused by human actions alone. A criminological reading can pull back the thick veil concealing institutional, extremely lucrative tartuffery. A crime-based approach also has the advantage of bringing the economy back

1. For details of this thesis, with accompanying bibliography, please refer to our book: Jean-François Gayraud, *La grande fraude: Crime, subprimes et crises financiers* (Odile Jacob, 2011). Also: Jean-François Gayraud, "Subprimes: Crise innommable, donc incurable. Ou comment récompenser les fraudeurs," in *La finance pousse-au-crime*, ed. Xavier Raufer (Choiseul, 2011).
2. On the history of financial crises and their fraudulent dimension: Charles K. Kindleberger and Robert Aliber. *Manias, Panics, and Crashes: A History of Financial Crisis* (John Wiley & Sons, 2005). On the role of fraud in periods of boom: Robert J. Shiller, *Irrational Exuberance* (Doubleday, 2005).

to the real world and its "animal instincts" (J.M. Keynes),3 far from the abstractions and abuses of mathematical modeling.4

Despite today's constant references to the Great Depression, no-one seems to remember the United States Congress's "Pecora Commission"5 whose hearings (1932–1934) revealed massive financial malpractice by establishment "robber barons" to an indignant public. President Franklin D. Roosevelt made skilful use of this widespread indignation to push through his major reform laws. The lesson of the senate hearings and the reforms enacted is clear: unregulated markets will inevitably descend into speculative and fraudulent excesses.

Dogmatic and criminogenic market deregulation

From the 1980s onwards, oversight and blindness began to take over.6 America, followed by parts of the rest of the world, began a dogmatic deregulation of its markets with criminogenic consequences. Criminogenic in the strict meaning of the term: new opportunities and impetuses for fraud were made available to the least scrupulous economic and financial players. For the subprime crisis has a history—it was not an accident, nor an isolated event. In fact, it is simply the most recent in a long list of criminal failures and crises spreading across a generation: the collapse of savings and loan associations,7 then of numerous multinational companies including the giant Enron, representing the epitome of the "rogue stage of financialized capitalism". However, when the financial and real estate bubble linked to subprime lending burst, the standard explanations immediately returned (economic cycles, greed, etc.). Economists attempted to use well-oiled but short-sighted concepts (market asymmetry, moral hazard, defaulting loans, etc.) to explain circumstances which they had previously failed to foresee. This was done with a certain level of discomfort, however, as economic science not only failed to predict the subprime crisis but also partly helped to trigger it by promoting an unreal vision of supposedly efficient and self-regulating (and thus infallible) markets.8 This crisis can be traced back to clear ideological roots. However, the "invisible hand of the market" is only a representation; moreover a quasi-religious one, with questionable scientific merit; by contrast, the "invisible hand of crime" working on unmonitored markets is always proven. Deregulation born of public policies thus initiated a cycle of criminal finance punctuated by fraudulent financial crises and collapses.

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3. George A. Akerlof and Robert J. Shiller. *Animal Spirits: How Human Psychology Drives the Economy, and Why it Matters for Global Capitalism* (Princeton University Press, 2009).
4. Excessive modeling has clearly resulted in excessive simplification and specialization. This is known as scientism.
5. Michael Perino. *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance* (Penguin Books, 2010).
6. On this concept of blindness:Xavier Raufer. *Les nouveaux dangers planétaires*. Coll. Biblis. CNRS éditions, 2012. Also:Jean-François Gayraud and François Thual. *Géostratégie du crime* (Odile Jacob, 2012).
7. Gayraud. *La grande fraude*. Also general literature on the subject: William K. Black, *The Best Way to Rob a Bank is to Own One* (University of Texas Press, 2005).
8. The ultra-liberal doxa has successfully attached itself to the edges of science, and thus gained an important legitimacy, thanks to multiple Nobel prizes during the 1970s and 1990s. On this ideology and its role in the economic and financial history of the United States: John Cassidy. *How Markets Fail: The Logic of Economic Calamities*. Farrar, Straus and Giroux, 2010. Also:James K. Galbraith, *The Predator State: How Conservatives Abandoned the Free Market and Why Liberals Should Too* (*L'Etat prédateur: Comment la droite a renoncé au marché libre et pourquoi la gauche devrait en faire autant*. Seuil, 2009).

