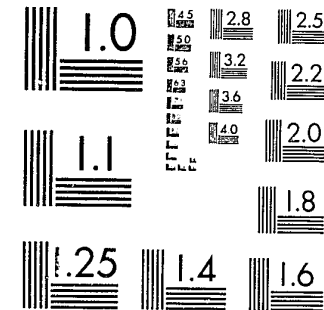


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Racketeering in Legitimate Industries: Two Case Studies

Executive Summary

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Racketeering in Legitimate Industries: Two Case Studies

Executive Summary

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January 1983

U. S. Department of Justice
National Institute of Justice

National Institute of Justice

James K. Stewart
Director

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The two case studies were carried out independently and each owes its existence to many individuals and institutions which provided support and information to the authors.

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The authors of both studies wish to join in acknowledging the unfailing good humor and patience of Ms. Beverly Hohn, C.R.I.S.P. Office Manager, in typing the report.

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It should be clearly understood that the findings presented in this report are entirely our responsibility. None of the many people and organizations which cooperated with us can be said to have endorsed any of the findings in this report. Nevertheless, we are in their debt.

Peter Reuter
Washington, D.C.

Jonathan Rubinstein
New York, N.Y.

Simon Wynn
New York, N.Y.

ABSTRACT

This is a report of a study carried out by the Center for Research on Institutions and Social Policy, Inc. on racketeer involvement in the solid-waste collection and vending industries. Each case study concentrated on specific geographical markets and particular industrial sectors.

The two studies drew on diverse information sources. As well as public record information, access was obtained to numerous law enforcement agency files and investigatory reports. In addition, informant evidence and, to a limited extent, observant participation were used. The solid-waste collection study is a conventional economic market analysis which focuses on the roles played by racketeers through cartels existing in the market. The vending study is a multi-disciplinary investigative testing of the existence within the industry of certain indicators of racketeering.

The two studies reach different conclusions about the roles of racketeers. The solid-waste study identified continuing criminal conspiracies in which force and coercion are important. These conspiracies are run mainly for the benefit of persons within the industry who do not, themselves, have a reputation within law enforcement circles as being racketeers. In these conspiracies, organized crime figures play important roles, although those roles are very different from those which the orthodoxy would have us believe. These people do not, it seems, control or dominate the participants in the business. Instead, the racketeers perform certain services for the industry, assisting in the enforcement and continuation of conspiracies which they originally instigated.

In contrast, the study of the vending industry demonstrates that reputed racketeers have had long and continuing associations with the industry and have often been open participants in it. However, there is little evidence that this involvement now has significant behavioral consequences for the industry. The study did not discover substantial evidence that racketeers within the industry operate their businesses differently from legitimate businessmen. Nor was evidence found of continuing criminal conspiracies among legitimate members of the industry. The study does not suggest that there is no racketeer involvement, nor that there is no criminality in the ordinary conduct of the industry. It does conclude that there is little justification for the repeated allegations of racketeer domination, and that those allegations have generally operated to dissuade outsiders from entering the business. In this sense, the orthodoxy has actually assisted

racketeers in exerting influence in the industry.

One common implication of these different conclusions is that the reputation of an industry as racketeer infiltrated is only a generalization which is productive of harmful consequences for honest business and counterproductive for the fight against racketeering. An industry's reputation as racketeer dominated may mean no more than the fact that years of law enforcement scrutiny have established contacts between people or corporations within the industry and recognized organized crime figures. The study presents two different sets of policy recommendations for the law enforcement community. The diversity in the case studies points to the need for further analysis if we seriously intend to address and eradicate racketeering in legitimate industry.

It is most important that new techniques for the analysis of business crime and racketeering be made widely available in the law enforcement community. The New Jersey State Police has already undertaken important work in this regard by setting up training programs for police and we suggest that this effort be continued and supported.

PREFACE

The Center for Research on Institutions and Social Policy, Inc. (C.R.I.S.P.) is a not-for-profit corporation established in 1978 as a center for the study of organized crime and related matters. C.R.I.S.P. has been supported by grants from the Law Enforcement Assistance Administration, the National Institute of Justice and the Ford Foundation. The case study of racketeer involvement in legitimate industries reported here was funded by the National Institute of Justice as part of its program of research on organized crime in America.

This study builds upon research conducted by Jonathan Rubinstein, C.R.I.S.P. Research Director, and Peter Reuter, former Research Fellow of C.R.I.S.P. and presently of the Rand Corporation, on racketeer involvement in illegal markets. This earlier work concentrated on organized crime involvement in illegal gambling and loansharking in New York. The study was supported by a two-phased grant from the National Institute of Justice. The report of the study has recently been published by the National Institute of Justice.¹

The present study on racketeering in legitimate industries draws upon some of the analytic approaches and information sources developed in the earlier project. The study relied heavily on the cooperation of a number of law enforcement agencies and also used informants within the various industries studied. However, the focus of the present study on legitimate businesses rather than criminal enterprises required some new analytic approaches. There was here no single data source similar to the New York Police Department gambling arrest records on which much of the earlier study was based. Many different criminal as well as non-criminal activities in diverse jurisdictions were in issue, with the result that a more multi-disciplinary approach proved to be the best method of organizing the information gathered.

1. Reuter, Peter, Jonathan Rubinstein, Illegal Gambling in New York: A Case Study in the Operation, Structure and Regulation of an Illegal Market, U.S. Department of Justice, National Institute of Justice (Washington, D.C.: U.S. Government Printing Office, April 1982).

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CHAPTER I

INTRODUCTION

The involvement of racketeers in legitimate business has long been identified as a significant social problem in America. The belief that there are legitimate businesses and even whole industries which are run by, or for the benefit of, racketeers has become firmly entrenched in the consciousness of the American people (see McClellan, 1970). Law enforcement efforts against organized crime and the citing of racketeer's involvement in support of proposals to increase police powers and resources (see U.S. General Accounting Office, 1981) have added to the credibility of this belief.

Labeling an industry as "racketeer dominated" has important consequences. Under existing law, it provides the basis for surveillance and information gathering and justifies grand jury investigations. There are also consequences for the labeled industry: the allegation once made tends to tarnish the reputation of almost all participants in the business. It thus acts as a barrier to entry into the industry of legitimate outsiders who wish to avoid acquiring an unsavory reputation. It may also change the conditions of carrying on business in the industry. For example, such allegations may act as a disincentive to financial institutions, fearful of doing business with crooks, from providing finance to the industry.

Despite these important consequences, there has been little study of either the validity of the assertions or the behavioral consequences of such racketeer influence or domination within the industry. Governments, police, scholars and journalists who identify racketeer holdings in legitimate industry then proceed to assert that the racketeers use in their legitimate businesses the same methods used in their criminal schemes. The methods usually cited (see, e.g. McClellan, 1970) are the employment of violence or extortion to achieve desired ends, fraud in the conduct of business, the corruption of public officials at every level and tax evasion.

This research project is the first attempt to study legitimate industries in which racketeers have been asserted to play a dominant role. There certainly have been studies of businesses which focus on roles played by particular racketeers; Kwitny (1979) is a fine example. Our study has a different approach. We assess both the evidence in support of the assertions and the consequences,

for the industry as a whole, of such racketeer involvement as we are able to identify.

This study does not purport to be definitive. It focuses on only two industries, the solid-waste collection and vending businesses. Within those industries, intensive study is confined to limited markets in special geographical areas. But the two studies do challenge orthodox claims about the sources and consequences of racketeer involvement in legitimate businesses.

Although it is difficult to define with precision, the orthodoxy takes a racketeer to be a person engaged in a continuing criminal conspiracy in which the objects of the conspiracy are to be attained through the use of force, fraud or corruption (National Advisory Committee on Criminal Justice, 1976, pp.7-8 and 213-5). In this sense, racketeering is a term used to describe how the conspiracy operates. However, this definition has had limited practical utility for law enforcement purposes. When the police and prosecutors talk about racketeers they usually intend to describe the Mafia, together with a group of fellow travelers associated with Mafia members. They also tend to include other groups of people (such as the "Black Mafia") who they identify as having a similar organizational relationships (see, e.g., Pennsylvania Crime Commission, 1980, p.18 ff.). Unfortunately, there exist no distinctive criteria for accurate identification of these persons. Instead, guilt by association has been adopted so that "organized crime" and racketeering have become little more than descriptions of networks of individuals whose connections to some "recognized" Mafia member can be established in some manner. The only means of demonstrating such connections are eavesdropping, surveillance or informant information. Consequently, the evidence-gathering process has come to replace efforts to define any more substantial criminal behavior.¹

For those outside the law enforcement community, these definitional problems are serious obstacles. Scholars are properly denied access to much of the evidence collected by the means just mentioned. This makes the task of assessing the validity of the orthodoxy extremely difficult. Generally, outsiders have had to rely on the police for their information, and that information has often taken the form of conclusions without supporting data.

