



**AUTHOR: Dr Keith Suter**  
Global Thought Leader  
Real Insights & Authority



## MONEY LAUNDERING



### International Crime

Of the six largest forms of international trade, only three are legal: the speculation in foreign exchange, the sale of oil and coffee. A fourth has some many questionable participants: the sale of weapons. Two are illegal: drug-smuggling and money laundering.

Crime is global but law enforcement is not. Criminal law is still largely only a national or local matter. International criminals are often better organized than national governments and their police forces - and they are increasing. Criminals can, for example, move across national borders more easily than can police officers, who are very restricted in their powers of detection, arrest and detention. There is no international police force to arrest criminals and no international prison. Organized crime pays.

The spread of organized crime has been benefited from three recent trends. First, the development of computer and communications technology means that electronic funds transfer systems can move billions of dollars around the globe in seconds. Second, as a result of the collapse of communism in the former Soviet Union and Eastern Europe, there are weak governments unable to control criminal gangs. China remains communist in name but it, too, has been unable to control the crime and corruption that it has unleashed because of the liberalization of the economy.

Finally, there is the declining significance of national borders. As late as the 1960s, the Japanese were not allowed to travel abroad for pleasure and just a few years ago exit visas for people living in the Soviet Union, Eastern Europe and China were a rarity. Now Czech prostitutes work the Italian Riviere; illegal Chinese immigrants to America are trans-shipped through Hungary; South American drug lords recruit traffickers in Nigeria; and refugees from Afghanistan travel to Australia with the aid of people smugglers.

A particular concern is the way that during the 1980s, the profitability of the drug trade meant that the "narco-dollar" began to assume the economic significance of the "petrol-dollar" in the 1970s. It had been estimated that the capital generated during the 1980s by illegal drug trafficking was in the order of US\$3,000 billion to 5,000 billion. A random scientific analysis of US currency showed that almost every note in circulation contained traces of cocaine, indicating that the notes had once sat in bags next to bags of drugs awaiting transaction.

## ✓ Money Laundering

The sale of drugs is often done on a cash basis to hinder the police tracking down the evidence. But the retention of cash is awkward. A stack of \$1 million in \$50 notes would reach almost three metres in height. Large sums of cash may be stolen by unscrupulous people. Therefore it is necessary to hide the illegally-obtained money: both to avoid detection from the police and to protect it from burglary.

Money laundering is the process whereby the proceeds of all types of serious crimes are turned into apparently legitimate financial resources. This ensures that if a criminal is under suspicion, there is little evidence that the money has been gained from illegal means. This requires putting as many national borders as possible between the original crime and the final account in which it resides. Money travels easily over national borders; police do not.

There are three stages in the money laundering process. First, "placement" is where the large amounts of cash are negotiated into some other less obviously suspicious form. One of the most common methods is to employ "smurfs": individuals who do not look out of place in a banking environment and who are used to dispose of large sums of cash by depositing small amounts at different banks. A smurf may also purchase international money orders to pass on to third parties, who will deposit them in a bank elsewhere. Money launderers may also operate behind the cover of cash-intensive businesses, such as casinos, betting shops, amusement arcades and foreign exchange bureaux.

Second, in the "layering" stage, money is spread within the financial system to create a false picture of the provider of the original cash. Over-invoicing and false invoicing of imports and exports are attractive methods of layering, enabling cash to be moved under the guise of legitimate documentation.

Third, in the "re-integration" stage, the cleaned-up money is brought back, supposedly legitimately, into the financial system operated by the end-user. Money launderers operate legitimate businesses and pay taxes like their fellow citizens.

For example, an American earns \$100 million from drug-smuggling in Asia, which that person puts into a bank on the Caymen Islands (which the person had bought previously) and the bank lends the money to a "shell" company owned by that person to buy works of art in Europe, which are then sold in the US, and the proceeds are then paid into another bank owned by that person in the Caymen Islands, which then lends money to a company registered on a South Pacific island, which then lends money to that person's real estate business in New York. The real estate business is legal and pays its taxes etc, so it would be above suspicion by the local authorities. If the police ask where the money comes from to finance the real estate business, the person simply says that it was lent from an overseas bank; the police cannot take their enquiries much further.

Money-laundering is facilitated in several ways in this example. "Shell" companies in this example are registered companies that do little if any normal trading; they serve as a way of passing money. People selling works of art (who earn a commission on each sale) stand to benefit from the sale and have a disincentive to enquire too closely how the money is obtained. The price of a bank in the Cayman Islands is about \$10,000 and the Islands (which are in Caribbean) have more "banks" than people; the banks exist more on paper than as buildings. At each point, the person may lose a little money on the transaction but that is of little worry because there was a large amount of money to start with.

### ✓ International Reaction

The international community opposes money laundering for six main reasons. First, law enforcement and revenue collection are vital activities for the stability of any country. Operations which hinder those activities jeopardize a country's financial foundations. They represent "financial termites" eating away at the ability of a government to raise money to pay for the provision of services. Additionally, money launderers are not so much interested in profit generation as in protecting their illegal proceeds. Thus they "invest" their funds in activities that are not necessarily economically beneficial to the country where the funds are located but in the best way of disguising them.

