

II. Transnational Issues of Organized Crime

1. MONEY LAUNDERING: MOTIVES, METHODS, IMPACT, AND COUNTERMEASURES

*by Christine Jojarth**

1.1 Introduction

Money laundering is big business. An estimated 2–5 percent of global gross domestic product – corresponding to \$1.3–3.2 trillion in 2010 (Camdessus 1998; World Bank 2011¹) – are being laundered annually. Demand for money laundering is driven by the need to create a false legitimate appearance for funds that are tainted by their illegal origin or indented purpose. All sorts of underworld figures, such as drug traffickers, tax evaders, corrupt officials, and terrorists, feel this need out of fear that their money trail will lead to detection and confiscation.

To obfuscate their transactions, money launderers use an ever-widening range of methods to first conceal dirty money, then to convert it into other forms of assets, and finally to integrate the funds into the licit economy.

The threats posed by money laundering are just as diverse as the people and organizations engaging in it and the methods used. The most immediate threat is the undermining of efforts to combat crime and terrorism with negative consequences for a country's security and political stability. More indirect, but by no means less severe, is the threat money laundering poses to economic development as a result of its distorting effect on investment decisions and competition.

It was only in the late 1980s that policy makers started to become aware of these threats and to discover the importance of “follow the money” and confiscation as a policing and a crime deterrence strategy. The United States was the first country to criminalize money laundering and the initiator of the internationaliza-

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1 | The United Nations Office on Drugs and Crimes estimates that around \$1.6 trillion, or 2.7 percent of global GDP, was laundered in 2009 (UNODC 2011).

tion of these norms. Other Western nations followed suit and adopted a series of anti-money laundering measures that spread rapidly around the globe. The underlying institutional approach represented a novel way to foster international cooperation in terms of the type of actors involved, the legal form chosen for codifying the norms, and its treatment of state sovereignty.

The motives, methods, impact, and countermeasures related to money laundering will all be discussed in turn in this chapter. The goal is to provide an overview² of these four central aspects of money laundering and to build a foundation for the other chapters in this part of the book.

1.2 Motives

While the legal concept and criminalization of money laundering is a fairly recent invention, the motives for engaging in this practice date back a long time.

Throughout history, people deployed a variety of tactics to ensure that enjoying the proceeds from their criminal activities would not lead to prosecution and the confiscation of their assets. A villager who had stolen his neighbor's cow most likely did not keep it. Instead, he led it out of the village to sell it or to exchange it for some other livestock in order to disassociate himself from the theft. He might even have felt the necessity to fabricate a story about an unexpected inheritance to create a seemingly legitimate rationale for the sudden increase in his wealth.

Back then, as much as today, the extent to which criminals feel a need to deploy techniques to conceal their loot, to convert it into other forms of assets, and to create a legitimate appearance depends directly on the extent to which they face a real risk of detection and sanctions by law enforcement officials or by their community. In the absence of criminalization and effective sanctions, money laundering is nonexistent, simply because criminals feel no need to turn on the "washing machine" when they know that they can enjoy their loot with impunity.³

Over the past decades, a widening range of practices have been outlawed and moved toward the top of law enforcement priorities. This development led to an increase in the diversity of individuals and organizations that resort to money laundering as a means to evade these control efforts.⁴ Initially, money laundering was most relevant to networks engaged in blue-collar crime – in particular drug

2 | For a more in-depth discussion see Jojarth (2009).

3 | Guatemala's President, Otto Pérez Molina, is thus correct when arguing that by decriminalizing drug trafficking, one would largely get rid of money laundering (*Economist* 2012).

4 | Another reason for this increase is of purely definitorial nature. Money laundering is a derivate crime, that is, it is predicated on other criminal endeavors. The list of predicate offenses for money laundering has expanded significantly over the past two decades so that today, the crime of money laundering is associated with most serious offenses.

traffickers⁵ – as they were in the spotlight of law enforcement. In the context of this book, the most important “newcomers” to the money laundering scene were corrupt government officials, sanction busters, and terrorists.