Our studies sought to ameliorate these problems by concentrating on two industries which have been for many years widely reputed to be racketeer infiltrated and about which there exists a considerable amount of accessible information. It should be stressed that the vending and solid-waste businesses are by no means the only industries in which racketeer domination has been a long-standing claim. Obvious others are pizza parlors, some fish and meat markets,

1. These issues will be fully dealt with in a forthcoming report written by Jonathan Rubinstein and Simon Wynn on the Racketeer Influenced and Corrupt Organizations Act (RICO).

linen supply and the trucking industry. But they are leading candidates for study from almost every viewpoint.

We have not studied the solid-waste and vending businesses in their entirety. The solid-waste study focuses on private firms collecting commercial waste. It does not deal in any detail with toxic waste collection, nor with municipal contract collection. The vending study is similarly limited to an emphasis on the amusement and slot-machine businesses. We do not deal with food service vending such as that provided at hospitals or airports. Both studies also concentrate on particular geographical markets, mostly, in the northeast, although we have, where possible, gathered comparative material from other parts of the country.

The two case studies use different analytic approaches. This is partly a consequence of distinctive research interests and training and partly a result of the different information sources available to us when engaging in this research. The solid-waste study applies relatively conventional economic analysis to a particular market. Peter Reuter, an economist, utilizes data derived from two major sources. The solid-waste industry in the markets selected for study is subject to certain regulatory controls; regulation provides an important source of information about the industry. Further, the industry has been the subject of many law enforcement investigations and prosecutions; these provide significant amounts of public record information.

In contrast, those parts of the vending industry on which we have concentrated are largely unregulated. There have been relatively few investigations of the industry in the last 20 years. The focus of Jonathan Rubinstein (an ethnographer) and Simon Wynn (a lawyer) does not rely on a single conceptual framework. It is investigative in nature, relying on a wide variety of sources including agency files, informants and public record information.

Still, the solid-waste collection and vending industries share many characteristics. They are both primarily small business operations, often family businesses. These enterprises are generally non-professional, low status occupations. They are mostly urban businesses, whose organization depends on the concentration of city populations. Solid-waste collection and vending are also industries in which technological innovation and technical training have not generally been important (until the recent technological revolution in the amusement business). Finally, they are businesses in which there are minimal economic barriers to entry.

As will be seen, the conclusions reached about the roles of racketeering in the two industries are very different. In the solid-waste industry, we have identified the existence of continuing criminal conspiracies in which force and coercion are important. These conspiracies are run mainly for the benefit of persons within the industry who do not, themselves, have a reputation within law enforcement circles as being racketeers. In these conspiracies, organized crime figures play important roles, although those roles are very different from those which the orthodoxy would have us

believe. These people do not, it seems, control or dominate the participants in the business. Instead the racketeers perform certain services for the industry, assisting in the enforcement and continuation of conspiracies which they originally instigated.

In contrast, the study of the vending industry demonstrates that reputed racketeers have had long and continuing associations with the industry and have often been open participants in it. However, we have found little evidence that this involvement has had significant behavioral consequences for the industry. We have not discovered substantial evidence that racketeers within the industry operate their businesses differently from legitimate businessmen. Nor have we found evidence of continuing criminal conspiracies among legitimate members of the industry. Our study does not suggest that there is no racketeer involvement, nor that there is no criminality in the ordinary conduct of the industry. It does conclude that there is little justification for the repeated allegations operated to dissuade outsiders from entering the business. In this sense, the orthodoxy has actually assisted racketeers in exerting influence in the industry.

One common implication of these different conclusions is that the reputation of an industry as racketeer infiltrated is only a generalization which is productive of harmful consequences for honest business and counterproductive for the fight against racketeering. An industry's reputation as racketeer dominated may mean no more than the fact that years of law enforcement scrutiny have established contacts between people or corporations within the industry and recognized organized crime figures. The study presents two different sets of policy recommendations for the law enforcement community. The diversity in the case studies points to the need for further analysis if we seriously intend to address and eradicate racketeering in legitimate industry.

CHAPTER II

THE SOLID-WASTE COLLECTION INDUSTRY

1. RACKETEER INVOLVEMENT IN LEGITIMATE INDUSTRIES: A CONCEPTUAL ANALYSIS

Racketeers are characterized by their ability to make credible threats of violence against a large segment of the community. The analysis here assumes that they make economically rational use of that reputational asset, maximizing their income while taking into account the risks of legal sanctions to which alternative uses expose them. The analysis also assumes that not all legitimate entrepreneurs have the same willingness to voluntarily enter into the agreements with racketeers yielding benefits to both parties, and that at least some of the variation in attitude will be explained by the social background of entrepreneurs in a particular industry.

Racketeers acquire interests in legitimate enterprises for a number of reasons. Continued involvement in illegal activities exposes them to ongoing legal and financial risks, since it can lead to the loss of assets and freedom through law enforcement agency activities. As racketeers become wealthier they are likely to wish to diversify their activities and assets. This leads them to seek involvement in legal activities where their asset holdings can be protected and thus, for example, provide a more secure means for passing on wealth to their children. This suggests that some racketeer involvement with enterprises in legitimate industries may involve little more than efforts to reduce certain kinds of risk through portfolio diversification. They may be passive investments, leading to little change in the operation of the enterprise concerned.

Our research does not concern this type of racketeer involvement in legitimate industries. We shall deal with industries in which racketeers are alleged to determine the conduct of all those in it. For a racketeer may be able to use his racketeering reputation and skills, in the legitimate economy, to earn high rates of return on the investment of time and capital. He might, for example, acquire a business and then use his reputation to intimidate all existing and potential competitors, thus creating a monopoly. This is a risky strategy. It generates many potential informants while some other competitors may turn to other racketeers for protection. In addition, naked monopoly is the outcome most likely to attract the attention of anti-trust authorities.

There is, moreover, an alternative strategy which can yield similar returns with less risk, namely the creation of cartels, i.e. an agreement between businessmen in the same market to coordinate their actions and restrain competition. Racketeers may induce entrepreneurs in an industry to form cartel arrangements which yield profits for the industry close to those that could be obtained by a monopoly. Some of these profits can be extorted from the businesses by the racketeers. Creating cartels also solves another serious problem for racketeers, namely the coordination of the activities of group members when they are involved in a particular industry. A number of members may have independent and potentially competing interests which are difficult to reconcile, for racketeers do not form the centrally directed organizations so often portrayed in fiction and political accounts.

Indeed, the historical record, certainly as illustrated by New York during the 1920s and 1930s (Block, 1980) suggests that racketeers often entered an industry in response to an invitation by the industry association, concerned about the difficulty of enforcing anti-competitive agreements during economically troubled times. The involvement of these racketeers with corrupt or weak unions provided them with particularly efficient enforcement devices, since enforcement of cartel rules could be dressed up as the less legally and politically vulnerable enforcement of union rules. The small literature on labor racketeering (Hutchinson, 1972) indicates that cartel formation and extortion is a common use of corrupt union power. The result was occasionally the extortion of both employers and employees by criminal controlling the union.

This analysis suggests that racketeers will probably play an important role in markets which have particular characteristics. For example, in these markets there should be strong incentives to create a cartel (inelastic demand for the good or service, little product differential,¹ etc.) but impediments to its formation (numerous firms, low barriers to entry,² etc.). The social background of the entrepreneurs is relevant. Low status backgrounds will ease contacts between entrepreneurs and racketeers; thus low status industries where the firms are owned by poorly educated entrepreneurs are more likely to involve racketeers. The union

1. Inelastic demand means that a large percentage increase in price will induce a small decrease in the amount sold; demand for trash collection services is likely to be inelastic because the customer must dispose of his trash and, if small, cannot self-haul without incurring substantial costs. Product differentiation refers to the homogeneity of the product; trash collection services are unlikely to differ much between firms, in contrast to automobiles. On these matters, as they affect cartel formation, see Scherer (1970, Chapter 6).

2. A barrier to entry is a factor which permits existing firms to operate at an advantage compared to firms contemplating entry into the market (Scherer, 1970; Chapter 8).

effective and available tool for racketeer run cartels where there are numerous firms employing low skill labor and which are vulnerable to a short-term strike (cf. Taft, 1958).

The little material available concerning industries in which racketeers have clearly acquired an important influence is consistent with this analysis. It is not in the industries controlled by large corporations or involving high technology that known racketeers are to be found. Rather it is in those essentially local activities where small, frequently family based, enterprises are particularly important. The solid-waste case study exemplifies this.

It can also be argued that racketeers will seek to organize a particular type of cartel, namely a customer allocation agreement. Here the principal cartel rule will be that each customer belongs to a particular cartel member; others cannot compete for the allocated customer's business. The cartel is unlikely to attempt to control member prices. This conclusion comes from consideration of the cost of detecting and sanctioning violations of other kinds of agreements, the probability of an effective prosecution of various agreements and the attractiveness of the simplest possible rule for an illegal cartel.³ Customer allocation agreements are only possible in particular industries, essentially those where the customer population is fixed in location and the service or good is delivered to the customer. Most of these industries are located in the intermediate goods, rather than final goods, sector.

What are the consequences of racketeer domination of an industry? Assuming that racketeers act as organizers of a customer allocation agreement we can predict (using conventional economic analysis) three major effects. As compared to the competitive alternative we should find less efficient production, higher price and small firms. Less efficient production is engendered by the reduced incentive for lowering production costs; the firm cannot obtain one of the usual rewards for lower costs, namely an increase market share since all existing customers are allocated. If, as has generally been the case, technological change raises the minimum efficient size of the firm, the customer allocation agreement may permit the continued existence of numerous sub-optimal firms. The higher prices result directly from the imposition of competitive constraints.

