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Improving the Global AML Regime

While the initial focus of the US anti–money laundering (AML) regime was the intersection of organized crime and drugs, the focus subsequently widened to include the proceeds from many crimes. Today the AML regime has multiple goals, including those identified throughout this study: reducing the incidence of crime, which includes but is far from limited to drug-related crimes; protecting the integrity of the core financial system; and controlling a number of global "public bads," particularly terrorism, corruption and kleptocracy, and failed states.

From its earliest days, money laundering has frequently involved cross-border transactions, since moving dirty money across borders is an effective way to disguise its trail. With the increased globalization of the financial system, money laundering has evolved into an activity affecting societies and financial systems everywhere in the world. Money laundering is a principal area of abuse of the global financial system—what has been called a dark side of globalization.

Based on our analysis of money laundering and assessment of the global AML regime, this chapter presents conclusions and recommendations for improving the global regime in seven areas: the appropriate scope of the AML regime, the regime as a means to various ends, challenges to US implementation of the AML regime, challenges to global implementation of the regime, opportunities for international cooperation, implications for domestic law enforcement, and a research agenda for an ongoing and comprehensive assessment of the regime as it adjusts to changing conditions.

Scope of the AML Regime

The scope and detail of the US and global AML regimes built up over a period of less than two decades is impressive. If diligently implemented on a global basis, the 2003 Forty Recommendations issued by the Financial Action Task Force will expand the global regime even further, particularly the prevention pillar.

The evolution of the enforcement pillar, with the exception of expanding the number of predicate offenses covered by the AML regime, has been less dramatic. In many jurisdictions enforcement still is minimal. Moreover, as is often true of structures resting on two pillars, there is tension between them including which should receive greater emphasis in implementation.

It is unlikely, and may well be undesirable, that the global AML regime will continue to expand at its recent pace. Even in high-profile areas such as terrorism, there are practical limits to extending the prevention pillar and resource constraints to aggressive use of the enforcement pillar.

Money launderers can be expected to change their tactics in response to enhancements in the global AML regime, so the task of combating money laundering is not likely to get any easier in the years ahead. However, it is reasonable to ask just how much can be expected of governments and the private sector. Constructing a zero-tolerance regime that was consistent with the smooth flow of finance would be costly and politically unacceptable. At the margin, the broadly defined costs of extending the regime are not likely to be worth the modest reduction in money laundering and small contributions to ultimate goals to which such an extension would contribute. The challenge, especially with respect to prevention, is to identify the margin where costs are roughly equal to expected benefits.

The 2003 FATF Forty Recommendations will provide additional challenges in terms of compliance with, and implementation of, the global AML regime. The standard for national regimes has been raised substantially through the explicit extension of the global regime to nonfinancial businesses and certain professions. Applying the basic elements of the prevention pillar (customer due diligence and reporting) to certain professionals such as lawyers and accountants will be resisted, and monitoring and enforcing compliance (supervision and sanctions) will be even more difficult. Almost all jurisdictions will fall short of perfection with respect to design and certainly with respect to implementation.

The issue will be the impact of such shortfalls on overall acceptance of the global regime. For example, if the United States is unwilling to apply the prevention pillar of the AML regime to lawyers and accountants, will this adversely affect US capacity to stiffen controls on terrorist financing? The answer surely is yes, but a sufficient case has not yet been made to overcome US political resistance to applying the prevention pillar more fully to these professions. The examples cited in FATF (2004b, 24–27) of lawyers and accountants acting as "gatekeepers" relate almost exclusively to their direct

involvement in facilitating money laundering. As they are already liable for such activities under criminal statutes, little would be gained by subjecting them to due diligence and reporting requirements.

Moreover, the costs that would be imposed by comprehensively extending the AML regime to lawyers, in particular, could be substantial. Law offices would be required to have a compliance officer and to develop mechanisms to implement a customer due diligence (CDD) program, which would involve training and internal and external audits. In addition, many lawyers are solo practitioners or work in small firms with limited financial and technical resources for tracking and linking dispersed information on clients and their activities. Finally, lawyers' insurance requirements no doubt would increase. Since there is no study on the role of lawyers in money laundering in the United States, it is impossible to assess whether the cost of extending the US AML regime to the legal or other professions is worth the benefits. At the very least, however, professional organizations should enhance their educational activities and standards in this area.

Money laundering is likely to evolve over the years in response to technological, economic, and social developments. The AML regime will correspondingly have to be adapted, and that task will be made difficult by the lack of hard information on either the costs or the effectiveness of the regime. Although the financial and nonfinancial costs of the current regime are most likely bearable for advanced economies and large institutions, they loom far larger for less developed economies and smaller institutions. The financial costs for institutions are to a considerable extent fixed, as in the case of having to adapt existing data management systems to meet new reporting requirements. These fixed costs are more difficult for smaller institutions to absorb. The nonfinancial costs are often associated with deadweight losses that are more burdensome for poor countries. In effect, combating money laundering is a luxury good, a reality that argues for increased technical assistance financed by the countries that particularly value the benefits of the AML regime. It also argues for direct financial assistance to countries to increase the probability of effective implementation.

The designers of the AML regime are aware of these circumstances and constraints, at least as they affect decisions involving financial institutions in the major centers. Consistent with the 2003 FATF Forty Recommendations, US authorities have embraced a risk-based approach in several areas. US financial institutions are expected to apply one level of CDD scrutiny to normal customers—having presorted them using a risk-based approach to their actual and potential use of the institution—and a higher level for "politically exposed persons," based essentially on the judgment of the institution. The level of scrutiny applied to potential sources of terrorist financing is higher still, as the authorities require institutions to do name checks for individuals and organizations against lists supplied by the government.