In the 1990s, international corruption gained significantly in salience. Corruption scandals like those involving the former Philippine President Ferdinand E. Marcos⁶ or Nigeria’s former military ruler Sani Abacha⁷ propelled Western leaders into action. They established national and international⁸ regulations, making it considerably harder for companies to bribe foreign officials. Until then, many Western companies had openly declared how much they had paid in “facilitation fees” to win overseas contracts, as such payments were not only deemed legal in their home countries but often even made tax deductible.⁹ The introduction of these new regulations forced companies to either compete fairly or to turn to techniques to conceal the flow of bribes. Similarly, corrupt government officials started to engage in money laundering in order to reduce the risk of having their (overseas) assets seized.¹⁰

Sanction busters present another type of money launderers of particular relevance to the democracy focus of this book. The end of the Cold War enabled the United Nations to agree on the imposition of economic sanctions much more frequently than in the past. This increase in the frequency and geographic reach of international sanctions strengthened the need for sanction busters to devise schemes that would obfuscate their dealings with a quarantined state or group and thereby boosted the demand for money laundering. The trend toward smart sanctions, and in particular targeted financial sanctions, has accentuated the

5 | In fact, the legal concept of money laundering was initially exclusively tied to gains from the illicit drugs business. See United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (Article 3 paragraph 1) or FATF (1990). Over the past two decades, the list of so-called predicate offenses for money laundering has been – and continues to be – expanded with the effect that it now encompasses most categories of serious offenses. See Interpretative Notes to Recommendation 3 of the FATF Recommendations of 2012.

6 | Marcos and his associates are alleged to have illicitly accumulated an estimated \$5–\$10 billion through a variety of corrupt schemes (World Bank 2010).

7 | Abacha, together with his family and accomplices, allegedly siphoned off \$4 billion from his poor country (Olson 2002).

8 | For example, OECD Anti-Bribery Convention of 1997; United Nations Convention against Transnational Organized Crime of 2000; United Nations Convention against Corruption of 2005.

9 | For example, Germany only barred this practice in 1997, in response to the OECD’s 1996 Recommendation on the Tax Deductibility of Bribes to Foreign Public Officials.

10 | For a recent example of an overseas asset freeze involving an allegedly corrupt official, see Teodoro Nguema Obiang Mangue, a son and likely successor of Equatorial Guinea’s incumbent President (BBC 2012; Silverstein 2011).

importance of money laundering further (Cortright et al. 2002). For example, Swiss authorities accuse associates of Syria's President Bashar al-Assad of trying to launder the more than \$50 millions Syria's first family holds in Switzerland in an attempt to circumvent international sanctions and the freezing of their assets (NZZ 2012).¹¹

Already before – and with an even greater sense of urgency after – the terrorist attacks of September 11, 2001, the United States and many other countries and international organizations increased their efforts to disrupt the flow of money to terrorist organizations.¹² Within the same month of the attacks, the United Nations Security Council adopted resolution 1373, which requires all member states to freeze funds and assets controlled by people or entities with links to terrorism.¹³ This and other initiatives targeting terrorists' soft financial belly made money laundering¹⁴ essential for terrorists to continue their operations.

In sum, every individual or organization – including criminals, corrupt government officials, sanction busters, and terrorists – with a reason to fear detection and forfeiture has a motive to engage in money laundering. The broader the scope of criminalization and the stronger the law enforcement offensive, the harder these wrongdoers will try to launder their assets.

1.3 Methods

Penal codes and law enforcement efforts determine the categories of individuals and organizations that will resort to money laundering and the intensity with which they will do so, as discussed in the previous section. In addition, policing strategies also shape the *methods* criminals will deploy in order to evade detection and forfeiture. Not unlike air in a balloon, money laundering adjusts to those areas with the lowest pressure. When policing initially focused on the banking sector, money launderers shifted to the insurance industry. When anti-money laundering (AML) efforts were broadened to include the insurance sector, crimi-

11 | The overwhelming majority of the \$1.5 bn Bashar al-Assad has allegedly amassed for his family and his close associates is kept in countries that have not adopted economic sanctions against his regime, notably Russia and China (Inman 2012).

12 | For example, the International Convention for the Suppression of the Financing of Terrorism of December 1999 (entered into force on April 2002); Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot Act) of October 2001.

13 | United Nations Security Council Resolution 1373 of September 28, 2001, Paragraph 1(c).