In each dimension the effect is likely to be greater than if the cartel did not involve racketeers. The reputation for racketeer involvement will raise the barriers to entry into the industry. Customer resistance to producer price increases will be lessened by a concern about the adverse consequences of aggressive complaints. Since racketeers increase confidence of entrepreneurs that the cartel will endure, incentives for efficient production will be even more sharply reduced than they would be by a conventional cartel in which confidence about its future success was never high, so that the probability of imminent competition never vanishes.

3. The analysis is based on the work of Stigler (1964).

2. THE SOLID WASTE COLLECTION CASE STUDY

Introduction

The first case study is of the solid-waste collection industry. In particular we shall be focusing on firms which collect waste generated by commercial and industrial establishments. It is estimated that the annual revenues generated in this industry is approximately \$1.5 billion. While many of the firms in this activity also collect solid-waste from residences, there are differences in the technology and marketing systems that permit the two activities to be treated separately.

The industry consists mostly of very small firms. In the two case study markets, firms with less than five trucks, and probably no more than 10 employees, account for the bulk of revenues. Indeed, nearly half of the firms in New York City have three or fewer trucks. The companies are closely held, either as partnerships or family corporations. Often membership is passed down from father to son. Moreover, there are family ties between many of the firms in the one metropolitan market.

The tendency to cooperation rather than competition is reinforced by two other factors. In most metropolitan markets it appears that one ethnic group is dominant, though the ethnicity is different for different cities. In addition, many of the firms started with minimal capital and no reserve equipment. Trucks broke down frequently, particularly with earlier vintage trucks. The only way that each firm could offer uninterrupted service, as customers needed, was to have reciprocal arrangements with other carters in the same local area to provide back-up when each experienced equipment failure.

The McClellan Committee held hearings on the solid waste industry in Los Angeles and the suburbs of New York in 1957. The results of these hearings were to provide a lasting reputation to the industry for anti-competitive practices and the involvement of racketeers.

In the brief hearings on Los Angeles it was shown that the carters' association had formally instituted a customer allocation agreement. Any carter who took the customer of another member of the Association was required by the Association to provide compensation to that other carter, the compensation being set at a multiple of the monthly revenues derived from the customer at issue. The union cooperated. Only firms who were members of the Association could make use of the disposal facilities; union officials would instruct employees at the landfills to refuse firms which violated Association rules. There are no suggestion that this agreement was enforced through use of violence or involved any gangs external to the industry; it was internally created and operated.

In the case of the New York suburbs the Committee found a much more menacing and complicated situation. In Westchester County a corrupt union had enabled a racketeer controlled firm to

gain a near monopoly. Violence, even homicide, had marked the acquisition of this power. In Nassau County the carters' association had been used as a vehicle by some Mafia members to create a customer allocation agreement. The union had used its powers to enforce the agreement. Racketeers had been critical to the creation of the agreement and had benefited in three roles; as Association organizers, firm owners (through uneven union contract enforcement) and paid associates of the union leader.

Since the time of the McClellan Committee there have been two notable changes in the industry. The disposal segment is now subject to much more government regulation and intervention. Stringent environmental regulations have led to the closing of many small privately operated landfills and their gradual replacement by higher technology and larger disposal facilities. The use of disposal as a means for organizing and extorting the collection sector has become less feasible, as the government has become more directly involved in disposal.

The second change is the development of three national collection companies.⁴ Each grew rapidly during the early 1970s through the acquisition of dozens of small local firms, though many of these affiliates retain considerable autonomy and are even run by their former owners. The introduction of modern managerial techniques and of corporations with broad reputational concerns may substantially change the behavior of the industry. However, it should be noted that these companies presently account for only about 10% of the total solid-waste collection and disposal market.

New York City

In New York City commercial and industrial establishments receive solid-waste collection services from approximately 300 small firms. The City provides residential waste collection and operates all disposal facilities within the city. The firms seem to be owned almost entirely by persons of Italian origin and are generally organized as partnerships. There are no affiliates of the three nationals in the city; indeed there are no publicly held corporations. The largest firm has approximately 20 trucks, while firms with just one truck account for about 17% of the total truck capacity, about 800 trucks.

Allegations of racketeering in the New York City industry predate the McClellan hearings. In 1956, when the city ended collection services to commercial establishments in residential blocks, there was a general concern about anti-competitive behavior on the part of the firms. The Department of Consumer Affairs (DCA) acquired regulatory authority, setting both maximum rates and screening licensees to ensure that no racketeers were present. There were also numerous inquiries by prosecutors into allegations of customer

4. The companies are also involved in disposal of solid and other kinds of wastes.

allocation and racketeering. These inquiries appear to have produced almost no indictments, probably because all those with useful information were themselves beneficiaries of the conspiracies.

The industry is organized into three regionally defined Associations. The Associations represent the carters in rate hearing applications before the DCA. It is also apparent that they serve as the vehicle for the operation of a customer allocation agreement. Indeed, one of them was convicted on such charges in 1974; the major result appears to be that it has had to change its name.

There is very direct evidence of the existence of a customer allocation agreement. In hearings before the DCA, carters were willing to state that the purchase of a customer by one carter from another gave the purchaser the exclusive right to service that customer. The 1974 investigation of the Brooklyn carters' association also provided direct evidence on this point.

More indirect but revealing evidence of the consequences of the agreement is the practice, permitted by the DCA, of selling customers at high multiples of monthly revenues. Carters routinely sell groups of customers to each other. The multiple of monthly revenues used in these sales has risen steadily over the quarter century of DCA regulation from about 10 to approximately 40. A single truck carter may be able in 1981 to sell his customers to other carters for a total of \$400,000. Customers become property.

The rise in the multiples probably comes from two factors. First, as the agreement continues to function without serious interference over a period of years, the confidence of participants concerning the future success of the agreement will rise. Thus they will have increasing confidence, based on experience, that they can exploit each customer in perpetuity. The second factor is also a consequence of the continued success of the arrangement. Threats of entry by new carters become more remote, customers become increasingly inured to the monopolistic practices of their carter and the carter is thus able to more fully exploit his monopoly power with respect to each customer. The increase in the value of each customer comes then from increases both in the certainty of retaining the customer and in the degree of perceived monopoly power.

The high multiples paid for customers also makes clear that carters are routinely evading income reporting requirements. The DCA requires that carters submit financial statements. These are used in rate hearings. Those returns show that the gross operating profit of the carters is less than 11% of total revenues. A customer who is charged \$100 per month should then on average yield a gross profit of no more than \$11 per month or \$132 per annum. If the customer is sold at \$4,000 this would suggest that carters are content with a return of only 3.3% on their investment. In fact there is a little anecdotal evidence to reinforce the impression conveyed by this figure of massive underreporting of income.

The true operating margins are probably 50% of actual operating costs i.e. the cost of servicing the customer billed \$100 per month is \$67 per month, rather than \$90 reported.

Why does the DCA not intervene? It certainly is aware of the prevalence of monopolistic pricing, customer allocation and unreported income. In part it is hindered by very limited legal resources (and uncooperative courts) and staff. More fundamentally though it is the carters' ability to overstate the level of service delivered that hinders aggressive DCA enforcement. Smaller stores put out their waste in irregular containers and are completely dependent on the carter for an estimate of the volume of waste collected. With larger customers, whose waste is collected in fixed size containers, carters may cheat in any or all of three ways; overstating the size of the container, not completely emptying the container when they pick it up or picking up the container when it is not full. All such practices are apparently common. Thus regulation of per unit price has little impact on exploitation of customers.

It is possible to use the size of the multiples at which customers are exchanged to make an estimate of the excess cost imposed on commercial establishments in New York as the result of the customer allocation agreement. A very rough but generally conservative figure is approximately \$45 million per annum or about 35% of the total payments for collection service.

Why do customers not take action against the carters? The customers include, after all, many large commercial establishments with a degree of managerial and legal competence. We suggest that the reputation of the industry for racketeer involvement serves as an important deterrent. The fact that solid-waste collection costs are also a very small percentage of total operating costs and that all firms are subject to much the same level of extortion with respect to this cost component also may hinder active complaint.

Racketeers play a continuing role in the operation of this agreement. That role comes mostly through the need to constantly mediate the disputes that inevitably arise in a conspiracy that involves the allocation of over 100,000 customers between 300 carters. The "grievance committees" that settle these disputes, using the basic rule that whoever serviced the site first has continuing rights to any customer that occupies the site, include at least one Mafioso. While there is little evidence of either threats or actual violence, it seems reasonable to infer that the racketeers provide a credible continuing threat of violence that ensures compliance with the rulings of the committee. The union, which was instrumental in the creation of the original agreement, now appears to play a negligible role. It did not prove possible to identify how much racketeers receive for their services or indeed learn much about the manner in which they are paid.