Thus, it is possible to adjust the calibration of the risk-based system. However, the nature and magnitude of the challenge is such that errors

will occur. On the one hand, money laundering or terrorist financing will slip into and through the financial system. On the other, individuals will be wrongfully denied access to the financial system or subject to harassing investigations, undermining the self-policing of compliance on which the regime primarily relies. If the AML regime erects excessive barriers for legitimate customers, transaction costs rise, the reputations of businesses are unnecessarily tarnished because of false links to money laundering, and the regime itself comes under stress.

Mariano-Florentino Cuéllar (2003, 453) offers a completely different take on the scope of the US regime and, implicitly, the global one. He argues that the regime's scope—particularly the long list of predicate crimes on which money-laundering charges can be based—is too broad. As a result, law enforcement officials use the AML regime to prosecute those who committed the underlying crime, but are distracted from focusing on the disruption of criminal finance, which he argues was the original intent of US money-laundering legislation. He proposes revising the US money-laundering statutes to provide a much narrower focus.[1]

The Cuéllar position is implicitly predicated on an unsophisticated application of the market model of money-laundering activity and an associated view that there are large numbers of stand-alone money launderers offering their services to criminal networks. The evidence reviewed in chapters 3 and 5 of this study suggests that stand-alone money launderers are the exception rather than the rule. In general, money laundering is an integral part of the underlying offense, or the money launderer is integrated in an overall criminal operation.

Cuéllar (2003, 456) advocates the use of information technology and artificial intelligence to review patterns of wire transfers to create "money profiles" and uncover the operations of criminal finance. But it is questionable whether developing such unique profiles in the transactions of money launderers is even possible. The US Congress Office of Technology Assessment (OTA 1995), whose report Cuéllar cites as supporting his view, is also skeptical. Robert Litan (2004) makes a similar proposal that is more promising as a research project: the US Financial Crime Enforcement Network (FinCEN) could examine a broad range of financial transactions by various types of criminals to look for patterns that could be shared with private-sector institutions and might enhance the detection of money laundering.

If other information were brought to bear in the examination of wire transfers, for example, origins and destinations, then Cuéllar's approach might be more fruitful. But the OTA report notes that this would likely lead

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1. The National Association of Criminal Defense Lawyers (2001, 1) made a similar proposal to rewrite the US money-laundering statutes. The association is critical of the "alarming expansion" of the scope of those statutes that, as interpreted and applied, subject unwary individuals and businesses to "overreaching investigations and prosecutions unrelated to drug trafficking or organized crime."

to a large number of false positives and raise a host of privacy concerns both domestically and internationally. Even if the technology were available at low cost to provide a passport and vaccination certificate for each dollar that moves through the global economy and the financial system, the suppliers and purchasers of goods and services and the financial system would balk at participating in such a regime. A "Big Brother" approach to money laundering, much less other issues, generally is not acceptable in democratic societies. The US political debate about renewing the USA PATRIOT Act in 2005 illustrates that such an approach is not universally accepted even in the special case of terrorism.

Moreover, if the AML regime becomes overloaded with requirements, pressures will mount to roll it back in all dimensions. In the mid-1990s, the US AML regime was scaled back by Congress with respect to the submission of suspicious activity reports (SARs) in response to criticism that some requirements were excessively burdensome. Cuéllar (2003), among others, advocates trimming the AML regime, and that view has considerable support in the US Congress.

Means to What Ends?

The global AML regime is a means to an end and a tool to be used to help achieve certain goals, but not an end in itself. In the United States as well as many other jurisdictions, the principal initial motivation in criminalizing money laundering was to support the war against illegal drugs and associated criminal gangs.

This rationale was based implicitly on the market model for money-laundering services and the hypothesis that there were large numbers of money launderers, associated with financial institutions, offering their third-party services. The policy implication of this view was that closing down the money launderers would sharply curtail the underlying crime. As economists, we embarked on this study from the same starting point. However, the evidence presented in chapters 3 and 5 suggests that the applicability of an unsophisticated market model to money laundering is limited, and that the hypothesis that there are a substantial number of stand-alone money launderers is not supported.

Nevertheless, the AML regime as it has evolved is employed to pursue a wide range of law enforcement and other social objectives, which has two consequences: first, the regime should be recognized as a policy tool, though only one of many, to achieve those objectives; and second, the AML regime is no longer all about drugs. Recognizing that the AML regime is a means to multiple ends, and not just directed at combating illegal drugs or organized crime, means that assessing its effectiveness depends in part on the particular objective being considered. This study has examined the contribution of the AML regime to three broad objectives: reducing crime,

maintaining the integrity of the core financial system, and controlling the global "public bads" of terrorism, corruption and kleptocracy, and failed states. But any assessment is limited at this point because it has to rely on indirect indicators of regime effectiveness. Better indicators can and should be developed, and we discuss some possibilities in the research agenda presented in this chapter. Data constraints aside, however, it should also be pointed out that multiple objectives require multiple indicators. In particular, even if it were possible to measure accurately the aggregate annual volume of money laundering globally, the findings would not adequately represent the precise contribution of the AML regime to combating terrorism, inhibiting the drug trade, discouraging white-collar crime, or protecting the integrity of the core financial system.

Following the money was an important law enforcement tactic long before money laundering was criminalized. However, criminalizing money laundering expands that tactic by enlisting the private sector in the process, and by allowing for targeting stand-alone professional launderers, to the extent that they exist. Criminalization also provides the basis for developing the prevention pillar, which is essential to protecting the integrity of the core financial system.

The prevention pillar has some deterrent effect on certain methods of money laundering, although it also creates incentives for the mutation of the phenomenon. The prevention pillar (most notably the reporting element) provides information for use in investigation, which is part of enforcement. The investigative element operates through several channels: as a primary tool to bring criminals to justice, leading to stand-alone prosecutions; as a secondary tool to expand cases and develop leads with respect to matters and persons already under investigation; and as a tertiary tool where money laundering merely turns up in the course of an investigation and adds to possible charges.