14 | Nb., in contrast to most other money launderers, terrorists resort to money laundering primarily in an effort to conceal the intended illegitimate purpose of their assets while the origin of those assets is often legitimate, for example, donations to charitable organizations (Greenberg 2002; Naím 2005; United States General Accounting Office 2003).

nals intensified laundering operations in real estate. The cat-and-mouse game continues, and money laundering keeps expanding into ever more sectors. In the process, criminals and their intermediaries have invented a myriad of different money laundering schemes. All these various schemes have in common that they seek to disassociate funds from their dirty origins (or purposes) and to create a false legitimate appearance through a series of transactions that are usually categorized into three distinct stages: placement, layering, and integration (cf. Zagaris 1992). This categorization serves primarily as a heuristic tool and does not represent some fixed “natural law”: Not all money laundering transactions run through all three stages, and additional layers of complexity are sometimes added. These transactions are usually, but not necessarily, carried out involving a number of different countries.¹⁵

During the placement stage, money launderers deposit their illicit cash into bank accounts, usually in the same country where the illicit profits were generated. They typically break up their funds into smaller amounts so that each individual deposit remains below the designated threshold level,¹⁶ above which financial institutions are required to perform customer due diligence.¹⁷ Money launderers will likely involve a number of trusted people and companies to make these deposits on their behalf over the course of some time.

The purpose of the second stage – the layering or moving stage – is to disassociate the “dirty” money from its source or intended purpose. Money launderers seek to achieve this through a complex series of financial transactions, such as the wiring of funds through a globally scattered network of bank accounts.

In the third and final stage – integration – the launderer integrates the processed funds and inserts them into the legitimate economy. Any legal investment vehicle (in the broadest sense) that generates some financial return – even if that return is smaller than the initial investment – can serve this purpose. The harder it is for outsiders to verify the declared sums spent on or earned from that enterprise, the better suited it is for money laundering purposes.

Following are a few examples illustrating the immense diversity of schemes devised by creative money launderers.

In one case, an individual raised suspicion with his unusual betting strategy. Over a long period of time, he deployed the very same betting strategy, which, with a high degree of certainty, made him win relatively small sums but resulted in an average net loss of 7 percent. To receive his payouts, he had checks issued to a total of 14 different bank accounts in the names of 10 third-parties. Some of

15 | For example, 80 percent of the money laundering operations detected in Canada (Beare and Schneider 1990) and 90 percent of those detected in Belgium (Stessens 2000) involved money that had been brought in from abroad.

16 | The FATF recommends a threshold of \$/EUR 15,000 (FATF 2012a).

17 | This process of breaking up larger sums into small individual deposits is also called “smurfing.”

these recipients turned out to be armed robbers or their immediate families. The money launderer had funneled a total of approximately \$3.3 million through this system (FATF 2002).¹⁸ In another cases, criminals establish front companies with the purpose of creating a cover for the dirty origins of the money they invest in the enterprise. Probably the most notorious illustration of this phenomenon is the Mafia's dabbling in gastronomy (e.g., "Pizza Connection" of the 1980s). More singular examples include laundering operations run through horse racing stables (Koppel 2012) and soccer clubs (FATF 2012b). By establishing overseas subsidiaries, a front company can also launder money internationally through trade-based operations. It can move value across borders by over-invoicing and under-invoicing commodities that are imported or exported around the world, often in several iterations (carousel transactions) (US Immigration and Customs Enforcement 2012). A front company officially engaged in the trade of exotic leather can, for instance, move drug money from the United States back to Colombia by overpaying for a shipment of caiman leather it received from Colombia. It would then later return that shipment, claiming some defect, but never receive a refund.

While by no means comprehensive,¹⁹ the discussion above provides a sampling of some of the most common money laundering techniques and illustrates the boundless creativity criminals develop to evade the ever-tightening net of anti-money laundering regulation.

1.4 Impact

If left unchecked, money laundering can cause significant economic and political harm as will be discussed in this section.

1.4.1 Economic impact

The negative economic impact money laundering exerts is hard to quantify but can be significant.²⁰ There are two main channels through which money laundering can suppress economic growth: the weakening of crime control and the distortion of market mechanisms.