"Victoria"

"Victoria" is the pseudonym for a state in the northeast where the solid-waste industry is also regulated. The industry in this

state also shares other characteristics with the New York City industry. Most of the firms are owned by persons of Italian extraction, indeed many of them descended from a group of entrepreneurs who came from the same town in Italy. They have many family ties within the industry. It is also an industry which has a long-standing reputation for anti-competitive practices and racketeer involvement.

An inquiry into these matters by a state agency during the 1960s showed that associations of carters had formal customer allocation agreements. Since the state lacked an anti-trust statute at the time, this was not clearly illegal. Following the report of the agency, the industry was brought under the regulatory control of the Public Utilities Commission (PUC). The PUC uses a more complicated approach than does the DCA to price regulation, with each carter being required to obtain approval for his individual tariff. There is abundant evidence that these tariffs are routinely ignored by the carters. It is unlikely that most customers are aware either of the carter's tariff or of the quantity of waste that the carter actually collects.

As in New York City, carters in Victoria routinely sell groups of customers to each other. The PUC, though somewhat troubled by the practice, has required only that each sale be registered with it. The price, expressed as a multiple of monthly revenues, is significantly lower than in New York City, tending to approximately 20, as compared to 40 there. The explanation may be found partly in the relative newness of the statewide agreement in Victoria.

Many of the commercial carters belong to a statewide Association, which replaced the various local Associations that had operated customer allocation agreements during the 1960s. The statewide Association now serves as the vehicle for these agreements, though its by-laws no longer contain the explicit rules that the previous Associations had before passage of the state anti-trust statute.

As in New York City, the current role of racketeers seems to center around the settlement of disputes concerning the assignment of a particular customer. Their role is less direct, in that they do not actually appear at grievance committee meetings. Nonetheless, there are some instances in which they have appeared as last resort enforcement agents when a dispute has not been resolved within the Association.

The major union is a singularly corrupt local of the Teamsters. Two of its officials have been murdered and various others convicted of labor racketeering activities of the last quarter century. It has certainly been active in the past in the enforcement of customer allocation agreements. However it is difficult to find any evidence that this still holds, despite the corruption of recent administrations of the local.

It again proved impossible to determine how much money racketeers receive in return for their services to this industry or indeed by what means they are paid. But there is some reason to believe that the carters are again the primary beneficiaries, though the lower multiples indicate less effective extortion of customers.

3. SOME IMPLICATIONS OF THE CASE STUDY FINDINGS

This analysis, emphasizing the mutual benefits derived by entrepreneurs and criminals in the operation of cartel arrangements, suggests the difficulty of effective remedy. Policies which assume that the racketeers are parasites on unwilling hosts (President's Commission on Law Enforcement and the Administration of Justice, 1967) and that the legitimate entrepreneurs would welcome a cleaning up of the industry, are doomed to failure. Where racketeers operate a cartel for the entrepreneurs, the parties adversely effected, the customers, are unlikely to be able to provide informative complaints. The experience of the numerous investigations of the solid-waste industry in the New York metropolitan area (at least 16 in the last 25 years) illustrates this.

Nor does regulation, even where it is set up precisely because of a concern with anti-competitive practices, seem to have much promise. In general, regulation is a blunt tool to promote a behavior as subtle as competition (cf. Phillips, 1975). It is likely to work particularly poorly where the units being regulated are small and numerous. While one may fault the precise administration of the regulatory statutes of New York City and Victoria, it is difficult to devise rules that hold much promise of striking at the evil of customer allocation. In particular it is not possible to prohibit the sale of customers, which is the central open manifestation of the allocation, in an equitable and effective way.

With respect to the solid-waste collection industry, there is one measure that may strike at the root of racketeer instigated customer allocation agreements. It requires more direct intervention of the government and is not without its difficulties. Under this policy, the government would in effect auction off limited duration monopolies for solid-waste collection in narrowly defined territories. The government would also set up a solid-waste firm which could bid on these territories and thus provide a benchmark for the existence of bid rigging by the private firms. This would at least have the merit of breaking existing patterns of customer allocation and any disturbance is likely to threaten the stability of the agreement.

It is not clear that the conditions found in the New York City and Victoria are typical of the industry in major urban areas. There is both evidence and argument that the problem of racketeer involvement and anti-competitive agreements are likely to be more significant in these two than in most others. Efforts to collect relevant data from a sample of other cities were generally unsuccessful but the one set of figures obtained, the share of the metropolitan market held by the four largest firms, showed that

the Victoria and New York City markets were less concentrated than others, consistent with our theoretical speculations as to where racketeers are likely to be found. The absence of the three nationals from New York City and small presence in the Victoria commercial collection market⁵ is also an important indicator of the possibly greater tendency to conspiracy in those two markets.

For law enforcement agencies the major utility of the study may be the suggestion of an approach to determining target industries for racketeer investigations. The empirical work bore out the basic theoretical arguments of Part I, suggesting conditions under which racketeers are likely to be particularly influential in the conduct of an industry. Given the difficulty of finding informants in such matters, such pre-screening may be of considerable value. It also suggests though the difficulty of making cases against racketeers. The failure of the more analytically oriented antitrust specialty to develop analytical techniques convincing enough to win even civil conspiracy cases, without direct evidence of collusion, suggests the magnitude of the problem.

The contrast with antitrust is worth extending, for the investigative problems in racketeering cases are more severe. Customers, a major source of informative complaints in antitrust, are likely to be deterred from complaining by the belief that racketeers are involved. Similarly, participants will be less likely to accept the inducements offered by prosecutors for cooperation, for precisely the same reason. And the reputation of the racketeers will serve to provide each of the participants with higher expectation that none of the others will become informants. Undercover investigations are likely to be the only successful ones.

One comforting implication of the study is that racketeer domination of an industry may be a phenomenon of small and declining importance. The small business sectors in which racketeers are most likely, both for economic and sociological reasons, to find the greatest demand for their services, are coming to form a decreasing part of the economy.

5. Two nationals are significantly involved in other segments of the solid waste industry in Victoria.

CHAPTER III

THE VENDING INDUSTRY

1. INTRODUCTION

Old-time racketeers largely controlled the supply of liquor during Prohibition. After 1933, liquor law prohibited the provision of credit to bar owners by normal trade sources, legitimate liquor suppliers. However, there was nothing in the law to prevent vending companies making loans to bars. This may have been the initial attraction of the vending business for those racketeers who sought to continue their involvement in, and consequent influence over, the newly legalized liquor trade.

The vending industry had some other inherent attractions, most of which still exist. For example, the lack of independently-verifiable cash return from machines makes the industry attractive to anyone who wishes to skim tax-evading income from vending machines. Equally, cash derived from illegal sources can be easily laundered by disguising it as vending machine proceeds.

These features of the vending industry could be attractive to many people. Yet the fact remains that the industry is one which has for over thirty years been asserted by law enforcement agencies to be under the control or influence of racketeers (see Kefauver Committee, 1950). This case set out to examine the value of these claims. It also examined the expected behavioral consequences of racketeer infiltration of this legitimate business.

The study drew on information from many different sources. We generated informants within the industry and also were able to engage in participant observation. We were also privileged to be able to work in cooperation with a number of law-enforcement agencies in New York and New Jersey without whose assistance the study would have been impossible. Despite certain criticisms of conventional law enforcement wisdom regarding racketeering, we believe that if notice is taken of our findings within police and governmental bureaucracies, then those who have assisted us will ultimately reap a benefit, as realistic enforcement strategies are formulated to combat criminal behavior in the vending and other legitimate businesses.

We also made use of public record information (including corporate annual reports, UCC filings, etc.) and data derived from credit agency reports. We studied the structure and ownership of

over 170 vending companies involving more than 560 individuals in New Jersey and in upstate New York. We accumulated a mass of information so great as to preclude simple manual analysis. We were, however, able to make use of the Organized Crime Analysis Program (OCAP) to assist us in managing the data. In this regard we gratefully acknowledge the assistance of the New Jersey State Police, and especially the members of its Intelligence Analysis Division.

The logic of our inquiry was patterned on the investigative methods used by law enforcement agencies. These agencies seek to gather evidence of specific conduct to prove the commission of specific crimes. Our approach sought to gather information about many individuals and enterprises which could be compared to specific allegations regarding criminal behavior of organized crime. The allegations we were testing are derived from a body of wisdom based on law enforcement investigations spanning forty years.

2. THE ORTHODOXY: SOURCES AND CONTENT

While allegations of criminal involvement in the vending industry can be traced back to the Prohibition era, the connection with organized crime was first clearly expressed by the Kefauver Committee in 1951-52. The committee's report included the vending business among some 50 sectors of the legitimate economy in which there was "evidence of hoodlum infiltration". No evidence is provided in the transcripts of the committee's hearing to support this finding.

In the hearings of the McClellan Committee in 1957-59, there is a wealth of testimony dealing with racketeering practices and organized crime involvement in the vending industry. Over 1000 pages of published transcripts deal with the roles played by racketeers in the business. The evidence is so extensive that it is impossible to summarize here: moreover, as we explain later, it is not necessary to do so. For present purposes it is instructive to outline the two major spheres of racketeer activity on which the testimony concentrated.

