

Review of: **The War Against the S & L Control Frauds**
by **William K. Black**

Review by: **George A. Akerlof**
Koshland Professor of Economics, University of California at Berkeley

William Black has written a very important book. As the preface makes more than clear, economists failed to understand the nature of the S & L crisis of the 1980's, both at the time of the crisis and also even in its aftermath. This failure was then repeated in a different context in the corporate frauds and excesses of the 1990's, as economists both failed to predict the scandals that occurred and then for the most part had an episodic interpretation of those scandals when they were unraveled. The concept that Black introduces in this book, of "Control Frauds," gets the S & L scandal right. At the same time it also gets much of the corporate excesses of the 1990's right. It does so by introducing a concept that is all but new to economics (the lone exceptions being work with which Black himself has been very closely involved and for which he has not received due credit and some recent work by Andrei Shleifer at Harvard and his team of co-authors.)

The theory of control fraud is quite simple. In traditional economic theory the fiduciaries responsible for corporate operations follow the rules; they seek to maximize corporate profits (or sometimes their own satisfactions subject to the legal rules that their firms should remain financially healthy.) At the very worst they may gamble against going broke by choosing an asset structure that is too risky. What no economist outside Black's orbit ever conceived until fairly recently is that those in control could completely forsake their fiduciary responsibilities, and seek to squirrel out of their institutions as much funds as possible into their own pockets in violation of their oversight responsibilities. It's as if the trustees of a valuable golf club should sell the premises to a partner at a considerable discount, while the partner then sells them options in his construction company very much below par (no pun intended). Black then offers us a magnificent portrait of the dark-side underworld of capitalism.

I, and quite recently Shleifer and company, who I shall mention below, are convinced that this dark side, which prevents the emergence of efficient corporate governance in the absence of effective regulatory institutions, is one of the leading factors in keeping much of humanity in great economic misery. We would view the small fraction of those in Western OECD countries as unusually lucky, because the type of financial fraud that is the subject of Black's book has driven out legitimate corporate enterprise. Thus Black's book will not only garner readers interested in a significant event in US financial history, but it is of great scholarly interest to a whole swath of economists and political scientists as well.

It is an achievement to conjure up such a negative vision as a theoretical possibility. What additionally makes this such a spectacular book, which should make the University of Texas Press justly proud when this book is published, is that Black not only offers this new vision of institutions with fiduciary control, but he also shows the reality of it in the S & L Crisis of the 1980's, where regulatory ineptitude (encouraged by political ambition, greed and naivete) created perhaps the world's best laboratory for "control fraud." This experiment occurred and,

unfortunately, most of those who were watching, especially those with economics backgrounds, were unaware of what they were seeing. It was outside of their theoretical vision. Black (and also some lawyers with which he was closely associated) were among the few who understood what was going on. Black held important positions at the time in the supervision of S & L's, and from very early on he understood what was occurring. Those who were looting the S & L's wanted to throw as thick a smokescreen as possible over their operations so the general public, and also reporters, regulators, politicians, and economists, could not nose into their business and infer exactly what they were doing. Thus to understand the business that Black pictures here requires access to data that those who generate it wish to remain as private as possible. To unravel what is happening requires both access to that data and also the skills of a rare sleuth with the skills to unravel financial fraud. Black has both the skills and the data, so this book is unique.

Black's book has several specific advantages over all previous books on the S & L Crisis. Some of those books have gotten some of the argument; many of them may have gotten the details right, but most, including the Pulitzer Prize winning *Den of Thieves* also, remarkably, completely missed the general argument. Black is the only person to fully understand the argument and also to get the details right. In addition he alone is able to integrate the important interactions between the operators of the S & L's and their regulators, between the regulators and the politicians, and between the S & L managers and the politicians who are, unwittingly, being bought off. No other account gives a complete picture of the control fraud that occurred in the S & L Crisis.

A significant part of this book is told as a personal account. A few years after his graduation from the University of Michigan Law school, Black became the director of litigation of the Federal Home Loan Bank Board. Immediately he became responsible for the litigation of the S&L scandal which was then just beginning to unfold. Black was probably the first person to understand what was going on in the S&L scandals, in which there was a nexus between S&L owners who were looting their institutions, while paying large sums to campaign funds of Congresspeople who were then protecting the S&L owners. There is no one else in the whole world who understands so well exactly how these lootings occurred in all their details and how the changes in government regulations and in statutes in the early 1980s caused this spate of looting.