First, successful money laundering operations weaken the fight against the offenses that generated the illicit cash or that use funds for illicit purposes. The policing tactic of "follow the money" to find the perpetrator is rendered ineffective when the money trail is successfully obfuscated through a web of complex transactions. Criminals, terrorists, and corrupt government officials – among many other

18 | See FATF (2009a) for an in-depth analysis of how casinos and the gaming sector can be abused for money laundering.

19 | The FATF's annual typologies reports provide a wide range of case studies on different money laundering schemes.

20 | The United Nations Office on Drugs and Crime estimates that every \$1 billion laundered reduced overall economic growth by 0.04 to 0.06 percentage points (UNODC 2011).

money launderers – remain undetected and continue to operate with impunity. As a result, households and businesses face increased expenses for private security. Jobs are lost when businesses relocate to safer places and investments are stalled. Tax money is squandered when public contracts are awarded to non-competitive – but well-greased – bids. And there are many more causal mechanisms linking high levels of crime with economic losses.²¹

Second, money laundering can impose significant economic losses on a society by distorting the licit economy. Money laundering undermines the effectiveness of the market mechanism in allocating investment money to projects that yield the highest expected returns, and thus, on aggregate, the strongest economic growth. In the licit economy, investment projects compete with one another for capital on purely economic grounds. To generate competitive returns and to attract sufficient capital, businesses face ongoing pressure to increase the efficiency of their operations and to move into segments with strong growth potentials. It is through this competitive pressure that an economy sustains growth. In contrast, in the shady world of money laundering the “investment grade” of competing projects is predominantly determined by non-economic factors. Dirty money is not invested in projects that offer the highest returns but in those with the lowest risk of detection and forfeiture. In exchange for reducing this sort of risk, underworld figures and organizations are even willing to accept a negative payback, as illustrated by the betting example in the previous section. The greater the risk of getting caught the greater the willingness of criminals to pay for laundering services. The greater the obfuscation and conversion potential, the more attractive the investment project. Well-regulated and transparent sectors will be shunned in favor of investment targets that offer *sui generis* transactions with profits that are harder to quantify for an outsider (see section on “Methods” above). In addition to this inter-sector distortion of investment flows, money laundering also distorts competition *within* the sectors that attract dirty money. Businesses that accept shady investments may eventually crowd out businesses that raise their capital in legal ways. How can a law-abiding pizzeria owner who needs to generate competitive returns compete with a pizzeria that can stay afloat even if it never turns a profit on its official gastronomic operations?

1.4.2 Political impact

In addition to economic losses, successful money laundering operations and the crimes and terrorist activities they allow to flourish also undermine the chances for democratic transition and consolidation. Three aspects are worth highlighting.

First, high levels of crime or terrorist attacks undermine a democratic government’s legitimacy, as citizens expect their government to provide security (cf. Pérez 2003–04) and conditions favorable for economic growth. Public support

21 | For a more in-depth discussion see Pinotti’s (2012) analysis of how the Mafia’s strong presence in Sicily stifled the island’s economic development.

for democracy is further eroded when authorities misuse their offices for private gain. The dangerous promise of a “strong leader” unfettered by constitutional or parliamentary restrictions in his or her relentless fight against these evils gains much appeal at the expense of the democratic process. Second, money laundering can also pose a threat to democracy by helping to cover up financial transactions related to crimes that unlawfully alter the conditions for political competition – ranging from violations of campaign financing laws to contract killings of opponents. Third, successful money laundering undermines the effectiveness of international sanctions against dictatorial regimes and thus the prospects of military containment or regime change.

In sum, by obfuscating financial flows associated with a wide range of illegal activities money laundering allows these crimes to flourish at the expense of economic and political development.

1.5 Countermeasures

The international coordination of the fight against money laundering and terrorist financing is remarkable, both in terms of the great speed with which the new norms were diffused around the globe and its underlying institutional approach.