Second combating money laundering is a costly exercise. Money has to be transferred from other areas (such as health, education or welfare) to pay for the additional law enforcement services. Additionally, tackling these people through the legal system is expensive because they can employ talented lawyers and accountants. Most governments cannot afford to pay to the top rate to lawyers and accountants

Third, money laundering is conducted as a way of handling illegal gains, and so stopping the laundering should restrict the committing of those other crimes. This is particularly the case with drug money. The US government has not been able to wean its citizens off drugs and the "drug war" military offensive has not stopped drugs from entering the US. The US government hopes that restricting money laundering will limit the capacity of criminals to capitalize on their crimes. Drugs traffickers can separate themselves from the criminal activity but they cannot separate themselves from the profits. Therefore, even if the police cannot stop the drugs, they can try to follow the money.

Fourth, money laundering distorts international financial flows and contributes to financial instability. Michel Camdessus, then the Managing Director of the International Monetary Fund (IMF) said in February 1998 that "the estimates of the present scale of money laundering are almost beyond imagination - two to five per cent of global gross domestic product". Money laundering may have contributed to the financial meltdowns in Mexico and parts of Asia because the money led to an over-heating of local economies.

Fifth, the need to find ways of injecting laundered money into a financial system means that some legitimate and unsuspecting businesses may be used as conduits for the money. Managers and employees may therefore be drawn into allegations of money laundering without their being aware that they were part of the crime. For example, most of the staff and customers of the Bank of Credit and Commerce International (BCCI) - whose collapse in 1991 was the largest bank crash in history - were ordinary law-abiding citizens, unaware that their bank was involved in extensive money-laundering.

Finally, this “cheap money” can undermine the market system. For example, in the United States organized crime has used pizza parlours to mask proceeds from heroin trafficking. These front companies therefore have access to substantial illicit funds, allowing them to subsidize front company products and services at levels well below market rates. They can then drive out the legitimate competition through their competitive advantage. This then leaves the organized crime with an even wider base of operations. This is also a problem with the “privatisation” of government assets. As a government puts its assets on the market, so they could be bought by organized criminals and so infrastructure projects such as railways, telecommunications and water systems could end up in the hands of organized criminals.

## ✓ International Co-operation

During the 1980s western governments began to give more attention to working together to try to stop money laundering. For example, the Financial Action Task Force on Money Laundering (FATF), which is part of the Organization for Economic Co-operation and Development (OECD) has created Best Practice Guidelines on how to monitor illegal financial flows.

There is also the 2000 UN Convention Against Transnational Organized Crime (with supplementary protocols on trafficking and migrant smuggling). This was signed in Palermo, Italy (where organized crime had tarnished the city’s name for many years). 124 countries out of the UN’s 189 members signed on the spot – never before had an international treaty attracted so many signatures so soon after its adoption by the UN General assembly. This is a clear indication of the growing international concern about organized crime.

But there have been only limited successes in international co-operation because criminals are able to exploit the lack of an international government to create and enforce laws on money laundering. Additionally, drug profits are so great that the drug traffickers can pay for the best lawyers and accountants, undermine governments and bribe law enforcement agents.

The FATF has a list of many countries criticized for lax financial supervision. The most well known include as the Bahamas, the Cayman Islands and St Kitts-Nevis in the Caribbean, and the Cook Islands, Marshall Islands and Nauru in the South Pacific. Other countries include: Russia, Lebanon, Liechtenstein and the Philippines. There is no penalty for being named by the FATF.

However, the public stigma may be having some impact, as people shy away from having legitimate bank account in those countries for fear of being seen as a “organized criminal”.

At a deeper level, the issue involved is national sovereignty. This works for the benefit of the criminals and against the honest citizens. Thus, international co-operation needs more creative thinking. First, there has to be an improvement in the sharing of information between national police systems. The risk here of course is that wealthy criminals can offer bribes to the police to get access to inside information on the current detection operations - but that is a risk that has to be taken.

Second, there should be standard legal procedures across national boundaries so that evidence collected in one country is admissible in the court of another country.

### ✓ **Keeping Yourself Clean**

A large proportion of money laundering activities involve innocent parties who are just doing their daily job unaware of their role in a crime. Here are some ideas for minimizing the risk of being caught up in money laundering.

First, "know your customer". This means that financial institutions and others should know the identities of their customers and do not, by allowing anonymous or false names dealings, facilitate crime or impede law enforcement and revenue efforts.

Second, always regard with suspicion a request by a client to preserve their anonymity.

Third, avoid association with any arrangement which involves the misrepresentation of the true nature of a transaction, the true source of funds, or the true ownership of an asset.

Finally, be wary of all large cash transactions from persons or companies that are not known to you or your company. Request that the transaction be done via a bank cheque.

These are all basic commonsense ideas. But, as the majority of honest staff and customers at the Bank of Credit and Commerce International found to their cost, it is easy to fall victim to money laundering.

Keith Suter