Two policy implications can be drawn from these observations. First, the AML regime can be proactively used to pursue certain objectives, as in sting operations that attract those seeking money-laundering services.[2] And second, to be effective as a law enforcement tool, the AML regime must be a two-way street in which the private sector not only supplies information but also is enlisted to participate in achieving regime objectives.

Both of these policy implications are controversial, particularly the latter. The private sector does not always welcome being coopted by government, yet cooperation by private-sector institutions is often essential to success. For its part, law enforcement often is reluctant to take private businesses into its confidence out of fear of damaging its case either prior to or during the prosecutorial stage. Given the extent to which the AML regime already relies on the quasi-voluntary cooperation of various private-sector institu-

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2. Cuéllar (2003) implicitly endorses a proactive AML strategy, and James (2002, 6) takes a similar position.

tions, US law enforcement authorities would likely best serve anti–money laundering efforts by cooperating more closely with the private sector, particularly when it comes to providing more information about what they are looking for and why.

Implementation Challenges for the United States

The United States has taken the lead in developing and establishing the global AML regime, recognizing that money laundering is inherently not only an issue without borders but, more importantly, one for which borders can impede progress. US authorities reached this conclusion in part as a result of efforts to level the international playing field for US financial institutions whose assistance is critical to effectively combat money laundering.

The United States faces several challenges going forward, including implementing the 2003 FATF Forty Recommendations, determining the future of the National Money Laundering Strategy (NMLS), and maintaining its global leadership role.

FATF Forty Recommendations

The 2003 FATF Forty Recommendations appear at first not to require a great deal from the United States, but issues lurk below the surface in at least two areas: application of the prevention regime to certain professionals (particularly lawyers and accountants), and the treatment of special purpose vehicles.

Many nations and territories face challenges from certain professions that have banded together globally to resist participation in the AML regime at the level recommended by the FATF. Resistance in the United States is likely to be particularly acute because of the interplay of privacy issues and the regulatory structure of the US federal system. Regulation and (limited) supervision of professionals occurs largely at the state level, which in part explains why the accounting profession has until recently been lightly controlled.[3] Regardless of current US arrangements, the fact that these professions will be included at least on a pro forma basis in regimes in other jurisdictions poses a problem for the United States.

The second issue for the United States with respect to the FATF Forty Recommendations involves the establishment and role of shell corpora-

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3. Lawyers also have generally been regulated by the states, but federalism is not an absolute barrier to federal regulation in the financial area. Much federal financial law explicitly preempts state law, and even where it does not, the federal banking supervisors and, to a lesser extent, the Securities and Exchange Commission have effectively preempted the states. In addition, the recent Sarbanes-Oxley legislation imposed a regulatory regime on lawyers representing corporations as a matter of federal securities law.

tions and special purpose vehicles at home (i.e., Nevada or Delaware) or abroad (i.e., the Cayman Islands or Bermuda) as part of a US business or financial structure, as well as ongoing pressure from some other jurisdictions for greater transparency as regards such arrangements. Authorities in many European jurisdictions favor the imposition of CDD and reporting requirements on such entities.[4] This issue involves the philosophy and the structure of regulation. In the United States, the structure, again, is one where the presumption is that matters are left to the states, and increased federal involvement requires jumping political and constitutional hurdles. The philosophy of regulation in the United States is one of limited regulation at every level—an activity is legal unless it has been decided it is illegal. In contrast, in many other nations with fully developed financial sectors, such as those in continental Europe, the philosophy is more along the lines that nothing is legal unless government has approved it.

The global AML regime associated with the 2003 FATF Forty Recommendations has relatively weak supervision and sanction elements in its prevention pillar, but they are there. The International Monetary Fund (IMF) and World Bank will evaluate performance under the new standards. The FATF has reserved the possibility of resuming its "name and shame" role. If the United States is found to have a low level of compliance, its capacity to exert leadership in this area will be adversely affected. Mark Pieth and Gemma Aiolfi (2003) have criticized both the United States and the United Kingdom for uneven application of the previous FATF Forty Recommendations.

National Money Laundering Strategy

The US Congress in 1998 mandated the annual development and publication of a *National Money Laundering Strategy* (NMLS) by the executive branch via an interagency process for five years, ending in 2003. Should the mandate be renewed?

On balance, the NMLS was a constructive instrument to focus executive branch attention and, more importantly, promote better interagency cooperation on money-laundering issues. On the other hand, it was far from successful in molding an integrated and coherent approach to money laundering, which must ultimately be based on a firm foundation of research and analysis. The preparation of annual national strategies on money laundering should be reauthorized, but with several important modifications

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4. Some US observers express similar views. Wechsler (2001) flagged the issue of Delaware corporations, and Jack Blum, a prominent voice on such matters, has called for national registration of corporations that identifies where they can be served with civil and criminal process. In addition, a Financial Stability Forum (FSF 2000) report on offshore financial centers focused attention on the need to better identify the beneficial owners of corporate vehicles established in those jurisdictions as part of the effort to enhance financial stability and fight financial fraud.

to encourage more analytical content, less wheel spinning, and greater continuity.[5] We offer the following four recommendations with respect to a revised NMLS mandate:

- A strategy document should be developed and publicly presented every third year, with annual updates on progress. Annual strategies tend to be wheel-spinning exercises. No sooner is the production cycle for the last document completed than the cycle for the next one must begin. The achievements of the previous strategy will not yet be manifest, however, so the next strategy will likely have a defensive air to it. Furthermore, money laundering is not such a rapidly evolving activity as to require annual adjustments in the AML regime. The annual progress updates can include amendments as needed in connection with any changes in emphasis, as in the case of the shift to focusing on terrorist financing in the wake of the September 11 attack.