First, there was evidence from at least one vending machine manufacturer that he knowingly made use of mob connected persons to arrange for the effective distribution of his company's machines. There was express acknowledgement that violence and, possibly, extortion could be among the methods used by these persons to overcome competition from distributors representing other manufacturers.

Second, the committee heard numerous witnesses tell of labor racketeering in the industry. This generally involved organized crime figures forming paper union locals, whose membership was mainly comprised of the owners of vending machine companies rather than legitimate employees of those companies. These locals would, for a fee, protect the vendor's machines against attempts by competitors to replace the union member's machines with their own. Attempts on the part of a vendor to avoid joining these "unions" were met with threats and, occasionally, violence directed either

at the machines or the vendor himself.

The evidence presented before the McClellan Committee is of the utmost importance to anyone seeking to understand the structure and history of the vending industry. But it is critical to remember that the Committee was taking testimony on events which are now between 25 and 30 years old. In the meantime, technological and other changes (including changes in the law) have totally transformed the nature of the business.

Some of the individuals identified in the McClellan Committee hearings continue to play a part in the industry today. Many of the companies involved still exist, albeit they are now multi-million dollar subsidiaries of major national corporations. But conditions within the industry have changed to such an overwhelming extent that it is simply impossible to conceive of the patterns of racketeering actively detailed by the Committee as significant in the contemporary world.

The most obvious example of changed conditions in the industry relates to the very practice which the McClellan Committee was established to investigate, labor racketeering. All the various forms of labor racketeering have at least one element in common, there must be a labor union somewhere in the picture. During the course of our investigation of the vending industry we were unable to find anywhere in the country any significant labor union activity. We were also told by many individuals within the industry and by the law enforcement agencies with which we had contact that they could not remember any union playing a relevant role in the industry for at least 20 years. If this can be attributed to the efforts of the McClellan Committee, then it is an important achievement indeed. For present purposes, however, the point is that labor racketeering in the vending industry as we have studied it has simply ceased to exist.

Although the McClellan Committee evidence is today of limited value, there have since been numerous official reiterations of racketeer involvement. Some of these relate to particular firms such as the Bally Manufacturing Company; others make reference to specific enterprise such as the "Scopitone" affair of the mid-1960s. But most simply restate the orthodoxy of racketeer involvement. An example of this is found in the Pennsylvania Crime Commission's assertion, contained in its 1980 report A Decade of Organized Crime, that "there is no doubt that...[vending] is a favorite business of crime family members across the state" (Pennsylvania Crime Commission, 1980, p.215).

Despite the continuing litany, there is no indication that the law enforcement community has been able to curtail the involvement of racketeers. This is not surprising, for one of our first research findings was the virtual absence of inquiry into what racketeers actually do in this industry. This absence persists in spite of the fact that the law enforcement community knows more about racketeering than anyone else and is in a position to collect and scrutinize that information in a manner impossible for

outsiders to undertake. Yet, without such inquiry, it is inconceivable that racketeer involvement can be eradicated.

In order to carry out our study we set out to ascertain the main consequences of racketeer domination according to the sources of the allegations. We early discovered, to our surprise, that there have been few attempts made to enumerate any such consequences which can be said to result from racketeer involvement rather than from some other source.

The main behavioral consequences of racketeering derive from the argument that racketeers are said to bring to their conduct of legitimate business the methods which they use in their illegal activities. This view has often characterized the debate on racketeer infiltration of legitimate industry. A fairly recent statement of Senator McClellan, expresses it succinctly:

"once [organized crime] invades a legitimate field of endeavor, the mob quickly brings with it a full range of corrupt practices. It sometimes uses terror tactics to obtain a larger share of the market.... It evades taxes and thereby gains an unfair advantage. It monopolizes goods and services thereby raising prices. Through the violence used in its operations and its rigidly enforced code of silence, as well as exploitation of nonmembers in its schemes, the mob seeks to gain immunity from the rules of our society governing business and labor practices. We cannot afford to allow it to succeed in this endeavor." (McClellan, 1970, p.141)

Perhaps the most common concern of the law enforcement community is that racketeer involvement is characterized by violence or threats of violence. It is obvious that racketeers use violence, and also their reputation for habitual resort to violence, in the conduct of their activities. But racketeers have no monopoly over the use of force, and the problem in this regard in any study of an industry is to ascertain whether any violence found is to be ascribed to the presence of racketeers or whether it is for some reason part of the "normal" way that the industry works.

Other common assertions are that racketeers make use of corruption (whether through bribery, extortion or political influence) of police and other public officials, in order either to acquire some advantage in their conduct of business or to insulate themselves from law enforcement scrutiny and prosecution. Again, this is obviously not a matter unique to racketeers, as that term is defined by the orthodoxy.

The same point can be made regarding the attainment of monopoly. It is trite to note that racketeers are not the only persons in legitimate industry who attempt to attain monopoly control over a market or industry. The Sherman Act was not motivated by fear of the Mafia.

But we should not assume that racketeers universally regard the attainment of monopoly as desirable. Some racketeers may do

so but others may not. The business may be acceptably profitable without monopoly; the attainment of monopoly may come at a high price, higher than the racketeer is willing to pay. Moreover, the risk of exposure to law enforcement efforts will be increased, something that we may rationally suppose the racketeer will wish to avoid.

Only if the attainment of monopoly can be quickly and cheaply assured should we expect the racketeer to undertake the effort. We know of no important market in which this is the case. The qualification of importance is necessary; it may well be possible to gain a monopoly over some small market without difficulty, but this could presumably be done by any sufficiently motivated group of thugs. Finally, it is by no means clear that profits perceived of as extortionate (always a value judgment) can result only from, or even most easily from, monopoly. There are many apparently competitive industries in which profits regarded as extortionate are regularly announced; consider the oil industry.

Two further indications of racketeer involvement are often linked in the assertions of the orthodoxy. The skimming of taxable income and the use of legitimate industry to launder illegally-derived income are regarded as major activities of organized crime. These two activities are in most cases mutually exclusive. The object of laundering money is to make it appear legitimate. This generally involves the payment of proper taxes. Clearly, there is no point in skimming "dirty" money on which no taxes are payable. Only those industries in which money is exchanged as a commodity ("bought and sold") are susceptible to dual skimming and laundering. Two of the most obvious examples of industries falling within this category are banking and legalized gambling. Both businesses have been shown to be attractive to racketeers, yet they are among the most stringently regulated, both as to fitness to operate and method of operation, in the land. If racketeering can take place within such an environment, then we doubt that there is any chance of eradicating this form of racketeer activity in less regulated industries. This has not prevented continued assertions of racketeer skimming and laundering in the vending business.

3. THE CASE STUDY FINDINGS

Structure of the Industry

Although the operations of the vending industry have been transformed through the advent of new technology within the last 6-10 years, its structure has remained generally intact. The vending business is organized in a manner generally similar to most industries in which consumer goods are manufactured, distributed and sold. It is distinctive, however, in that the ultimate consumer does not buy the product manufactured (the machine), but instead makes use of it either to obtain from the machine some other product (e.g. candy) or for amusement purposes.

Vending machine manufacturers are located around the country, with the amusement machine sector (the object of primary focus in

this study) centered in Chicago. Most of the major manufacturers are subsidiaries or divisions of large, publicly traded corporations. In recent years, the popularity of video amusement games has been such as to command the interest of many of the nation's largest communications and entertainment enterprises. An example is found in the case of Atari, a pioneer in the development of video games. Atari, purchased in 1976 by Warner Communications, Inc. for \$28 million, contributed in 1980 almost \$70 million in operating income for its parent, roughly one-third of Warner's total operating income. The 1981 figures were even higher.

Machines are sold by the manufacturers through distributors. These are either owned by or affiliated with the manufacturers or are independent firms. The independents are almost invariably closely-held corporations and are often family businesses. There are over 400 independent distributors in the country, most of which are over 20 years old and have an average of about 25 employees. Their annual sales can be as high as \$50 million, though most are much smaller.

Distributors in turn sell machines to operators. The vending operator is the company or individual most people refer to as the vending company. Operators actually own vending machines and are responsible for their service. They collect the money.

Operators rarely own the locations where machines are found (the bar, restaurant, food store, etc.). The owner of the location has an agreement with the operator allowing the latter to place his machines on the premises. In return, the operator pays the location owner a commission out of the proceeds of the machine. This commission is almost invariably 50% of the take and is essentially uniform throughout the country. It has not changed since the earliest days of the business.

The vending industry does not invariably follow the simple structural model just described. Some manufacturers distribute their own products. About 40 percent of distributors have some route operation and a few operators are part-time distributors (called "jobbers"). Some operators own or rent their locations (this is usually the case in amusement arcades) and some location owners own their own machines (commonly the case in bars with pool tables). Indeed, at least one manufacturer (Bally) has combined all four elements of the industry. Bally has its own distribution outlets in certain parts of the country and operates a chain of amusement arcades, called "Aladdin's Castle". Bally has been to date the most innovative and aggressive manufacturer in this regard, but we expect that other manufacturers will follow the Bally example of increased vertical industry integration.