Black realized in 1984 what *no* economist understood until very much later: that money could be extracted from S&Ls not by legal means of excessive gambling on risk, but rather by illegal, but almost un-prosecutable means, by accounting fraud, and sweetheart deals with the expectation on the part of the owners that the S&L would go bankrupt later. The owners would take the money and run. Once this basic mechanism is understood it unlocks the secrets of the financial wizardry of the 1980s -- not only the S&L crisis, but also the building boom and busts, and the takeovers financed with the help of S&Ls by Michael Milken.

To an economist, Chapter Two is especially powerful because it gives the details as to how the S & L frauds actually occurred. What were the detailed regulations that were exploited in this crisis. This chapter, shows exactly how it would be profitable to take over an S & L and run it into the ground, which shows how this was done in the 1980's. What is so magnificent

about his book is that he gets the *exact details* right. What is so interesting about this chapter is that it shows how items that would pass by almost anyone as unimportant, such as the exact provisions for goodwill accounting, could play a key role in generating opportunities for the massive defrauding of the US public. To my mind this is the key chapter of the book and especially the immensely insightful account of how with goodwill accounting the worse the financial position of an S & L the greater would be its profits. Any purchaser who has only gone through Chapter 2 will have recouped many times over her investment in time and money. The book is worth it for that alone. But then the subsequent chapters show further how the opportunities for fraud that are described in Chapter 2 are grasped and exploited by the avaricious, and how they systematically bend the regulators and the politicians, largely through lack of understanding, to their will. They show how the theoretical possibilities pictured in Chapter 2, came alive in the real world in the 1980's, in the interaction between opportunity and those who make use of it, all to end up in a cumulative tragedy built on misunderstanding and avarice. It is a good tale.

In sum then, this is an extraordinary book. It is a real opportunity for the University of Texas Press to publish an important book, that will make a great scholarly contribution and also be popular with a more general audience, as well. This book will be a classic.

Let me also make some more detailed recommendations to the author regarding potential revision.

The book is written in a style that makes it accessible to the general public. To my mind that is a useful goal. But in general I consider this to be far too important a book for that to be in any way a priority. I personally would have preferred a more lawyerly style that would also be closer to Black's standard mode of exposition. I would recommend an edit of the book so that it reads more like a legal brief, or better yet conforms more to standard journalism, where the facts are supposed to speak for themselves. There should be no problem to accomplishing that since every paragraph here is based on well documented fact, and also Black's background as a lawyer makes this his natural style. The author should especially avoid sentences that seem to convey his own opinions, such as, "Wall was petrified of Keating's power." He should only allow himself that luxury on the rare occasion and only after having laid the factual basis of the argument. I do not think that such revision will entail more than superficial rewriting of the manuscript, where the argument is already carefully mapped out. A rewrite, more with the stricture of the journalist that the facts speak for themselves, should do the trick, easily.

The elimination of sentences where the author is editorializing will also eliminate another problem in the manuscript. The manuscript is especially clumsy where the author himself plays a part of the action. Here especially it will be important for the author to avoid drawing conclusions for the reader. The preface is particularly salient on this point. In the very beginning the author sets a tone that he is the good guy and the others are the bad guys. I think that a better tone would be that those who were in error, among those who were not taking money out of the pot, made honest mistakes. That is consistent with the purpose of the book, which is to add to our social science knowledge about why such events do systematically occur so that those like Alan Greenspan, who is a very dedicated civil servant, whatever errors he may have made, will have reason to be more alert in the face of Charles Keating.

The book should also be more careful in annotating all its sources, and also in citing the recent economics literature on the subject of tunneling by Andrei Shleifer. There is a particularly excellent article in the *Quarterly Journal of Economics* by La Porta, Florencio de Silanes, and a third co-author on the subject of the insider interests in Mexican banks by methods similar to those described in this paper. I believe that more careful sourcing goes hand in hand with elimination of editorializing since what the source says is fact, which speaks for itself.