Money laundering was not illegal anywhere until the mid-1980s. The United States was the first country that dedicated a national law exclusively to the laundering of illicit proceeds (Money Laundering Control Act of 1986). From the outset, the US government was keen to convince other countries to follow suit. It realized that given the international mobility of capital a unilateral approach to combat money laundering was doomed to fail and risked jeopardizing the international competitiveness of its financial sector. These efforts first bore fruit in December 1988 with the adoption of the Basel Statement of Principles for the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering and – only a few days later – with the inclusion of anti-money laundering provisions in the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.²² The Financial Action Task Force (FATF) was formed in the summer of 1989. Less than a year later, the Paris-based institution released the most important of all international agreements on money laundering: the first version of the so-called Forty Recommendations.²³ A number of additional inter-

22 | Article 3, paragraph 1. See also the 1998 Political Declaration and the related Action Plan (“Countering Money-Laundering”), which details the money laundering-specific obligations under the 1988 Convention.

23 | These recommendations were fully revised in 1996, 2003, and most recently, in February 2012. In October 2001, the FATF also issued the Eight (later expanded to Nine) Special Recommendations on Terrorist Financing, which were incorporated into the 2012 version of the Recommendations.

national agreements²⁴ on money laundering have since been created with regional or global reach; and a number of specialized private sector²⁵ and governmental organizations²⁶ have been established specifically to focus on this issue.

The FATF is an intergovernmental body that functions largely as a loose policy forum in which government officials (typically from the finance ministry) deliberate on legally non-binding measures to counter money laundering. It thus represents a prototypical example of Slaughter's (2004) concept of "government networks," which she contrasts with the "old world order" characterized by formal international organizations and binding international agreements negotiated by career diplomats of foreign ministries. The central normative document produced by the FATF are its Recommendations. After their first release in 1990, these Recommendations were fully revised in 1996, 2003, and most recently, in February 2012. In October 2001, the FATF also issued the Eight (later expanded to Nine) Special Recommendations on Terrorist Financing, which were incorporated into the 2012 version of the Recommendations. Each revision expanded the scope of the money laundering offense: first from only drug-related crimes to all serious crimes – with one recommendation specifically dedicated to high-level corruption – later also terrorism and terrorist financing, and, most recently, the proliferation of weapons of mass destruction. These revisions also brought about an expansion of the circle of addressees from governmental authorities to the private sector, including financial institutions and a growing list of designated non-financial businesses and professions.²⁷ The private sector is thereby assigned the main responsibility for preventive measures.

However, despite of their legally non-binding nature the FATF Recommendations are far from toothless. Quite to the contrary – the FATF has been very successful in not only imposing its standards on its members but also, and most remarkably, on non-members. In violation of the traditional understanding of the sovereignty of nations, the FATF set out to monitor and sanction nations for non-compliance with standards that they had never officially endorsed, and in the creation of which they had not been granted any official say. Most countries found the

24 | For example, Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds of Crime of 1990; United Nations Convention against Transnational Organized Crime of 2000; United Nations Convention against Corruption of 2003.

25 | For example, the Wolfsberg Group was formed in October 2000 as an association of 12 global banks.

26 | For example, the Egmont Group was established in 1995 as an informal group of Financial Intelligence Units to facilitate international cooperation. At present, the Egmont Group has 128 members (Egmont Group 2012).

27 | Namely, casinos; real estate agents; legal professionals; accountants; dealers in precious stones and metals; trust and company service providers.

reputational and financial²⁸ costs of being classified as a “Non-Cooperative Country or Territory”²⁹ to be too high and felt compelled to subscribe to these norms (Sharman 2008). While highly successful in spreading the anti-money laundering norms, this approach earned the FATF considerable criticism for being imperialistic, biased against the “small fish” (Palan, Murphy, and Chavagneux 2010), and methodologically weak. The FATF has reacted to this criticism by strengthening its methodology for assessing compliance (FATF 2009b) and through the expansion and diversification of its membership base. The initial 16 Western members³⁰ were complemented by 20 members³¹ from every continent. To further strengthen its geographic reach, the FATF grants eight so-called FATF-Style Regional Bodies the status of associated members.³²

1.5.1 Intended effects

The most remarkable success of the FATF is the rapid diffusion of its norms for anti-money laundering (AML) and the combating of the financing of terrorism (CFT). Only a decade after its first appearance on the international stage, the legal concept of money laundering was adopted by more than 130 jurisdictions (Myers 2001). Today, the criminalization of money laundering is virtually universal, with more than 180 jurisdictions around the world endorsing the FATF Recommendations (FATF 2012c). The extent to which the global criminalization of money laundering and terrorist financing has helped reduce the underlying crimes remains disputed.³³ The United Nations Office on Drugs and Crime estimates that maybe only 0.2 percent of global illicit financial flows are being currently seized and frozen (UNODC 2011). While this number is certainly low, it would be overly

28 | Johnson (2001) finds evidence that blacklisting led indeed to financial flows to these countries being constricted or even severed.