At the bottom of the industry structure comes the player or consumer. In 1980, consumers spent \$12.8 billion on vended products in the U.S. An estimated \$3 billion was fed into the coin slots of video games. Slot machine gambling is a multi-million dollar business. Over 400,000 jukeboxes plus an unknown but much larger number of pinball machines, shuffle alleys and pool tables

also contribute to the total dollar volume of the industry.

Racketeer Involvement on the Record

There is no doubt that the vending industry has attracted the interest of known organized crime figures. This is true at every level of the industry. "Doc" Stacher and later, Gerard Catena, were shareholders in Runyon Sales Ltd., an operator and distributor (one of the largest in the country) which also became involved in the establishment of Bally Manufacturing (see Moffitt Commission, 1974). Angelo Bruno was closely involved in the management of a number of Philadelphia-based vending companies (Pennsylvania Crime Commission, 1980). Meyer Lansky ran a large New York distributorship, called Emby Distributing, in the early 1950s (McClellan Committee, 1960). All these examples are well known in the law enforcement community. However, apart from these documented instances (there are others, but not many), virtually nothing is known about on-the-record involvement of racketeers. Moreover, most of the known cases are extremely dated. Meyer Lansky left the industry in the early 1950s. Catena's involvement on the record in Runyon and Bally ceased over ten years ago. This same period has seen the transformation of the industry by new technology and the entry of major and clearly "legitimate" corporations such as Warner Communications and Gulf & Western. Yet the reality of racketeer involvement continues to be asserted as if little had changed.

The search for racketeer involvement is made extremely difficult by the orthodoxy itself. For obvious reasons, we could not get access to police intelligence files which would provide us with a list of names of people known or suspected to have connections to known organized crime figures. But, as discussed earlier, the law enforcement community defines the racketeer in such a fashion that only access to this information can provide a means to test the validity of their assertions. Denied, properly, this information, we could do no more than note the potential weakness of our research and attempt to remedy that weakness by looking for evidence of racketeer involvement through its expected consequences. Here, we were dependent on police intelligence.

One finding requiring specific comment concerns the nature of racketeer involvement in the day-to-day management of vending companies. The vending business is not conducive to an easy life. Vending operators work long hours. They spend a great deal of their time traveling between locations. They must always be on their guard against employee theft (a major problem in any business without strict cash control) and competition from other vendors. In other words, consistent attention must be given to the business. For these reasons, we do not expect that racketeers are likely to be involved on the level of day-to-day management.

This would, not, however, be a bar to racketeer control through ownership. In order to test for absentee control, we carried out research on the recorded ownership of over 170 vending companies in New York and New Jersey. We examined, to the extent that our data allowed, the identities, prior employment histories,

and (where possible) criminal records of virtually all the companies' personnel. We examined corporate records to discover whether the companies used the same lawyers, accountants or banks (all of which could, we hypothesized, possibly indicate that these apparently independent corporations were fronts for some person or group of persons). While recognizing the problems of identification of racketeers discussed above, we found no significant indication of organized crime involvement on-the-record or of third-party control.

Indicators of Racketeer Involvement

As has already been noted, we were unable to find any evidence of labor racketeering in the vending industry, for the simple reason that there are no longer any labor unions active in the industry or markets we studied. Insofar as the corrupt use of union power is an indicator of racketeering, it sheds no light on the contemporary vending industry.

More surprisingly, our research with informants and scrutiny of police files did not uncover significant evidence of the use of violence or extortion. The historical record, especially the McClellan Committee hearings, is replete with stories of violence and intimidation, usually directed either at vending company owners or at location owners. There is also a great deal of evidence of interference with machines, through the introduction via coin slots of acid or Coca-Cola syrup (by all accounts still the best way to gum-up a machine). But these methods appear, according to our informants, to have died out over the last twenty years or more. There are cases of violence in the industry, but they are rare. We have learned of no case within the last twenty years of conviction of an industry figure of a crime of violence connected with his business.

Instead, we heard of many cases in which the reputation of the industry as being prone to possible violence due to its unsavory participants was cited as a reason to dissuade legitimate people from entering the industry. One of the authors, posing as a professional person wishing to invest in a vending company, was warned by a distributor not to attempt to set up business in an area where there were already "old-time" vendors established.

Two features of the operation of the industry at the route company level caused us some concern. First, we noticed that vending servicemen (who collect the money and service machines) were extremely unobtrusive, indeed almost invisible, in their work. We discovered that this was not due to stealth or secretiveness designed to hide criminal activity. Rather, it was motivated by a desire to avoid exposure to the patrons of locations (especially bars) who represent a very real threat to the serviceman who is often working alone and carrying large sums of cash.

Second, and more significant, was our observation that location owners rarely, if ever, checked the serviceman's count of the coins taken from their machines. Could this, we wondered, be the result of the location owners' unwillingness to risk

antagonizing a possibly violent operator by appearing to suggest that there might be cheating on the count? In fact, the reason is that trust between location owner and vending operator is essential in the day-to-day operation of the business. In a critical way, the two are partners. The operator cannot exist without the space made available by the location. On the other side, the operator is, as was explained to us, "the bar's best customer", representing a steady source of income which is, for the location, almost entirely profit.

We found evidence of considerable competition amongst the companies at the operator level. Operators are continually on their guard against competitors "jumping" their locations and generally are always on the lookout for an opportunity to jump the locations of competitors. Locations are sometimes protected against jumping by the use of contracts, usually entered into in order to secure loans provided by the operator to the location and repaid out of the proceeds of the machines. Written contracts are, however, rare and when they do exist often provide that the agreement is terminable at will.

Nevertheless, operators regard their locations as business assets (property) and, when they are sold, they are invariably treated as goodwill. Our research indicates that locations may be sold for an amount anywhere between 17 and 25 times monthly earnings. This may be regarded as a multiple so high as to suggest the existence of an agreement between operators not to compete for the location after it has been sold.¹ However, we could find no evidence to support such a view and much anecdotal evidence to counter it. Moreover, we discovered some features of the industry which, we believe, explain the high price of locations and which are not indicative of industrial conspiracy.

First, an operator who jumps the locations of another risks retaliation in kind. This may set off a "war" between operators which will inevitably result in the expenditure of substantial amounts of money by all participants as they attempt to lure away location owners from their former operators, usually through the offer of a bonus payment, loan or new machine.

Whichever course is taken, the effort will be expensive, especially once an operator's other locations hear of the monies being offered and ask why they, too, should not receive some consideration for remaining loyal? Under the circumstances, quiet purchase of a location makes sense. So does the amount which may have to be paid to acquire the location; it is simply a matter of supply and demand.

In a further attempt to ascertain the existence of customer allocation agreements which would suggest the presence of racketeering

1. Compare the treatment of selling prices of solid-waste collection stops outlined above, p.10.

(though not, of course, of racketeers as defined by the law enforcement community), we conducted surveys of locations in Trenton, New Jersey and, with the assistance of the Rochester Police Department, Rochester, New York. Our aim here was to find evidence of route concentration which would, we believe, be regarded as desirable by anyone engaged in a rational customer allocation conspiracy. Far from providing such evidence, our surveys demonstrated an almost irrational pattern of routes. In some cases, we discovered that two route companies would travel 5 miles or more to the same shopping mall in order to service one or two machines each.

We found little evidence to indicate improper price manipulation within any sector of the industry. Informants within the industry put the rate of return on investment at around 12 to 15 percent. This is not notably high. However, in the video game sector the returns can indeed be astronomical. We heard of some machines paying for themselves in as little as 10 days on location! But these cases are extremely rare and, while the returns on videos can be great, so too is the risk. A game greatly in demand today may die in a month. Machines, which usually cost between \$2,250 and \$3,000 to buy, may be virtually worthless after 3 months.

Perhaps most importantly, we could find no indication of price manipulation at the most basic level of the industry - the cost to the consumer or player. The cost of playing a video game, pool table, jukebox, buying a pack of cigarettes etc. is generally the same around the nation. It is inconceivable to believe, and it has never been asserted, that the entire industry throughout the country is subject to racketeer domination. Yet the industry behaves in this crucial respect identically in Brooklyn, Miami, Omaha and Anchorage. It is extraordinary that this fact, which is readily available to the law enforcement community, has never been referred to in assessing the validity of the assertions of racketeers involvement.

It was more difficult for us to gather data on the two aspects of taxation and the vending industry, namely skimming and laundering. It has not been possible for us to assess the extent of either of these activities, although we have no reason to doubt their existence. Significantly, we have been unable to find any evidence, either from the public record or from the police files to which we had access, to suggest that law enforcement agencies have any significant information about either activity. Both are obviously possible, but the analysis has not, to our knowledge, proceeded beyond the possible to deal with the actual. In other words, the assertion has been repeated without any substantial evidence to support it.

Nevertheless, the potential of the vending industry for tax evasion is well understood by people in the business. Literature distributed by a company which advertises opportunities for entry into the video game business (and whose clients include doctors, attorneys, college students and landlords) point out that the industry is one in which there are "No Strict Controls". This is an obvious invitation to skimming. If it is a feature which appeals

to ordinary people, we must assume it has the same appeal to racketeers. We do not suggest that all participants in the vending industry engage in tax evasion, simply that it is impossible to believe that only racketeers engaged in the industry do so, or that they skim more than anyone else.