These problems, however, and suggested revisions, while requiring time and care, are only necessary to turn a very, very good manuscript, into an utterly superb volume, which will be the basis of the field of "control fraud." To repeat, I expect this book to be a classic, which year by year will increasingly be seen to describe the fundamental problem involved in financial regulation, with a tremendously interesting case study of where almost everything went awry. I do not think that I could write a stronger recommendation for publication for any manuscript.

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Dear Professor Wilson,

This is in reply to the request that I serve as referee for the review of William Black for advancement to Associate Professor in the LBJ School of Public Affairs. Black is an unusually fine scholar, with interesting, important and original ideas. His promotion should be automatic. He defines what an excellent academic should be.

To begin, I think I should state the obvious, which is that Black is different. John Kenneth Galbraith once wrote a novel whose protagonist was an economist at a prestigious university and whose career had mainly been the study of the refrigeration industry. Galbraith's point, beyond the amusement of his readers, was that this was the typical academic, perhaps even at Harvard, and that academics should be different. They should be like Bill Black.

Black's scholarly writings are highly unconventional and they are as important as they are unconventional. His core contribution to date has emerged from his study of the Savings and Loan Crisis of the 1980's (extending into the 1990's). He himself was a lawyer holding a variety of high level positions in the regulation and supervision of Savings and Loans from 1984 to 1994. Thus there is some confluence between what happened in the S & L crisis and his own personal circumstances. But the story told by Black goes far beyond his own personal experiences. He is the first person to truly understand both *in detail and in theory* exactly how that crisis occurred. That story has been told in a large number of books. Some of those books have gotten some of the argument; many of them, including James Stewart's Pulitzer Prize winning *Den of Thieves* may have gotten the details right, but failed to get the basic argument entirely. Black is the only person to fully understand the argument and also to get the details right.

A few years ago after his graduation from the University of Michigan Law school, Bill became the director of litigation of the Federal Home Loan Bank Board. Immediately he became responsible for the litigation of the S&L scandal which was then just beginning to unfold. Bill was probably the first person to understand what was going on in the S&L scandals, in which there was a nexus between S&L owners who were looting their institutions, while paying large sums to campaign funds of Congresspeople who were then protecting the S&L owners. There is no one else in the whole world who understands so well exactly how these lootings occurred in all their details and how the changes in government regulations and in statutes in the early 1980s caused this spate of looting.

Black realized in 1984 what *no* economist understood until very much later: that money could be extracted from S&Ls not by legal means of excessive gambling on risk, but rather by illegal, but almost un-prosecutable means, by accounting fraud, and sweetheart deals with the expectation on the part of the owners that the S&L would go bankrupt later. The owners would take the money and run. Once this basic mechanism is understood it unlocks the secrets of the financial wizardry of the 1980s -- not only the S&L crisis, but also the building boom and busts, and the takeovers financed with the help of S&Ls by Michael Milken.

It is difficult to know how much of this correct analysis of the Savings and Loan Crisis originally came from Black since much of that understanding must have come from those who, along with Black (as the most distinguished) were also attempting to regulate the S & L's at the time. His central role in this effort is indicated by his acting as keystone in the report of the National Commission on Financial Institution Reform, Recovery and Enforcement, of which he was Deputy Director. This commission turned out a very impressive report. I know that this was one of those cases where the "staff", in this case Black, played the major role in the writing and the research for the report so that the credit for this magnificent piece of work should go almost entirely to him. This report shows, as does the bulk of Black's subsequent writings, how owners of S & L's managed to run their companies into the ground while taking money out in various ways that were sufficiently close to the law that their depredations could occur for some period of time under the eye of the supervisory agencies (whose hands were also tied for a variety of legal and political reasons). He (perhaps with some help from James Pierce, who was the chair of the National Commission) documented this extraordinarily well in the report.