29 | The practice of labeling non-compliant countries as NCCT was in place between 2000 and 2006 and stirred up the most controversy. The FATF has since changed its monitoring process and terminology.

30 | The G-7 members plus the European Commission and Australia, Austria, Belgium, Luxembourg, Netherlands, Spain, Sweden, and Switzerland.

31 | Thirty-four jurisdictions and two regional organizations (namely the Gulf Cooperation Council and the European Commission) (FATF 2012d).

32 | Namely the Asia/Pacific Group Against Money Laundering; the Caribbean Financial Action Task Force; the Eastern and Southern African Anti-Money Laundering Group; the Financial Action Task Force of South America; the Inter-Governmental Action Group against Money Laundering (covering West Africa); the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (covering Central and Eastern Europe); and most recently, the Eurasian Group in Central Asia; and the Financial Action Task Force for the Middle East and North Africa (FATF 2012d).

33 | For a critical discussion of the effectiveness of anti-money laundering measures in suppressing crime, see Levi and Reuter (2006) and Sharman (2008).

hasty to conclude that AML/CFT efforts are worthless. For one, measures against money laundering and terrorist financing may be no less cost-effective than other strategies to fight crime. Also, the confiscation of criminal proceeds is of symbolic importance, as it signals to law-abiding citizens that crime does not pay, at least not always (Levi and Reuter 2006). Finally, the arsenal of laws and regulations to fight money laundering and the financing of terrorism has proven to be useful in the investigation and prosecution of certain criminals and in the recovery of ill-gotten assets in instances where it would have been difficult to win a case otherwise (Levi and Reuter 2006).

1.5.2 Unintended effects

As with any policy intervention, the drafters of AML/CFT regulation need to analyze possible direct costs³⁴ and unintended negative side effects of their proposal, identify mitigation measures, and balance the remaining unmitigated effects with the expected benefits. The following paragraphs highlight four examples of how AML/CFT legislation can unintentionally harm developing nations and vulnerable members of society.

First, the cost of establishing and maintaining a designated anti-money laundering office – as required under international money laundering regulations – can be disproportionately high for small countries with an infant banking sector.³⁵ The international community acknowledged this problem in 2000 and created donor-supported trust funds at the IMF to finance technical assistance in the implementation of AML/CFT regulation (IMF 2009).

Second, AML/CFT provisions can make it harder for marginalized people to access the formal banking sector. Compliance with these provisions results in higher administrative costs, which banks tend to pass on to customers. Furthermore, “know your customer” requirements for proper identification can present a serious obstacle for undocumented immigrants or people living in countries where identification papers are not readily available or prohibitively expensive to obtain for the poor.

Closely related to this second point, is a third mechanism through which AML/CFT regulation can harm poor people and nations by increasing the transfer costs of remittances. The money immigrants send back to their families in their home countries constitutes an important source of income not just on the family level but also in terms of many nations’ overall economies. In 2011, global flows of remittances were estimated to amount to a staggering \$372 billion, almost

34 | Financial firms in Europe and America spent more than \$5 billion on tackling money laundering in 2003 (The Economist 2004). These costs have risen sharply since then (KPMG 2011). See also Levi and Reuter (2006).