- A review of progress during the period in achieving previously identified goals, which appeared only once in the previous five NMLS, should be institutionalized. The constructive precedent in 2002 was not followed in the 2003 NMLS, except for an appendix on online terrorist financing that had been identified as an objective in 2002.

- The NMLS should include and report analytical work on money laundering, which is essential to developing a transparent and defensible policy. The 2001 and 2002 NMLS contained more analytical material than the previous two strategies or the one that followed. Rigorous analysis enhances communication, and an important role of the NMLS is as a communication device not just between the executive and legislative branches but also with the general public and the world at large.

- Oversight hearings should be employed systematically in connection with the NMLS and its annual updates on progress. Hearings enhance communication among the branches of government and promote interagency cooperation, which is a chronic problem in dealing with issues as complex as the AML regime.

Global Leadership

Although the United States has been a driving force in shaping the global AML regime, continuing in that leadership role will require addressing a number of challenges in the years ahead. The first concerns the issues raised above with respect to leading by example in complying with the 2003 FATF Forty Recommendations. The power of persuasion depends in

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5. This position is similar to that found in General Accounting Office (2003a), although we reached our conclusions via a somewhat different route.

part on a demonstrated commitment to global norms, even those that may not be at the top of the US list of priorities. To the extent that the US authorities are unable or unwilling to implement FATF recommendations regarding the legal and accounting professions, shell corporations, and special purpose vehicles, the United States will have to explain and justify its position. One useful step in this regard would be for US authorities to articulate that they are open to expanding the US AML regime in these areas once it is demonstrated that there are substantial net benefits.

A related aspect of this challenge is whether the United States is willing to follow the United Kingdom and submit to a full assessment of its financial-sector regulation by the IMF and World Bank, including its compliance with international standards in the area of money laundering. The United States did volunteer for a review of its compliance with the old FATF Forty Recommendations and the Eight Special Recommendations on terrorist financing as part of the IMF/World Bank pilot program. The United States has since volunteered for the FATF assessment of its regime, a review that would employ the revised methodology endorsed by the FATF, IMF, and World Bank.[6] However, this type of review would not result in a formal assessment or rating of the US regime, but rather only a report on US compliance with the FATF 40 + 8 recommendations.

The United States has argued, with some merit, that scarce IMF/World Bank resources to conduct such full assessments should be devoted to other countries where risks to the global AML regime are greater. On the other hand, the United States is in a position to set an example for the rest of the world by submitting to the review, yet has elected not to do so. Moreover, a case can be made that money laundering is substantial in the United States and should receive special attention as part of the global AML regime. Because of the central role of the US financial system, as well as the role of the US dollar as a medium of exchange and a standard of value in the global financial system, many if not most criminals want the proceeds of their crimes ultimately to be in dollars and potentially integrated into the US economy, even if the crimes were committed in other jurisdictions. The United States should reconsider its position and volunteer for a full IMF/World Bank assessment of its financial sector.

A second challenge to US global AML leadership is the choice of priorities. Over the past three years, the United States, understandably, has emphasized combating terrorism financing but has not garnered as much global support as it might have hoped (chapter 7). Terrorism financing is not the top priority of most countries' AML regimes, and many of these regimes are supported by very limited resources. Some countries may prefer to concentrate on extending the global regime to cover accountants, smuggling, or tax evasion. Those efforts, even if they do not match US pri-

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6. In the meantime, the US Treasury Web site has posted previous self-assessments of US compliance with FATF standards on combating money laundering and terrorism financing.

orities, warrant increased bilateral and multilateral technical assistance. The United States, along with other major countries, should consider stepping up such assistance to jurisdictions that are struggling to establish or implement their regimes.

A related third challenge to US global AML leadership involves the frequent criticism that the US regime is overly selective in the list of foreign predicate crimes that qualify as money-laundering offenses under US law. For example, the 2003 FATF Forty Recommendations designates 20 categories of high-priority offenses that should be covered by national money-laundering statutes. However, seven of those offenses related to money laundering—including sexual exploitation, trafficking in human beings, and counterfeiting—cannot be prosecuted in the United States if the underlying crime was committed abroad.

Foreign or domestic tax evasion—other than failure to pay US taxes on the proceeds of a crime—also does not qualify as an underlying crime for US prosecution as a money-laundering offense. While US prosecutors can work around this lacuna and do not regard it as an impediment to an effective US AML regime, the absence of foreign tax evasion as a predicate offense under US law is often cited as impeding international cooperation.[7] Latin American leaders, for example, often complain privately that while the US insists on cooperation on issues it considers important, the US itself often fails to cooperate on issues of importance to other countries, such as evasion of taxes on income from assets held abroad. In this context, the US policy becomes a barrier to leadership. Thus, US law should be changed to make tax evasion, whether in the United States or elsewhere, a predicate offense for money-laundering prosecution.

The United States also needs to be more forthcoming in helping to enforce the tax laws of other countries. The interaction of capital flight and tax evasion is a particular problem where governments have difficulty raising adequate revenues to finance their expenditures, resulting in a run-up of unsustainable stocks of sovereign debt to foreign as well as domestic holders. Though macroeconomic policy failures in Latin American countries and elsewhere often provide substantial inducement for capital flight, the United States also is regarded as one of the world's leading tax havens, which contributes to fiscal problems in other countries. US critics counter that many countries' tax laws are flawed, but what country's are not, to one extent or another? A compromise approach might be to condition increased US cooperation in the tax area on criteria that apply to the structure and efficiency of the other country's tax system. For example, the criteria might address the balance between direct and indirect taxes, or the maximum tax rate applied to earned income. One should not be too sanguine about the

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7. Such criticism is not directed only at the United States. An IMF (2001, 24) review of Cyprus as an offshore financial center observed that international cooperation would be strengthened if Cyprus were to clarify that tax evasion is an offense under its money-laundering laws and regulations.

chances of agreement on mutually acceptable criteria, but the effort might produce some positive results over time and reinforce the willingness of other countries to cooperate with the United States on money laundering in general, and the financing of terrorism in particular.