We cannot make the same claim in relation to the laundering of illegal income through vending machines. Informants told us of vending companies being purchased for this purpose in the past, although we received no information that this is a contemporary feature. We had one means only of testing for evidence of laundering. There is little point in putting machines in actual locations if the object is to report fictitious income (this is never checked by the I.R.S.). Yet all but one of the companies we studied did have machines on location. This contrasts with the stories of laundering in previous times, where apparently the machines were never taken out of companies' warehouses. Obviously, our study in this regard is inconclusive. Again, however, we must note that we found no contemporary evidence amongst law enforcement agencies to support this allegation.

Racketeering Among Distributors and Manufacturers

It was our early hypothesis that vending machine distribution could represent a "choke-point" over the operators which would allow racketeers to exercise great influence over the industry. Since the amusement industry is to a great extent dependent on the novelty appeal of new machines to players, the sale and maintenance of these machines is of critical importance to the operator. There is little point in a Mafia member having a video machine in a bar if all the playing customers have gone across the street to play the "hot" machine in another bar. One means of preventing competition from other vending operators using better equipment would be to ensure that only the racketeer-connected operators could buy popular machines.

Our research failed to uncover evidence of any such practices among distributors. We found distributors whose exclusive product lines (i.e., where a manufacturer has only one distributor of its machines in a particular geographical area) suggested potential anti-competitive monopoly, but we discovered no evidence that it was impossible for an operator who wished to purchase such a machine from another distributor outside his home area to do so. Neither is it, apparently, impossible to get a machine serviced (in the case of failure) by the local distributor even if it was purchased from another source.

We also sought evidence that distributors gave some operators preferred treatment through the extension of credit, discounted prices for machines and faster delivery of new equipment. According to our informants, these were all features of the industry in its early years. Since the transformation of the business following the introduction of solid-state electronics, such practices appear to have become rare. This seems to be a result of the massive increase in demand for machines by operators who would now be prepared to go to another distributor if their local firm failed to provide

the goods on competitive terms. Further, the new technological sophistication of machines forced many operators to hire servicemen who could do more than merely collect the money. These operators were thus less reliant on distributors for the provision of maintenance.

The video boom has also had a critical effect on distributors, who now increasingly find themselves caught between the pressures of manufacturers requiring payment within 60 days for inventory and operators clamoring for new equipment, invariably on credit. We found that even long-term customers are now required to put down 20-30% on machines costing \$3,000 and pay interest at market rates ranging from 15% upwards.

The history of the vending manufacturers is fascinating, colorful and, perhaps unfortunately, beyond the scope of this report. It is clear from the few histories of the industry in circulation (see Sharpe, 1975) that the personalities and experience of the men who brought the industry from its infancy in the Depression to its present state have shaped its behavior and image (both self-perceived and public) up to the recent past. The reason for this rests primarily in the extent to which the major manufacturers have remained in the ownership of the families which created them and the lack of entry, until recent years, of outsiders into this sector. Until the mid-1970s, the major manufacturers such as Gottlieb, Williams, Rock-ola (actually owned still by the Rockola family) and Seeburg remained in private hands, owned by the families which formed them.

The result of this continuity in management and ownership has been to create within the manufacturers a network of association bred of competition and, occasionally, cooperation in the face of threats to the survival of the industry. The relatively small number of manufacturers has also resulted in routine movement of key employees between the various companies, sometimes because of poaching by competitors and also because for many workers there was simply nowhere else to go.

From the earliest days, the manufacturers have been involved in conflict with law enforcement agencies and governments borne of the association of the industry with gambling. Almost all the manufacturers built pinball or slot machines which could be used for gambling purposes. But there was at that time nothing illegal in such production. Gambling law enforcement, however, involving both federal, state and local law enforcement agencies, resulted in a pattern of routine scrutiny over the industry which has remained until the present day. It is small wonder that the manufacturers have remained a tightly-knit group, displaying outward signs of hostility and vigorous competition toward each other (the first manufacturers' association was formed within the last six months) while, according to our informants, maintaining a rough and ready camaraderie behind the scenes.

The description of the major manufacturers as family businesses has for the most part changed in the past five years. Some

of the majors have made their own public offerings, others have been purchased by other large public corporations, often those already in the entertainment business. Table 1 lists the majors, their main products and their ownership.

Although in recent years there has been a spate of new products entering the market from Japan (almost entirely consisting of video games), the vending machine business worldwide remains overwhelmingly dominated by these U.S. firms. The major manufacturers are responsible for most of the research development and design work for the products they sell. They also are largely responsible for component manufacture, except for micro-processors produced mainly by independent firms in California's silicon valley. The wooden cabinets which house almost all machines are also often built by contractor cabinetmakers.

The major manufacturers are booming. The figures provided earlier for Atari are indicative of the current levels of profitability within the industry, spurred on by the enormous growth in the video game sector. Midway Manufacturing, Bally's wholly owned subsidiary which makes the company's video games, increased revenues from \$21.5 million in 1978 to \$60.8 million in 1979, \$133.8 million in 1980 and has projected sales of \$220 million for 1981. The other manufacturers in this sector of the industry are enjoying similar levels of growth.

This phenomenal increase in revenue comes at a price. Capital expansion for plant and component purchases is such that the smaller companies are unlikely to be able to keep up with the boom. Already a number of the smaller manufacturers are turning to the majors for the purposes of actual production of their machines. Licensing agreements have become an increasingly common means for the industry as a whole to cope with the capital demands of product manufacture.

The manufacturers have recently faced serious illicit competition from small, independent companies copying their video machines. Copies of popular machines, known in the trade as "knock-offs", have become increasingly common in the last year, forcing the manufacturers to form an industry association, one of whose major tasks of which is the detection and eradication of knock-offs.

During our research, C.R.I.S.P. investigators were openly offered a number of knock-off games by a distributor. These games sold at an average discount of 10% less than the originals (which the same distributor also offers for sale) which sold for about \$2,750 each. While this savings does not seem significant in light of the fact that the knock-offs could not have received service from any of the regular distributors in the area, they have the attraction of ready availability.

It is worth noting that if the manufacturers are controlled by racketeers, then racketeers seem to be no more successful in preventing copyright and trade secret infringement than any reputable

TABLE 1

MAJOR VENDING MACHINE MANUFACTURERS

<u>Company</u>	<u>Location</u>	<u>Major Products</u>	<u>Ownership</u>
ATARI	Sunnyvale, CA	Video games	Warner Communic' (NYSE) (100%)
BALLY	Chicago, IL	Pinball, Slots, Video games (through its Midway subsidiary)	Publicly traded (NYSE)
CENTURI	Hialeah, FL	Video games, Jukeboxes	Publicly traded (OTC)
EXIDY	Sunnyvale, CA	Video games	Privately held
D.GOTTLEIB	Northlake, IL	Pinball, Video games	Columbia Pictures (NYSE) (100%)
NATIONAL VENDORS	St. Louis, MO	Cigarettes, Food, Beverage	UMC Industries (NYSE) (100%)
ROCK-OLA	Chicago, IL	Jukeboxes	Privately held
ROWE INT'L	Whippany, NJ	Cigarettes, Jukeboxes, etc.	Triangle Industries (OTC) (100%)
SEGA	Los Angeles, CA	Video games	Gulf+Western (NYSE) (87%)
STERN ELECTRONICS	Chicago, IL	Video games, Pinball, Jukes	Privately held
WILLIAMS	Chicago, IL	Pinball, Video games	XCOR INT'L (OTC) (100%)

computer company.

In the midst of this booming industry, one company stands out as deserving of specific attention for the purposes of this report. More than any other entity, the Bally Manufacturing Company represents the known pariah of the industry, chosen many years ago to bear the brunt of law enforcement scrutiny of the vending industry.

Bally has a long history as a manufacturer. The company originally called Lion Manufacturing, was building machines under the Bally trade name in the early 1930s. Following the death of its founder, Ray Maloney, in 1958, Bally was taken over by a syndicate loosely based on the owners of Runyon Sales, then the largest Bally distributor in the country. One of the shareholders in Runyon was the well-known organized crime figure, Gerard Catena. Over the years since the company was reorganized, it and its officers have been the subject of repeated investigations. Most of these investigations stem from Bally's position as the major manufacturer of slot machines in the world and, more recently, the company's entry into the casino business in Atlantic City. One of the conditions of entry into the highly regulated world of casino gaming (either as a casino operator or as an equipment supplier) is that the subject agrees to accept and pay for scrutiny by regulatory agencies. Consequently, we know more about Bally than possibly any other participant in the industry.

Despite the massive investigations of the company (summarized in New Jersey Division of Gaming Enforcement, 1980), there is virtually no evidence in the record which casts light on the consequences, if any, of Bally's admitted underworld connections. Neither is there evidence that, even in the old days, Catena's involvement in Runyon led to that company engaging in criminal behavior. Bally was ordered by the Nevada Gaming Commission to cease dealings with Runyon in the mid-1970s. Once this took place, a new distributor took over Runyon's business. Did this new, and apparently entirely legitimate, distributor act differently to Runyon? There is no evidence to suggest so. This either indicates that the new distributor is now engaged in identifiable and visible racketeering activity or that Runyon was not. Given the degree of law enforcement interest in Bally and its associates, the latter proposition commands significant attention.