You will see this analysis reproduced in Bill's recent manuscript: *The War against the S & L Frauds*. I especially commend to you Chapter Two of this manuscript. That chapter, shows exactly how it would be profitable to take over an S & L and run it into the ground, which shows how this was done in the 1980's. What is so magnificent about his book, which characterizes Bill's work more generally, is that he gets the *exact details* right. This is especially important in his chosen area of white collar crime (and "control frauds" in particular) because control frauds typically take advantage of loopholes in the law where the public, the legislators, and often even the regulatory authorities do not see them. The S & L crisis is a special case where a variety of regulations that might have seemed to have been possibly ill-advised resulted in an industry turned out much worse than that: not just ill-advised, but disastrous. The book is also good

because, unlike what an economist would write, or a political scientist, Bill tells all sides of the story. He has told the economics of how the S & L's got away with it, but he also tells the story from the point of view of the supervisory agencies and from the point of view of legislators, why others were so blind as to let them get away with it. We see parts of his analysis not only in the manuscript, but also in a variety of his papers: "The Dog that Didn't Bark," "Control Fraud as an Explanation for White-Collar Crime Waves," and "White Collar Crime and Corporate Crime: Control Fraud and Control Freaks."

I first came to know Bill at the time that he was working for the Commission because Paul Romer and I were writing a paper with a similar point of view. This paper was published with a great deal of help from Bill as "Looting: The Economic Underworld of Bankruptcy for Profit," in *Brookings Papers on Economic Activity*. Bill gave us so much help on that paper, and had such a detailed knowledge of the facts and "how it was done" (the looting of the S & L's) that it is unfair not to think of him as a co-author. What we present in the paper is the theory as to how such "looting" *could* happen; Bill, in addition, corrected all of our facts and mis-statements because he knew how it actually *did* happen. That made a great difference in turning our paper from a theoretical speculation into a description of reality. Bill was extraordinarily generous with his time and his intellect. Underlying this contribution was especially his influential published paper on the accounting of goodwill of S&Ls (which also underlies the most interesting part of a key paper by Richard Breeden on the same subject) and also the staff reports written and documented by him to the National Commission on Financial Institutions, Reform, Recovery and Enforcement. These long staff papers are undoubtedly the best things written on the peculiar behavior of U.S. financial markets in the 1980s. They explain in detail what happened and why it happened.

Bill has now developed terminology and theory to describe more generally the type of fraud that occurred in the S & L Crisis and that, for want of taking notice of the type of abuse in those frauds, repeated themselves in the 1990's, especially in the case of Enron. His analysis of the Enron Case is so far the best that I have seen so far. He again understands the detailed operation and also why the disaster occurred as it did, as explained in "Beware of the Geeks Bearing Gifts." I understand that he is currently at work, as I would have predicted, on a book on the second Control Fraud Crisis, of the 1990's. I expect that work to be as insightful as the work that has gone so far. The "Geeks" article is a demonstration that Black has insights into the scandals of the 1990's that are highly unique. He gets right, what other analysis has so far treated more superficially.

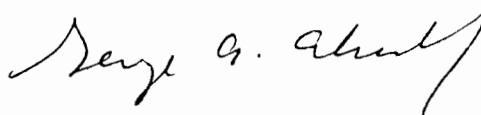
Other writings by Black show his general intelligence. For example, the first few pages of "Why the Non-Heathens Rage?" gives a very subtle (and to my view, correct) analysis of British and American history and the role of the law in empowering some people, but also dis-empowering others. The "Dango Tango" gives an insightful view of the nexus between corruption and construction investment in Japan, although here the argument is mainly leading because, understandably, he does not have the access to the detail that has made his analysis of Enron and the earlier S & L scandals so very rich.

Let me now try to place Black's contribution relative to the contemporary literature. Indeed, he is working in a very different and original way on a topic that is now at the forefront of economic research. Following the lead of Andrei Shleifer at Harvard (winner of the John Bates Clark Medal in economics) a number of authors including Florencio de Silanes of Yale and Robert Vishny of Chicago are researching the effects of legal systems (including the possibilities for what Black calls "Control Fraud.") The interest of this group in this topic comes from their assessment that abuse of legal systems plays a leading role in economic development. (I concur with their assessment). I would say that the relation between the work by Shleifer *et al.* and Black's work is the relation between Watson and Crick, on the one hand, and Rosalind Franklin, on the other. The economists have the theories of how such schemes *could* operate. They may even make statistical studies of this. But Bill's work supplies the facts. He goes out and collects the detailed observations of how the frauds operate. From that he constructs the theory. The two types of work are interactive. From the point of view of where he fits into social science as a whole that means that his work is comparable to that of leading professors, at Harvard (Shleifer), Yale (de Silanes) and Chicago (Vishny). With this comparison in mind there should be no question that Black's tenure should be automatic: he is a pioneer in a field that is of fundamental importance, not just for the United States economy, but also in explaining why some economies grow and others stagnate.