From traditional fraud to innovative fraud

In order to understand some of the hidden roots of this crisis, we need to think outside the box of the common patterns prescribed by the mediasphere. So what do we find? Series of genuine (systematic) frauds have polluted every single real estate and financial market (the system), helping to create speculative bubbles. Something out of the ordinary emerges: "Crime scenes" on a macroeconomic scale which enable this to be reclassified as a "subcrime" crisis. The long and opaque financial chain of subprime loans evolved into a "food chain" attracting multiple predators, with almost no obstacles in their way thanks to deregulation. There are two possible approaches to describing this systemic criminal predation.

An initial analytical approach on both a macrocriminological and a macroeconomic level demonstrates how the entire American financial system was reorganized following the collapse of savings and loan associations to prompt a massive transfer of wealth from the poorest to the richest in American society, at a time when a lack of desire to distribute purchasing power to those on the lowest incomes (income and salary stagnation) meant that they were sold an illusion of enrichment through an ill-considered and cynical development of debt. Deregulation was a concomitant of greater inequality at a level not seen since the nineteenth century, temporarily hidden by those in power by encouraging debt, off-balance-sheet activities, and securitization. However, is it possible to handcuff cynical public policies, or dreams ("a house for all") which have transformed into nightmares?

A second approach, this time on a microcriminological and microeconomic level, seems even more relevant to our demonstration. The apparent complexity of the system thus barely conceals two major frauds. First of all, we discover a more traditional and unpolished fraud consisting of encouraging modest and vulnerable households (which are in theory not solvent or barely solvent) to take out loans which will inevitably choke them. The nicknames given to these loans perfectly sum up their true nature: they are known as "liar" or "predatory" loans. They explicitly target the weakest members of American society: ethnic minorities—in particular blacks and Hispanics—as well as the poor, the handicapped, and senior citizens. These fungible categories, for example poor and black senior citizens, are urged to take on more debt than they are able to repay, intentionally deceived by cynical professionals. Even worse, these loans are described as "neutron loans", which (like the eponymous bomb) kill the people and leave the houses. In fact, these subprime/liar/predatory loans are "ghost" loans—also known as NINJA loans as they intentionally target households with no income, no job, and no assets. These explicit qualifiers describing the true nature of these loans were not invented a posteriori by sensationalist commentators, but instead were used right from the outset by financial professionals themselves. The terms thus reveal their guilty intentions and consequently make a mockery of any attempts to claim ignorance or incompetence. All of these loans are concentrations of plainly criminal acts: breach of trust, fraud, abuse of weakness, forgery, etc.9

A posteriori evaluation of these subprime loans is overwhelming. At least three-quarters of all cases involved an element of deceit! Mortgage lenders and their lobbyists, the mortgage brokers, are in practice two professions with little regulation where monitoring and controls are slack. Mortgage lenders are also a central element of what is

9. For a more detailed description of the landscape, far from economic theory, and of the formation of this fraudulent real-estate bubble: Richard Bitner. *Confessions of a Subprime Lender: An Insider' Stale of Greed, Fraud, and Ignorance* (John Wiley & Sons, 2008).

known as "shadow banking". Therefore, in the absence of any real regulation, bad (dishonest) professionals gradually replaced the good (honest) ones and bad practices superseded good ones, like a new Gresham's law on a major scale.