Chapters 4 and 7 explained how the legal framework of the AML regime aimed at kleptocrats is in its infancy, especially with regard to enforcement. The United States should ratify the new UN Convention Against Corruption (United Nations 2003b) to accelerate the development process, and implement streamlined procedures (which might require changes in US laws) to facilitate cooperation with other countries in freezing, confiscating, and returning the assets of kleptocrats to the home countries from which they stole them.

Global Implementation Challenges

Even if one accepts the premise that expansion of the global AML regime will slow in the years ahead, the regime still will have to be regularly adjusted, in part to address the continually changing mechanisms of money laundering and the tactics of those needing to launder the proceeds of their crimes. The FATF's mandate was renewed in May 2004 for another eight years. While it is premature to speculate about when the Forty Recommendations should again be revised, it is reasonable to expect that adjustments and a new set of recommendations will be required at some point in the future. What is significant and disturbing about the announcement of the renewal of the FATF's mandate is that it made no mention either of the importance of research on, or ongoing assessments of the costs and benefits of, an effective anti–money laundering regime.

In the meantime, the principal global issue is implementation of the AML regime on the basis of the 2003 FATF Forty Recommendations. Monitoring compliance with global AML standards has been largely turned over to the IMF and World Bank following a common methodology worked out with the FATF (chapters 4 and 7). This transfer of responsibility has the benefit that reviews are now conducted by organizations with near-universal membership, rather than by a self-selected group of countries that may be reluctant to render frank criticism of fellow members.

On the other hand, while peer pressure, transparency, and accountability are enhanced by the involvement of the IMF and World Bank, the fact that their mandates are far more diffuse has substantially reduced the capacity to apply meaningful leverage, as compared with a process that was exclusively run by the FATF. It is unrealistic to presume that money laundering will rise to the level of importance of fiscal, monetary, exchange rate, and banking policies in connection with IMF support for member countries' economic programs (chapter 7).

A clear challenge ahead to the global AML regime will be to balance the role of the FATF, as the standard-setting body, with the involvement of the

international financial institutions. Countries that some members of the IMF and World Bank might see as candidates for peer pressure in terms of improving their AML regime compliance with international standards may not be seen as candidates by other member nations or by the managements of those institutions.

A related international challenge lies in the scope and utility of sanctions invoked against countries that do not comply with the global regime. As noted in chapter 7, experience with the FATF's Non-Cooperative Countries and Territories (NCCT) initiative has generally been positive, but not completely successful or without controversy. In response to the initiative's "name and shame" approach, about 70 percent of jurisdictions with initial shortcomings have brought their AML regimes into better alignment with international norms. Only Nauru and Myanmar/Burma have been quarantined. Although the process has not yet been fully effective in convincing Nauru to mend its ways or in shutting down Nauru as a host to money launderers, some improvements have been made. Nauru's role in money laundering appears to have been reduced if not eliminated, but it never was large! Myanmar/Burma has made even less progress.

An issue for the global system going forward is to develop criteria upon which similar sanctions can be imposed on other jurisdictions. Is it realistic to expect that such sanctions can in fact be imposed on jurisdictions that are more relevant to the international financial system than the two countries sanctioned to date? How will such countries as Indonesia, Nigeria, and the Philippines respond to pressures from the FATF, and what will the FATF do if their response is inadequate? Will the FATF try to add other countries to its list of uncooperative jurisdictions and incur the displeasure of at least some members of the IMF and World Bank? The standard for noncooperation will have to be raised substantially for this to happen.

This is an issue regarding which one must consider carrots as well as sticks. The concept of mutual recognition of the AML regimes of other countries—or at least institutions from other countries that have passed their FATF examinations or IMF/World Bank reviews—deserves more consideration than it received in the 2003 FATF Forty Recommendations or under the USA PATRIOT Act. As noted repeatedly in this chapter already, serious consideration should be given to increased technical and financial assistance to countries trying to establish and implement national AML regimes on the basis of international standards.

International Cooperation

The AML regime serves multiple though generally concordant goals, despite different emphases in different jurisdictions. Conflicts do sometimes arise as a result of different regulatory philosophies and issues regarding the allocation of limited resources.

International cooperation is often a challenge not only because of differences in AML regimes but because of differences across countries with respect to the structure and development of their financial systems. For example, the limited role of retail banking for both households and small businesses in Switzerland leads to less emphasis on the formal ex ante CDD aspects of the prevention pillar for Swiss banks and greater emphasis on identifying actual money-laundering operations through a cooperative relationship among financial institutions and the authorities.

The issue of limited resources is relevant both to choosing objectives for the global AML regime and determining to which of those selected objectives to allocate scarce governmental or private resources. Limiting money laundering was a high-profile public good in the United States even before September 11, 2001, but today it is still regarded as an unaffordable luxury good in some other jurisdictions.