You ask whether Black would receive tenure at Berkeley. The answer is that I would very much expect that Black would receive tenure at the Goldman School of Public Policy. We have a special pride in promoting those scholars who are highly original and who are doing work of first rank importance. I know that if I personally were on the *ad hoc* committee I would not only vote for his promotion, but I would take an active role in trying to convince any dissenters to vote likewise. I would expect the other members of the *ad hoc* committee to behave in the same way, because his work is exceptional.

In sum then I do not have any doubts that this is the strongest possible case for promotion. Bill Black is what an academic should be. He is doing work that is highly original. It is also of the greatest importance. I do not know how any one could ask for more.

Sincerely yours,



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Nobel Laureate, 2001



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August 26, 2003

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Dear Professor Wilson:

I first met William Black in 1992 in my capacity as Executive Director for the National Commission on Financial Institution Reform, Recovery and Enforcement (NCFIRRE), a commission appointed to investigate the origins, causes, and solutions of the savings and loan debacle of the 1980s. The Federal Home Loan Bank of San Francisco, Black's employer at the time, graciously agreed to release him to work as my deputy. That rather lofty title did not connote any administrative authority but rather recognition of his expertise in S&L matters. Bill's insider's knowledge and first-hand experience made him a valuable resource. At that time Black displayed a sharp mind and an encyclopedic knowledge of S&L matters, but he lacked intellectual discipline and scholarly detachment. We have had little contact since, so when you asked me to evaluate his scholarly contributions, I was looking forward to reading the new, trained Bill Black equipped with Ph.D. and academic appointment. After reading all the material, I regretfully conclude that he still lacks discipline and scholarly detachment. In the eleven papers and one manuscript there is plenty of reminiscing, opinion, polemics and assertion, but little scholarship. Black's research record would not gain him tenure at Berkeley and does not merit tenure at any serious public policy school.

One way or another, virtually all of Black's work involves the role of fraud during the S&L debacle. It will expedite matters for me to review briefly some crucial issues and to debunk some strong assertions Black makes concerning the views of economists and those in law and economics concerning the role of fraud and abusive practices. During the 1960s and 70's, S&Ls experienced increasing interest rate risk. When interest rates soared to unprecedented levels 1979-82, S&L liability costs rose far above the return from their fixed-rate mortgages; much of the industry became bankrupt. The government responded by allowing insolvent institutions to continue operation while virtually

eliminating regulation and supervision. Net worth requirements were effectively eliminated, allowing weak and failed S&Ls to grow as rapidly as they wished using insured deposits; accounting practices were permitted that made it virtually impossible to detect misuses of resources; individuals with serious conflicts of interest were allowed into the industry and allowed to take controlling interests in S&Ls. These policies and others created powerful incentives and opportunities for insolvent and weakly capitalized S&Ls to engage in abusive practices. It was no accident that so many crooks flocked to the S&L industry; they went where the money was. Using little or no money of their own some started new S&Ls and others acquired bankrupt institutions. The payoffs from dishonesty were so great and the chances of getting caught so low that it is a wonder that fraud was not more wide spread. Despite the incentives and opportunities for abusive behavior, most S&Ls continued to operate in a conservative and safe manner. They did not grow at unmanageable rates and they avoided high-risk and fraudulent activities – these institutions survived, the “high-fliers” failed.

The S&L debacle involved a unique set of circumstances. Owners of undercapitalized S&Ls could drive them ever deeper into bankruptcy by ripping off the federal deposit insurance fund which, as the creditor at risk, allowed a huge expansion in insured deposits to finance payouts to abusive operators. Professor Black faults economists generally, and law and economics practitioners specifically, for not having standard models for analyzing what went on during the debacle. The standard models assume that those at risk – stockholders or creditors – will look out for their own interests. They may not always succeed but will try not to advance funds to enterprises in which they are likely, if not sure, to get ripped off. In various articles, Black cites some economists who assert that fraud and abusive practices were not important elements in the S&L debacle. These individuals are not among the strongest economists in the profession and they typically have a vested interest in concluding that S&Ls had little choice but to take honest but risky bets.¹ Although most economists have never thought about the S&L debacle, when presented with the unique circumstances surrounding the debacle any well-trained economist would conclude that, of course, there would be abusive and fraudulent behavior. It is unlikely that anyone would be surprised that those who engaged in highly lucrative but abusive practices would go to virtually any lengths, including applying pressure on politicians and debunking critics, in order to continue to loot.