The same proposition is indicated in relation to Bally itself. In all the reports on Bally, there is very little analysis of racketeer involvement which goes beyond the simple assertion of its presence. This is graphically demonstrated in the now infamous photograph taken by the F.B.I. (who, according to an informant, were informed of the event by a Bally employee attempting to discredit a rival) of a company officer playing golf with Gerard Catena, some years after the company had been ordered to cease any contact with him. What does this photograph mean? Was Catena still involved? Frankly, this never seemed to be an issue of concern to the agencies which seized on the picture to castigate the company.

We do not mean by this analysis to suggest that Bally has not engaged in criminal conduct. We do not know whether it has. We do suggest that Bally cannot be distinguished according to the evidence available to us from other participants in the industry. The company dominates the slot machine manufacturing business, but every person involved in that business with whom we spoke vouched for Bally's technical excellence in this field. Furthermore, it must be remembered that, despite the stringent inquiry into Bally's fitness to own and operate a casino in Atlantic City, no significant wrongdoing was attributed to the company. The company president, William O'Donnell, was forced to resign but the company itself was granted a clean bill of health in an extremely hostile environment. Mr. O'Donnell's sins appear to be based on his inability to cease communication with racketeers. We have not found significant evidence to cast light on what the consequences of this communication are alleged to be. This demonstrates the problem inherent in the failure of the law enforcement community properly to define racketeering while at the same time continuing to assert its importance.

4. IMPLICATIONS OF THE STUDY

In order to assess the nature and extent of racketeer involvement in the vending industry we took the orthodox perception and attempted to analyze its components. We then tested those components by seeking an awareness of what law enforcement agencies knew about the vending industry and then comparing that knowledge with such knowledge as we could gather by our observations and research of conditions within the industry. Our initial assumption was that we would find a wealth of information among police intelligence files which we would then have the task of comparing, critically and constructively, with our independent findings.

We were amazed to discover that the police in fact have almost no knowledge about the industry other than information on associations between individuals, some of whom are members of the Mafia.

We do not suggest that it is easy to understand what it is that members of organized crime actually do with a legitimate business which they have infiltrated. However, we believe that the law enforcement practitioners have eschewed that issue in order to concentrate on presence alone.

The implication from these findings is not merely that law enforcement practitioners should attempt to understand the nature of ongoing criminal conspiracies as they exist in legitimate industry. This they should certainly do, casting aside to whatever extent is possible the orthodoxy of organized crime and receiving instead training in the detection of corporate crime, tax evasion (from IRS investigators, for example, who know full well that skimming is possible in non-cash businesses to no lesser extent than cash ones) and the effect of government regulation, especially licensing, on the motivation of criminals to enter and remain in an industry.

The implications of our study go further; we have found that the vending industry is affected by the continued assertions of racketeer involvement. Although the industry can be highly profitable to the legitimate investor, a major incentive to entry for outsiders appears to be its potential for tax evasion. At the same time, we were told by legitimate people already established in the industry that they have found the negative image of the business a significant barrier to the obtaining of credit from banks and other finance institutions.

This reputation has also been a problem when dealing with government at all levels. Informants told us that governmental attempts to impose heavy taxes and license fees on amusement machines are often motivated by a desire to make the business less profitable for organized crime. This is of course the exact reverse of the true picture; even by the orthodoxy racketeers have hidden assets which allow them to profit when legitimate businessmen cannot.

Our discussions with officers in the law enforcement agencies with whom we cooperated make it clear that they know of the deficiencies in their analysis and understanding, and that they have the capacity to correct them. But these officers also understand the impossibility of attempting such a new analysis as long as the orthodoxy holds sway and prevents, or at least inhibits, the vending industry from being able to behave in a fashion which will allow them, and us, to distinguish between business as usual and racketeering. In the meantime, the continued assertions of racketeer involvement in the vending industry are only counter-productive.

CHAPTER IV

IMPLICATIONS OF THE STUDIES

The two case studies give rise to very different implications for the law enforcement community. This should not be surprising, for the case studies only mirror diversity in the patterns of racketeer behavior within various segments of the legitimate economy. Such diversity may stem from a number of causes. Changing economic and social conditions are likely to be crucial. For example, it may be that the traditional racketeer has in a sense "outgrown" the solid waste collection business with its low social and economic status. But the connections formed within the trade linger, and the racketeers are still called upon to provide services, such as dispute resolution, for the people in the industry. While this role may be critical to the continuation of criminal conspiracies in the industry, in no real sense can it now be said that the racketeers control the trade or primarily motivate criminal behavior.

Equally, it may be argued that the vending industry has outgrown the racketeers. The growth of the amusement business and its technological transformation has given rise to market forces which simply prevent old-time muscle tactics and coercion from being effective. There is no point in a racketeer using force to control machine placement in a bar or restaurant unless he is also able to provide the patrons with the games they desire. If he cannot, the patrons will just move to another bar. If the racketeer has the resources to provide the games, then there is little need to engage in criminal behavior. The racketeer should act like any other member of the industry, making decisions based on economic factors and shaped by market demand.

Another critical factor in determining the nature of racketeer involvement in legitimate industry is the motivation behind that involvement. It is not necessarily true that the prime motivation of racketeers is the desire to maximize income at all costs. Criminals may wish to invest in legitimate business in order to legitimize their illegally-derived income by laundering, to provide a cover for other activities or to provide financial security for themselves and their families once their criminal careers come to an end. In none of these cases should we necessarily expect to discover evidence of criminal behavior by the racketeers in their conduct of legitimate business.

This is not to suggest that racketeers are not attracted by the possibility of under-reporting taxes. Like most people, racketeers are likely to regard taxation as a burden to be avoided wherever

possible. It may be that racketeers are more likely to evade taxes than other businessmen engaged in similar industries, but the difference in the extent of evasion may be marginal.

What is it, then, that sets racketeers apart from other people? Obviously, the use of violence as a business tactic is factor of the gravest importance. However, these case studies have not found evidence of habitual use of violence by racketeers in the two industries under examination. Instead, evidence has been found that suggests a more subtle racketeering tactic. The reputation of certain individuals as being racketeers may make even the threat of force unnecessary. When a wholly legitimate vending operator can collect on a debt by "talking like an Italian" rather than getting his attorney to issue a summons, then it seems that law enforcement efforts have actually entrenched racketeering.

The two case studies have presented different proposals for the law enforcement community to consider in fighting organized crime involvement in the two industries. Both approaches have difficulties. For government to become an active participant in the solid waste collection industry (as is suggested in Chapter II) clearly involves political and economic questions of great complexity, especially at a time of general curtailment of government expenditure. So too, the suggestion that law enforcement agencies should cease scrutiny of the vending industry altogether is bound to cause problems, given the continued and open presence of known organized crime figures in the business. However, these questions should be addressed directly and openly, if there is serious commitment on the part of law enforcement agencies and their political superiors to do something about ongoing criminality in these industries.

In more general terms, there is much that can be done to improve the effectiveness of enforcement efforts. We need to broaden police and prosecutorial perspectives on racketeering, and to provide them with greater training and support in the investigation of business crime. Enhanced training must have as its primary aim the encouragement of new analytical approaches in police work. As long as police investigation continues to focus on individual criminals and their associations (essentially, criminal networks) there can be little hope of effective prosecution of racketeers. Even if a top level known organized crime figure is indicted, there will be many others to take his place.

In contrast, broader perspectives on racketeering will allow effective action to be taken against the specific criminal activity which is to be targeted. For example, if it is decided that there is an unacceptable level of skimming of taxable income in the vending industry, then relatively simple measures can be taken which will substantially diminish the possibility of under-reporting. There would, for example, be no major difficulty in establishing a system of verification of vending machine proceeds. The technology for accurate, reliable and discreet coin counting mechanisms readable from outside the machine already exists. Any state government seriously concerned about lost revenue would only need to enact

legislation mandating the use of such equipment to provide an inexpensive (the equipment would be installed by the machine owner) means of checking the "take" of machines. Such measures would be far more effective in promoting compliance with the law than rote repetition of the racketeer domination orthodoxy.

This is merely one example of the potential benefits of a new analysis of racketeer activity. There are many others which police and prosecutors will, when they are freed from the limited perspectives of traditional methods, develop for themselves.

The development of these new perspectives requires only initiative and will. Indeed, at least one program which takes important steps along this path already exists. The New Jersey State Police currently conducts a training seminar on Organized Crime Intelligence Analysis at its academy in Sea Girt, N.J. which provides a model for the sort of effort we propose. At this intensive seminar, students from law enforcement agencies around the country and even overseas are lectured by specialists in law, business, computer science, accounting and sociology. These students are exposed to analytical methods and supporting computer programs, new perspectives on racketeering and conspiracy law and a variety of particular aspects of criminal behavior. The authors of this report can testify to the effectiveness of this training seminar in promoting new ways of thinking about organized crime. The experience of those officers responsible for the New Jersey program should be invaluable for concerned members of the law enforcement community as they attempt to set up effective procedures for the eventual control of racketeering.

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