Developing countries, in particular, are sometimes ambivalent about creating or giving priority to AML efforts. Brent Bartlett (2002) points out three common reasons why: (1) money laundering brings funds from developed economies to developing economies; (2) the crimes that generate the funds occur in developed rather than developing countries; and (3) money laundering adds to the demand for banking services in developing countries. Bartlett argues that that the data do not support any of these statements, that money laundering undermines confidence in the financial system, and that developing countries in general share a broad interest in an effective AML regime. Nevertheless, it is safe to say that reducing global "public bads" is not a high priority for many of these countries, which often are unattractive to begin with as locations for financial transactions because of a lack of integrity of domestic financial institutions. For countries with weak financial systems—as evidenced by extensive use of informal value transfer mechanisms—money laundering may seem a minor problem compared to inadequate supervision of lending practices or tracking of nonperforming loans. The sophisticated human and organizational resources required to create an effective AML regime are particularly scarce in such countries, which is one reason why the IMF and World Bank have been encouraged to develop technical assistance programs to help them develop those resources.[8]

It is an article of faith to the authorities in industrial countries that all nations need to have effective AML regimes, but resources are scarce. The global threat posed by weaknesses in poor countries may be quite minor, and complete convergence of national AML regimes is not necessary to achieve an effective global regime. The trick is to identify weaknesses that need to be addressed and regimes that need to be upgraded before they become major problems for the system as a whole.

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8. The World Bank (2003a) and IMF have developed a reference guide for that purpose.

Having effective AML regimes in poor or small jurisdictions identified as offshore financial centers (OFCs) is particularly important to the global system. The IMF has identified 44 such countries and territories, most of which are classified as developing. These jurisdictions need unimpeded links to mainstream financial centers—even if it reduces their attractiveness to some investors. Thus, an AML regime that is certified by the FATF and international financial institutions is a critical asset. The rapid response of the Cayman Islands and most other OFC jurisdictions to the FATF's designation of them as uncooperative suggests that they understand the importance of cooperation.

Achieving a better alignment of national regimes with the global regime is complex. Russia struggled to align its AML legislation with global standards because of a desire to include broad and vaguely defined economic crimes within the ambit of its law, in part out of concern about capital flight. Chinese authorities have articulated a similar position in the context of the release of money-laundering rules by the People's Bank of China (*Financial Times*, January 14, 2003). India sees money laundering principally as an activity induced by capital and exchange controls, which it is slowly dismantling.

Continued progress in developing the global AML regime also will require better alignment of predicate offenses internationally. The 2003 FATF Forty Recommendations include a roadmap for cooperation with a list of core offenses, but there are important omissions.

Greater and ongoing international cooperation also is needed to forge consensus on global strategies that can adequately serve the disparate needs of the global community. Intensified efforts since September 2001 to combat the financing of terrorism illustrate both the potential for focusing the tools of the AML regime on particular objectives and the pitfalls associated with a failure to recognize that some countries consider other objectives to be of equal or greater importance.

One relatively weak test of international cooperation on money laundering will be the UN Convention Against Corruption (United Nations 2003b). To be effective, the convention must be ratified by the major nations, many of which will have to change their domestic legislation and then actually implement the convention's provisions, in particular its asset recovery provisions.

The enforcement pillar of the global AML regime, often constrained by tensions and differences between national criminal justice systems, will also have to evolve in the years ahead. For example, more fully streamlined modalities of information sharing in money-laundering cases should be established between law enforcement authorities to replace the cumbersome multistep processes of existing multilateral assistance arrangements that require the use of diplomatic channels. Global standards with respect to asset freezes and forfeitures are also needed so that such actions are not only internationally coordinated but also comprehensive in their effect. A third area

where progress is needed is extradition. International agreement is needed to streamline procedures in connection with certain money-laundering offenses, perhaps those 20 designated by the FATF to be particularly important. Members of the European Union are considering implementing such procedures in connection with a specified list of crimes.

Consideration should also be given to producing a global equivalent of the US State Department's *International Narcotics Control Strategy Report* (INCSR) on money laundering. Although the INCSR identifies nations that the US believes have major money-laundering problems, the principal concern is with money laundering that facilitates drug trafficking. The report correctly states that this cannot be separated from money laundering problems more generally. Nonetheless, the INCSR presents a US perspective, whereas a periodic report from an international agency—such as the United Nations Office on Drugs and Crime, which has itself no actual regulatory responsibility—that rated nations in terms of the extent and nature of their money-laundering problems might serve a useful global educative function and support better analysis of money laundering and its control.[9] The ratings could draw on but be separate from IMF/World Bank reviews and FATF mutual assessments.

Domestic Law Enforcement

Regulation and supervision alone can do much to keep financial institutions clean of money laundering. Chapter 6 showed that the global AML regime has been quite effective in meeting this goal with respect to the core financial systems of the major financial centers. However, this success will tend to push money laundering to other less regulated and supervised channels, which in turn points to the importance of effective law enforcement cooperation across the global AML regime.

Unfortunately, it is difficult to judge the effectiveness of current money-laundering investigations because assessment of the enforcement pillar lags that of the prevention pillar, perhaps inevitably, since the former requires much more detailed knowledge of the underlying reality. Still, enforcement assessments have not even been attempted, so definitively determining their feasibility is difficult. Even the greater focus on law enforcement envis-

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9. Winer (2002) proposes that the United Nations establish a "white list" of financial institutions committed to the global AML regime that have passed rigorous reviews of their compliance with and implementation of AML standards. Once on the white list, they would become exclusively eligible to receive and manage funds from the United Nations and other international organizations. This proposal apparently has received little attention since it was put forward two years ago. The cost of the administrative apparatus it proposes might exceed the benefits to the AML regime as a whole, but such a proposal nevertheless represents the type of imaginative thinking on international cooperation that warrants consideration.

aged in the 2003 FATF Forty Recommendations centers around organization and resources, which are important but do not emphasize results.