Fraud was not the only factor involved in the S&L debacle. There was lots of incompetence as inexperienced and greedy managers were fleeced by Wall Street operators and others; many S&Ls grew at ferocious rates and were overwhelmed in the process; others took large bets and lost. From a public policy point of view it really doesn't make much difference whether S&L failures were the result of fraud, legal-but-abusive behavior, incompetence, or bad luck. The policy lesson is the same: the government must never again eliminate all regulation and supervision of weakly capitalized institutions (or any other insured entities for that matter), while allowing them to issue federally insured liabilities without limit. Issues of fraud and political

¹ Black is wrong to include Ed Kane among misguided economists. Kane was a lonely voice during the debacle warning all who would listen about what would happen.

manipulation are important and worthy areas of serious academic study. The S&L debacle provides some insights, but because it is such an extreme case, it is not a reliable foundation for building general models.

Review of Papers

"The Savings and Loan Debacle of the 1980s: White-Collar Crime or Risky Business?" (1995) co-authored with Calavita and Pontell is the most scholarly paper. The discussion of whether criminal prosecution and conviction should be the measure of the extent of fraud is interesting as is the brief discussion of the authors' surveys, but Professor Black indicates in his "Research Statement" that this is the work of his co-authors. Black's contribution involves attempts to use characteristics of failed institutions to infer that fraud was a major factor in the S&L debacle. Hypotheses are stated concerning the behavior that he expects of S&Ls that were rational risk takers, versus those that had incompetent managers, versus those that were fraudulent. It is difficult, if not impossible, to evaluate his conclusions because there is no formal hypothesis testing, and the characteristics that are the basis of his informal tests are not mutually exclusive among the three types of S&Ls. Relying on secondary data sources, Black concentrates on the "worst" failures. He observes that these S&Ls had experienced changes in ownership, had little asset diversification (not defined), and had deficient internal controls and underwriting – characteristics he asserts as consistent with fraud but not with rational risk taking. But these characteristics are also consistent with incompetence as the paper's Table 1 indicates, illustrating the problem that the characteristics are not mutually exclusive. In fact, the table indicates that the only characteristic posited to be unique to fraud is "no responsiveness to regulators". It is not clear why risk takers or incompetents should be responsive to regulators and not the fraudulent. Professor Black's "tests" of his hypotheses have no power whatsoever. Furthermore, the presence of fraud does not prove that it caused failure. Professor Black might have made more progress by examining primary data to determine the extent to which failed institutions had been "milked" by their managers through high salaries, dividends, and other methods. This behavior is only consistent with fraud and abuse.

Many of Black's papers are repetitious so I shall review several together

"Control Fraud and Control Freaks" (2000), *"Re-examining the Law & Economics Theory of Corporate Governance"* (2003), *"Using the Criminal Law to Control 'Control Fraud'"* (unpublished), and *"Control Fraud as an Explanation for White-Collar Crime Waves: the Case of the Savings and Loan Debacle"* (unpublished).

Professor Black uses the experiences of the S&L debacle in an effort to develop a theory of "Control Fraud". The idea here is that those who "control" firms (typically CEOs) can use their position to defraud the firm. This proposition is hardly a revelation. Professor Black seems to be ignorant of the vast literature on corporate governance that deals with "agency problems": management may behave in ways inconsistent with the interests of

stockholders and creditors.² And what could be more inconsistent with these interests than fraud? In “Reexamining the Law-and-Economics Theory of Corporate Governance”, Black cites Easterbrook and Fischel as typical of the law and economics approach which according to Black asserts that fraud and white collar crime cannot be common because market mechanisms develop to prevent the practices. This characterization of the “law and economics” field is a surprise to me, and I suspect it would be to the serious scholars who concern themselves with information asymmetries and other market failures that make corporate governance such a fertile field of study.