Secondly, we now have an innovative and globalized fraud, modern in a manner of speaking, consisting of dispersing these questionable loans by removing them from the balance sheets of financial institutions. This time, the victims were not average Americans but international investors. The fraudulent real-estate bubble was followed by an equally large financial bubble. Subprime/predatory loans were transformed into financial securities: securitized. Mortgage lenders understood that securitizing high-risk loans left them as sure-fire winners. They ceded legal and financial responsibility for these loans with a high likelihood of default (due to their fraudulent nature), and also immediately cashed in the liquid assets. The securitization process thus encouraged them to pursue loan policies, which were not qualitative (prudential) but rather quantitative (always more), even as far as fraud. Risk taking was at a maximum, as the income earned by these professionals was index-linked to the volume of loans. The technique of securitization had been praised by dogmatic liberals and monetarists (such as Alan Greenspan) as a factor in spreading risk. Instead, it was an instrument infecting the entire financial chain. Questionable loans were regrouped—and in fact hidden—in debt packages (automobile loans, student loans, etc.), with the bad apples (subprime/predatory loans) contaminating the rest of the basket. With these "innovative new financial products" (CDOs etc.), the sorcerer's apprentices of Wall Street believed that they could suddenly turn lead (bad debts) into gold (sustainable profits). These alchemists of innovative finance imagined that they were defying the laws of financial gravity and common sense, blinded by euphoria and profits, making themselves believe that "this time it's different".10

These new financial products, toxic in nature due to being crippled by subprime loans, contaminated the entire American and subsequently global financial system, producing a chaotic butterfly effect: small fraudulent causes, large macroeconomic consequences. At this stage, deceit was being skillfully spearheaded by those responsible for ensuring *de facto* regulation of the financial markets: The three main rating agencies, one of which is French (Fitch),11 and the major investment banks (Goldman Sachs, Lehman Brothers, etc.).

The record of the rating agencies is a painful one.12 The 9/10 ratings given to securitized products would prove to be erroneous. Such incompetence is stunning. These massive errors can surely be explained by the fact that the loan files they received were booby-trapped with fudged figures by mortgage lenders, mortgage brokers, and sometimes even households themselves. However, ratings with this level of fantasy can also be traced back to the two "conflicts of interest" governing these agencies' economic model. First of all, the agencies are paid by the issuers of securities (issuer-pay principle),

10. Carmen M. Reinhart and Kenneth S. Rogoff. *Cette fois, c'est différent: Huit siècles de folie financière.* Pearson, 2010. The phrase "this time it's different" (*cette fois, c'est different*) is simply a manifestation of the blindness we have already touched upon.

11. The French press has always been very reticent regarding this rating agency's role in the crisis, most likely because it belongs to the FIMLAC group which is owned by French capitalism baron Marc Ladreit de Lacharrière.

12. Rating agencies are structurally short-sighted. They failed to anticipate the financial crises of Latin America in the 1980s, the collapse of the American savings and loan associations and the giant Enron, the Greek sovereign debt sinkhole, etc. In fact, they tend to give yesterday's forecast or announce catastrophes which are then triggered by their pronouncements (self-fulfilling prophecies).

a fact which does not encourage critical thinking and foresight, particularly with the ratings market becoming increasingly lucrative: who would bite the hand that feeds them so well? Secondly, agencies are involved in the upstream structuring of innovative financial products, in theory in different departments (the Chinese wall principle): Is it conceivable that a restaurant guide could offer impartial evaluations of restaurants it owned?

As for the large Wall Street investment banks, their fraudulent record is equally substantial. They tried to present themselves as the victims once the crisis emerged, forgetting that they were in fact working at the upstream end of the financial chain. These merchant banks were the financers and sometimes even the owners of dishonest mortgage lenders. Right from the outset, therefore, they were the financers and dealers of the highly addictive drug that subprime loans and "innovative financial products" became. Furthermore, the Wall Street merchant banks also directly indulged in multiple forms of malpractice. Massaging their accounts to hide losses linked to subprime loans, failing to advise investors on the level of risk associated with securitized products, betting that the securities offered to their clients would fall, manipulating the interbank lending rates (Libor, Eurobor), etc. Ultimately, bankers and rating agencies colluded to deceive purchasers/investors regarding the actual quality of "innovative financial products". Despite such a high level of malpractice which became so glaring after 2007/2008, fraudulent activities continued after the outbreak of the crisis, this time as part of "loan renegotiation/alteration" operations and foreclosures (foreclosure-gate).