Money-laundering convictions in the United States average no more than 2,000 annually, even on a generous measure. Given the suspected scope of the activity, this suggests that money laundering is not a very risky activity, particularly when one considers that most convicted launderers are associated with sums of less than $1 million. A very speculative estimate of the risk of conviction faced by money launderers is about 5 percent annually. However, some who provide money-laundering services may only be convicted on other charges, probably related to the predicate offenses that can generate longer sentences.[10] This may be the result of plea bargaining or of a decision to bring only the charges with the longest sentences. Thus, there is no way to measure the actual risk a money launderer faces of going to prison. US seizures and forfeitures of $700 million annually suggest that either a trivial fraction of laundered money is seized, or that much less is laundered than is indicated by official statements about the scale of the activity.

Interviews with both former and current law enforcement officials suggest that the existing regulatory system and the information it generates is not well used in prosecutions. The US Customs and Internal Revenue Services use suspicious activity reports skillfully for specialized purposes, but the reports are rarely used to initiate investigations; instead they are used as additional information for making a case that has originated with another type of lead. Indeed, apart from sting operations, money laundering is rarely the initial offense for an investigation. Some knowledgeable observers have described the sting operations of the early 1990s, when a number of drug traffickers were brought down employing such techniques, as the heyday of money-laundering investigations. But they add that the culture of the major federal law enforcement organizations has since become less hospitable to making money laundering a central investigative focus. The deemphasis of drug investigations has apparently led to less commitment to money-laundering expertise in some key law enforcement organizations. The shift in focus by federal enforcement to countering terrorism financing also has likely been at the expense of more general money-laundering investigations.

However, the reduced emphasis on large-volume money-laundering operations also may reflect the training and orientation of the federal law enforcement community. Money laundering is complex and often difficult to follow for anyone without highly specialized knowledge of finance, and relatively few agents and prosecutors are in a position to acquire the skills necessary to pursue such cases. This is not a problem that can be solved

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10. Cuéllar (2003) provides some evidence that prosecutors tend to pursue the easier money-laundering charges for low-level perpetrators rather than the more-difficult-to-establish charges for the underlying crime or major financing networks.

with a simple recommendation, but we do believe that finding a way to give more priority to money laundering as the initiating offense, and making better use of the existing SAR database, could improve the effectiveness of the AML regime in fighting crime.

The federal government, of course, has often run undercover money-laundering operations, sometimes to considerable investigative effect. However, these operations pose two interesting problems that have received little attention. First, in order to generate business, agents offer low-priced money-laundering services, which may drive down prices and thus actually facilitate laundering. This is a theoretical possibility and a difficult one to investigate, since it depends on how well the market actually operates. The market effect may well be insignificant, but it is a concern that should nevertheless be explicitly addressed when setting up these operations. Second, the operations do facilitate, temporarily at least, the workings of criminal enterprises. To catch senior drug dealers in Operation Polar Cap, a sting operation in the mid-1980s, federal agents allowed large amounts of money to be laundered successfully back to Panama. The trade-offs in terms of the targets apprehended may well be reasonable, but again these are issues that warrant explicit consideration and assessment.

Research Agenda

One clear finding of this study is that there has been little research on either money laundering or the anti–money laundering regime. The law enforcement community simply does not use the types of systematic measurements of inputs and outputs necessary to allocate scarce enforcement resources effectively.

The multiple goals and complex cost considerations of the AML regime point to the potential of using the cost-effectiveness of AML enforcement as a framework to assess the regime. The implied outcome measure is the cost of law enforcement with an AML regime in place as compared to the cost of enforcement without it. While it would be difficult to assemble the information necessary to estimate this difference in any formal sense—"experimenting" per se is impossible, and the effects of the regime on costs are too subtle to be measured—such an approach suggests at least at the conceptual level the value of obtaining data on the number of cases in which money-laundering controls generated valuable information, or provided the legal basis for conviction and incarceration, and on the costs of those controls.

Empirical research on money laundering is even more challenging than for most other criminal activities. There are no victimization surveys of the kind that allow measurement of the volume of other white-collar crimes. Population surveys that provide so much insight into drug distribution and other consensual crimes are unlikely to provide much information

about the narrow set of participants involved in money laundering, most of whom are often closely linked to, if not part of, the crimes.

Nevertheless, the AML regime ought to be susceptible to research. Formidable bureaucratic obstacles arise from the complex structure of law enforcement, which involves multiple agencies that are parts of different cabinet departments, each with its own mission, expertise, and data systems. Data do not travel easily across such bureaucratic landscapes.

An active AML research program will not resolve every issue at hand, but six broad recommendations for a research agenda are offered below.

1. Create a Database of Detected Money-Laundering Transactions

A great deal of information can be gathered about money laundering through compilation of investigations in various countries. However, this information has yet to be systematically assembled into a searchable and researchable database. A starting point for money-laundering studies should be the creation of just such a database that contains all the investigative information, as has been done over the past 30 years in the study of terrorism by organizations such as the RAND Corporation (e.g., Fowler 1981). For each transaction, data would be available inter alia on the predicate offense, the price paid to the launderer and the total cost of laundering to the customer, the stages of money laundering covered by the transaction, and the characteristics of the customer and the provider.

The database would not constitute a representative sample of money-laundering operations, but rather the results of investigative decisions. Having such data available, however, would facilitate analyses of how prices vary across transactions, how they have changed over time for particular kinds of transactions, and how the patterns of utilization of different institutions vary across countries, offenses, and time. The results would only be suggestive, but nevertheless would provide insights that are currently not available.

2. Track Usage of Suspicious Activity Reports

The suspicious activity reporting system in the United States has expanded over time, particularly since the mid-1990s, and now represents a substantial effort by both the government and the private sector. The SARs database contains a vast amount of information assembled at considerable expense. The risk of information overload is real and substantial, and some argue that the system is essentially dysfunctional—valuable warnings and leads are lost, mislaid, or overlooked. No US agency has yet assessed how effective SARs are in contributing to the arrest and conviction of money launderers, or to achieving the specific goals of the AML regime such as combating terrorism financing. The GAO has tried to arrive at an assessment but has been unable to do so.