In his several papers, Professor Black does not analyze the conditions under which it is possible for controlling interests to take advantage of stockholders and/or creditors, he just tells some stories, e.g., undeserved favorable audits and accounting abuses. This is remarkable because the law and economics field is concerned with establishing and studying the conditions under which control problems arise and how to deal with them. His assertions notwithstanding, Black does not have a theory of control fraud, he has only coined terms and given some examples.

Professor Black typically shifts from his “general” case of control fraud to a special one in which an individual buys a failed or soon-to-fail firm, and proceeds to rip off creditors. This is the case of S&L fraud, where the stories of Keating, and other villains are told over and over again. Black provides no evidence that this kind of fraud extends beyond the special case of the S&Ls. In order to engage in fraudulent payouts it is necessary to come up with cash. Normally, creditors at risk won’t supply an ever-increasing amount of money to support payouts as the insurance fund did for S&Ls.

It is possible the “dot.com” bubble could yield examples, along with S&L, in which those at risk continued to throw good money after bad, but Professor Black doesn’t consider this possibility. In his forthcoming “*Beware of Geeks Bearing Gifts: Enron Uses Its High Tech Information System Defraud*”, Professor Black explains why he considers Enron to be a “control fraud” but there is no discussion of the role of the bubble in inducing investors to providing funds to feed wrong doing.

“A Tail of Two Crises” (2002) and “The Dango Tango: Why Corruption Blocks Real Reform in Japan”

I hesitate to comment on these papers because I am not an expert on the Japanese economy, but then again neither is Professor Black. In the first of the two papers, the collapses of the Japanese equities and real estate markets are likened to the S&L collapse in the U.S. Black argues, incredibly, that one of the reasons the Japanese experience was so much worse was the low quality of “leadership in the financial regulatory ranks” relative to the U.S. “Japan never produced a regulator willing to buck the powerful politicians and industry groups ...” Who is the superperson of U.S. regulation who stood up to powerful politicians and industry groups? None other than Black’s former boss Edwin Gray. The record shows that after a poor start and with some slips along the way,

² A recent review article on corporate governance and control by Patrick Bolton of Princeton and co-authors cites over 500 references

Gray tried to do the right thing but he was ineffective as head of the Federal Home Loan Bank Board. I doubt that finding his counter part for Japan will solve their problems.

Many experts have opined on the problems in the Japanese economy -- none of whom Black cites -- and there are many suggested approaches to a solution. Unlike Professor Black, these experts do not view the problems to be easily solved. They stress many factors beyond corruption and needless to say none of them offers Ed Gray as the solution.

"The Dog that Didn't Bark: the Key Role of Ethics in Limiting the S&L Debacle"
(unpublished)

Here Black asserts that ethics explains why the S&L debacle wasn't even worse. He finds fault with economists (again); this time because they study issues involving moral hazard. He doesn't seem to realize that this is done not because economists as a group believe that people are immoral but rather because they want to explain why morality is helped along when lenders require a down payment on a house or when insurers refuse to insure houses for 150% of their value.

As is so often the case, Professor Black seems to be unaware of the literature on an issue he discusses. This time he shuns the literature on reputation formation -- which helps explain why many S&L operators did not go for the quick gains available -- and the literature on the "agency problem" where managers are willing to take less risk than stockholders.

"Teaching Socio-Economics to Law Students" (forthcoming)

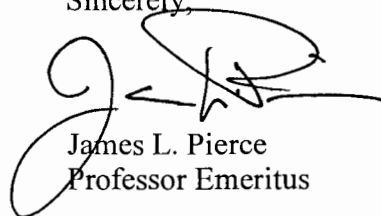
Here, Professor Black displays a remarkable ignorance of economics generally and of law and economics in particular. Probably the less said the better; except I hope that law students discern, through all the superficiality, that a little knowledge of complicated disciplines can be dangerous.

The War against S&L Control Frauds (unpublished)

Contrary to Professor Black's denial, this is a memoir. It is possible that with the successful efforts of a hard-nosed editor, a scaled-down and tightened version could be publishable. Black played an important role as a whistle blower and his version of events may be of interest to some scholars in political science and related fields.

If I can be of further assistance, please let me know.

Sincerely,



James L. Pierce
Professor Emeritus