35 | See Sharman and Mistry (2008) for a detailed analysis of the costs and benefits for three small developing nations – namely Barbados, Mauritius, and Vanuatu – from global AML/CFT initiatives.

three times higher than official development assistance, contributing more than 15 percent to the total gross domestic product of a dozen developing countries (World Bank 2012a). In response to the terrorist attacks of September 11, 2001, the international community strengthened controls over money transfers,³⁶ realizing that even relatively small sums can cause unimaginable harm.³⁷ These efforts to curtail the flow of funds to terrorist activities need to carefully take into account that even small changes in money transfer costs can have a big impact on the ability of immigrants to support their families in their poor home countries.³⁸

Fourth, the experience of the small Pacific island nation of Nauru illustrates how tightened international AML/CFT regulation can dash the hopes of developing nations to establish themselves as international financial centers. Nauru's "no questions asked" approach to banking had transformed the tiny island nation of about 10,000 people from being entirely dependent on its almost depleted phosphate deposits into an international financial hub. At its peak, it registered a total of 400 banks – virtually all without a physical presence on the island itself ("shell banks") (US State Department 2002). These banks allegedly helped to launder about \$70 billion of illicit proceeds from Russian criminals in 1998 alone (Hitt 2000). In response to Nauru's lacking willingness to implement tougher oversight of its banking sector, the Financial Action Task Force black-listed³⁹ Nauru in 2000. Financial institutions in FATF member states were requested to apply enhanced surveillance and reporting procedures of financial transactions involving Nauru. These measures robbed Nauru of its appeal for money laundering and international finance in general, resulting in the bankruptcy of all its banks. With the depletion of its primary reserves of phosphates and the loss of its only alternative strategy for future income generation – banking – Nauru depends today almost exclusively on aid transfers from its far away neighbor Australia.⁴⁰ Nauru represents unquestionably an extreme case. However, it illustrates how efforts to ensure global implementation of minimum AML standards and a level playing

36 | The focus of particular interest became so-called alternative remittance systems or value transfer systems like *hawala* or *hundi* (see Cao 2004 or US State Department 2005).

37 | The National Commission on Terrorist Attacks upon the United States (2004) estimated that the terrorist attacks of September 11, 2001, cost Al Qaida a total of \$400,000 to \$500,000 to execute, of which only \$270,000 was spent within the United States on inconspicuous expenses such as lodging, flight training, and airplane tickets. The Madrid train bombings in 2004 cost as little as \$15,000 (Levi and Reuter 2006).

38 | The World Bank estimates that a reduction of five percentage points in money transfer costs can save up to \$16 billion annually (World Bank 2012b).

39 | The official terminology used by the Financial Action Task Force in its first assessment round in 2000 and 2001 was to designate Nauru (along with 23 other nations) as one of the "Non-Cooperative Countries or Territories."

40 | The Australian government budgeted aid transfer of Aus\$31.6 million to Nauru for the Fiscal Year 2012–13 (DFAT 2012).

field can deprive newcomers of one of the few attractive selling propositions they can offer, namely light-touch regulation and ease of business.

The above discussion highlights four important mechanisms through which global AML/CFT efforts can unintentionally harm developing countries and marginalized members of society, and the drivers of this agenda – mainly the governments of developed nations – should take this into account.

1.6 Conclusion

Globalization – the increasing cross-border circulation of goods, funds, and people – offers important opportunities for economic and political development. By the same token, globalization offers criminals, corrupt officials, sanction busters, and terrorists a myriad of ways to obfuscate the trail of their dirty money and thus enjoy the rewards of their illicit activities or fund their terrorist cause. The challenge policymakers face is to devise mechanisms that reduce this dark side of globalization without unduly jeopardizing its positive aspects. On the one hand, prevalent money laundering keeps crime – including corruption and the violation of international sanctions – undetected and financially rewarding and terrorist attacks and weapons proliferation funded, thereby undermining economic and political development. On the other hand, overly zealous anti-money laundering and anti-terrorist financing efforts risk marginalizing vulnerable members of society and imposing unduly high implementation and opportunity costs on developing nations. Efforts to control illicit financial flows face an uphill battle, as money launderers are highly innovative, the volume of proceeds laundered through the international financial system is massive, and even small sums of money can cause major harm in the hands of terrorists. The Financial Action Task Force can pride itself on driving the rapid global diffusion of regulation to combat money laundering and the financing of terrorism. However, the effectiveness of these measures in suppressing crime and terrorist activities remains disputed. Making headway on this front requires the closing of remaining loopholes and, a fortiori, a shift away from a compliance system that is too heavily focused on whether recommended policies and procedures have been adopted – and instead a shift toward an assessment of whether the intended results of those policies and procedures have been achieved.

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United States

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