To be useful, the SARs database needs to be made available to many agencies that have neither the incentive nor the means to provide FinCEN with feedback about the outcome of their use of the information. For example, a particular SAR may be just one of many pieces of evidence that lead to a conviction many months if not years after the initial SARs database query. The inquiry may be initiated by one agency, but the information is passed on to another that then uses it to obtain a conviction.

Creating a system to report all successful uses of SARs is a daunting and expensive task. Universal reporting on outcomes may not be necessary, however; periodic targeted studies might be sufficient. A sample of queries could be followed up and traced to the end of the initial investigation, or a sample of cases involving crimes likely to be related to money laundering could be examined to determine whether and how SARs played a role in the convictions.[11]

Given the continued pressure to expand the range of institutions required to report suspicious activities, an effort must be made to assess whether the system does in fact produce enforcement information of sufficient value to justify that expansion. Without getting into specific details of the appropriate investigative approach for such a study, it might lead to improving the design of the SAR system in terms of the identification, selection, and coverage of information that is worth gathering.

3. Sponsor Research

More sponsored research on money laundering and how to improve the AML regime is needed at the national and international levels. In the United States, research funds should be earmarked in the budgets of the principal agencies responsible for the AML regime (the Homeland Security, Justice, and Treasury Departments). Research program design and results should be subject to outside evaluation, with a strong presumption that the results will be published. Other agencies responsible for supervision of the financial system, such as the Federal Reserve and the Securities and Exchange Commission, should be encouraged to have parallel programs.

At the international level, the FATF, IMF, and World Bank should support cooperative research programs.

4. Maintain a Scorecard on Core Financial System Integrity

Short of developing a more complete database of money-laundering cases, supervisory authorities should at least regularly assess (perhaps every two years) the extent to which money laundering threatens the integrity of the core financial system. If necessary, law enforcement authorities in the United States and other countries could assist in carrying out such reviews.

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11. Gold and Levi (1994) conducted such analyses using data from the United Kingdom, which has made more progress with assessing SARs than has the United States.

Chapter 6 provided a prototype for this type of research project. Cases that involve core financial institutions should be classified into categories based on whether there was institutional solicitation, solicitation by a rogue officer, or unwitting participation or negligence. Cases should then be cross-classified by the size of the financial institutions involved. This exercise would provide an initial baseline against which subsequent reviews could assess progress of the AML regime in protecting the integrity of the core financial system. The results of these assessments should be published.

5. Measure AML Regime Costs

A major shortcoming of the AML regime is the lack of hard data on what it costs. Chapter 4 drew on the limited literature available and attempted to come up with a rough estimate of the gross financial costs of the US regime, including costs to taxpayers incurred by government, costs imposed on financial and nonfinancial businesses and institutions, and costs for customers. Former US Treasury Secretary Paul O'Neill was right to push for work on this topic, and it is unfortunate that he was not more successful. Developing more and better data on AML regime costs should be part of an overall research program.

6. Use Economic Modeling

While the first five suggestions for the research agenda have emphasized empirical research, establishing a firm empirical basis for decisions about the AML regime also requires developing models of money laundering. Theoretical economists have begun to work in this area, but at a very aggregate level that reflects only the most schematic knowledge of money laundering (Masciandaro 1999; Masciandaro and Portolano 2002; and Mauro 2002).

Also needed is a microeconomic research agenda that examines such elements of money-laundering analysis as the market model for laundering services, as well as how the activity might respond to different kinds of regulations and other interventions. The theoretical research could be strengthened by the empirical analyses recommended above.

Final Comments

The global regime that has been constructed to combat money laundering is as complex as the phenomenon itself, in part because of the regime's multiple goals, but also because of institutional and attitudinal differences across countries. These circumstances will continue to shape the international regime and strategies to control money laundering.

With the 2003 revision of the FATF Forty Recommendations on money laundering and the relatively recent promulgation of the Eight Special

Recommendations on Terrorist Financing, the global AML system confronts new challenges with respect to compliance, implementation, and sanctions. Even the United States, one of the principal architects of the AML regime, is unlikely to comply fully with the letter of the new FATF framework. To ensure an effective strategy going forward, the United States should submit to a full IMF review of its financial sector, including review of its anti–money laundering and terrorism financing policies. In addition, the United States should expand the list of foreign offenses that can lead to US money-laundering prosecutions to include tax evasion as well as other serious crimes not now covered and step up cooperation with other jurisdictions on actions against corruption and kleptocracy.

Different countries have different AML priorities, but cooperation is essential to achieve an effective overall global strategy. Ratification and effective implementation of the UN Convention Against Corruption will be a test for the AML system as a whole. The global AML regime clearly needs further development and promulgation of anti–money laundering strategies at the international as well as national levels. Cooperation with the private sector also should be enhanced, and more technical and financial assistance should be made available to poorer jurisdictions.

At present, there is no empirical base to assess the effectiveness of the current AML regime in terms of suppressing money laundering and the predicate crimes that generate it. Sifting of the limited available information suggests that the global AML regime has made progress in the general area of prevention, but without much effect on the incidence of underlying crimes. Critics argue that the regime has done little more than force money launderers to change their methods. Felons' lives are a bit more difficult and a few more are caught, but there is little change in the extent and character of either laundering or crime. Critics may well be right. To rebut such charges and continue to expand, the AML regime needs to demonstrate progress toward its announced goals. The research agenda set out in this study, if implemented conscientiously along with the other recommendations made here, could contribute substantially to further progress in combating money laundering for many years to come.