White-collar organized crime

Let there be no doubt regarding the criminological species in question here. While "traditional gangsters" (organized crime) were able to benefit from the windfall, the architects and main beneficiaries of these frauds were primarily members of the respectable elite installed in high and select society. Moreover, was it not an American sociologist, Edwin H. Sutherland, who invented the concept of "white-collar crime" in the 1930s?13 However, this concept seems to have been rather surpassed in the present day. In effect, on close examination the white-collar fraudsters of globalized finance reveal planning and association. We also ask ourselves why the organizational and managerial powers retained a monopoly of the traditional gangsters (organized crime)? What has been (newly) unveiled by the subprime crisis is the emergence of an unfamiliar "white-collar organized crime/criminality".14

However, the record of criminal convictions is disappointing, to the point of being pathetic. In the face of so much fraud, the American courts proved unable to react in credible fashion. They punished only the dishonest borrowers (speculating households, opportunistic gangsters) but no financial professionals—with the sole exception of one low-level banker. However, 80% of fraud is attributable to them. Why this impunity? First of all, the production of evidence is always a delicate operation for crimes which are invisible, complex, and committed by intelligent individuals embedded deep in a system which they helped to create. Secondly, in accordance with a stubborn tradition, the justice system and federal regulation agencies often prefer to "wipe the slate clean" with agreements negotiated on a penal or civil level (plea bargaining, settlement). The rating agencies escaped the long arm of the law by taking refuge behind the First Amendment to

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13. Edwin H. Sutherland. *White Collar Crime: The Uncut Version* (Yale University Press, 1983). Also, an earlier book on the criminality of the elite written in 1907 by an American sociologist: Edward Alsworth Ross. *Sin and Society: An Analysis of Latter-day Iniquity* (Bibliolife, 1907).
14. We suggested this new approach in Gayraud, *La grande fraude*.

the United States Constitution guaranteeing freedom of expression. The agencies were granted the status of press agencies, rather than financial institutions: offering opinions rather than providing ratings.

As has become clear, the American federal system never wanted credible means to deal with waves of white-collar crime on a macroeconomic level. Admittedly, the diversion effect produced by the "war on terrorism" prevented the American police and justice system from focusing on the criminals of the upperworld. The American police and justice system found themselves swamped by a wave of crimes, too numerous and too opaque, while their manpower was dedicated to tracking down Al-Qaeda as the hypothetical priority.

The tragicomedy that has been played out on Wall Street for the past 30 years remains the same: Rogue bankers (banksters) pay lip service to confessing their sins, pay a fine, promise not to do it again, then reoffend a few years later. What conclusion can be drawn from this? That impunity serves to encourage repeated offences, both for bank robbers and a for rogue bankers/financiers. In accordance with the doctrine of "too big to fail" (financial systems) which has prompted the American federal authorities to save questionable and interconnected financial institutions, the failure to punish thus highlights the new reality of "too big to prosecute, too big to jail" (financial fraud): Too big to prosecute/jail, and consequently both intimidating and extortionate.

Frauds on financial markets are a matter of breathtaking routine, accidentally revealed in isolated incidents of rare legal cases or systemic crises. It is a kind of normalization of deviance and crime. This crisis comes from "on high", just like those which were once so commonplace in the Third World and were viewed with such condescension by the West. Published in 2011, the United States Congress's two voluminous reports on the financial crisis (hearings held by the Financial Crisis inquiry Commission, or FCIC15; and work undertaken by Senator Carl Levin) returned a bleak picture of Wall Street and left no doubt regarding the criminal dimension of this crisis. Frauds appear to be the common thread explaining the origin of the subprime crisis.

"Madoffified" finance, a trapped system…

The massive fraud (60 billion dollars?) perpetrated by Bernard Madoff—incidentally revealed as a result of the subprime crisis, like collateral damage—was not an aberration but rather the symptom of an American finance and economy system in general that had become pyramid-shaped, as if "Madoffified". Bernard Madoff simply performed on his own personal (microeconomic) scale what America had allowed to happen on a large (macroeconomic) scale for a generation: a pyramid of private debts reeking of fraud. The same context of blind deregulation incentivizing fraud produced both the subprime crisis and the Madoff affair; moreover, numerous other fraudulent pyramids subsequently emerged when the guardians of the temple (financial market authorities, etc.) finally awoke.

The real question behind this crisis, however, is a political rather than strictly legal one. Where do such destructive and criminal laws of deregulation come from? Since the 1980s, the powerful Wall Street finance lobby has been able to literally and legally trap—in fact purchase—a large part of the American political class, followed by Washington's institutions.16 The now astronomical costs of electoral campaigns mean that the

15. *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Public Affairs, 2011).

16. Galbraith, *The Predator State*, Op. cit. Also: Simon Johnson and James Kwak. *13 Bankers: The Wall Street takeover and the Next Financial Meltdown* (Pantheon Books, 2010).

American political system puts elected representatives with more money at a significant advantage. Concerned about its privileges, the powerful finance lobby only supports Democrat and Republican candidates who have been won over to their deregulation cause. These laws are thus sold to a financial oligarchy. We therefore see a transfer of power from Wall Street to Washington—and this geopolitical swing is facilitated by the questionable practice of "revolving doors" between the financial industry and the upper echelons of federal administration. This practice creates infinite "conflicts of interests" conducive to real instances of corruption, or at the very least to an osmosis of interests and points of view between financiers and political/administrative decision makers. This broadly criminal crisis brings up to date the new balance of powers in the United States between politics (Washington) and finance (Wall Street); is the "military-industrial complex" denounced by President Eisenhower (1961) being followed by a surreptitiously imposed "political-financial complex"?17 Moreover, this is most likely a new balance of power common to numerous countries across the world. The finance lobby is not content to limit itself to part of the American political class. It has successfully attached itself to academics,18 financial analysts, and finally journalists trapped by the complexity of the subject matter and the majority of media's membership of major capitalist groups. Fraud has thus managed to disappear from mainstream analysis. Is that not precisely the perfect crime—one where reality is ignored, or better still where the idea itself seems inconceivable?

A predatory system remains intact

The predatory system behind this social disaster has remained intact, even following the Dodd-Frank financial regulation law passed in the summer of 2010. Despite its bulk, this law has proven to be a paper tiger whose rare binding standards for American finance were steamrolled by the finance lobby during the legislation editing process. It is a far cry from the New Deal laws which successfully stood up to the financial powers.

Ironically, or in a barely concealed logic of the system, the institutions and individuals most responsible for this criminal disaster have themselves emerged from the crisis stronger than ever. What, then, should we think of a system which ultimately rewards the fraudsters so well? This is a troubling status quo, since this criminal diagnosis was made by Americans themselves through Congress's Inquiry Commissions. This was clearly insufficient, suggesting that the "power of the word" (executive, legislative, and media power) no longer carries any weight in the face of the "power of the real" (money). Like the genie of the lamp, the players in globalized finance have broken free with no-one now able or willing to discipline them.

17. In 1956 American sociologist Charles Wright published *The power elite* which describes the new American ruling elite, whose main characteristic is their capacity to circulate between three echelons of power: The economy, politics, and the military. He denounces an immoral and concentrated elite able to rely on "celebrities", the product of mass media, and on "intellectual tightrope walkers". Nothing has really changed since then—at most, the addition of finance to the triangle of power.

18. On the complicity of certain academics, well paid by the financial industry, and the conflicts of interest affecting them, the 2010 documentary *Inside jobs* written, produced, and directed by Charles H. Ferguson is currently the best reference. The real issue is in fact to establish cause and consequence. Are they chosen because they profess "good" ideas a priori, or do they accommodate them a posteriori because they have agreed to endorse positions which are favorable to the financial industry?

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