

Diffusion of the Unproven: The Global Anti-Money Laundering Regime

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Abstract

The Financial Action Task Force's global anti-money laundering regime has developed and diffused without any evaluation of utility or cost benefit analysis to indicate that individual policies or the regime as whole is effective. Private actors are at the forefront of this regime using compliance requirements to reinforced their position in the market and create market entry barriers for smaller firms. A majority of the countries implementing AML policies, and almost all developing countries, have no say in the AML best practice standards. If developing countries do not implement the policy regime they face restricted access to financial investment and isolation from the global economy. Three policy options are introduced in an attempt to mitigate these negative outgrowths of the anti-money laundering regime. This paper proposes an policy option to develop an independent collective research agenda to develop measure of effectiveness, a policy option to bring about a United Nations anti-money laundering standard, and a policy option to reorient the anti-money laundering policy toward corruption in the developing world. This paper recommends the independent collective research agenda, as it is the most politically feasible, and the most likely to address all of the shortcomings of the regime.

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Introduction

Anti-Money laundering (AML) policy attempts to affect a diverse range of public policy issues relating to crime by targeting the proceeds of successful and prodigious criminal acts. The illicit profits garnered, of a volume, must be disguised to avoid suspicion. International AML policy is a reaction to a globalizing world with greater economic enmeshment and free moving capital. Organized criminal enterprises and money laundering are progressively more international, but states are consistently bound to their territorial sovereignty. The idea behind AML policies is to improve cooperation between national jurisdictions, to stifle many social and economic problems that are exacerbated by increasing capital mobility, and an increasing transnational space. By targeting the proceeds of crime the AML regime aims to address myriad associate public policy concerns.

The secretive and illicit nature of the criminal activities that inspire the need to launder money makes measurement and data collection difficult. There is much debate within the literature regarding quantities and techniques, the only thing that is clear from the debate is that at this time there is no robust technique for quantifying the problem, and no technique for gauging effectiveness or efficiency of the policies implemented. Without a metric or a method to provide either baseline knowledge of how much money is laundered or a gauge of effectiveness for individual elements of the AML regime this paper would not be able to prove, or even argue with validity, that the policies are ineffective, either in an absolute sense or relative to cost. This makes micro policy

analysis of the constitutive part of the anti-money laundering regime non-beneficial, and is a reason for this policy paper's macro level analytical approach.

This policy paper will address the global Anti-Money Laundering regime, the systemic concerns for policy development and diffusion, the need for evaluation and measurable effectiveness, and implementation on to the developing world. This paper is an attempt to be clear and simple as well as specific, with little technical language.

This paper is written with a specific audience in mind. The policy options proposed can be acted on by a diverse range of actors in the public sectors, at a range of levels. However, the recommended policy option and the focused critique of the Anti-Money Laundering Regime targets an elite grouping of actors operating in a transnational space. This policy paper is addressed toward: the Executive Board, Administrator and Associate Administrator of the United Nations Development Programme; The Under Secretary General of the United Nations Office on Drugs and Crime; The Board of Executive Directors and the Director of the International Development Association; The Executive Director, the Strategy, Policy and Review Department Director, the Western Hemisphere Department Director, the Middle East and Central Asia Department Director, the African Department Director, and the Asia and Pacific Department Director of the International Monetary Fund. These actors are unlikely to have a technical knowledge of the Anti-Money Laundering regime, though their positions would require their familiarity with it. They also have the knowledge to understand the critiques presented and the power to act upon the final recommendation.

Due to length restrictions this paper will be unable to address all of the debates within, and critiques of, the AML policy regime. Many issues such as: tax havens and tax evasion; off shoring; the specific counter terrorism financing aspects within the policy regime; the spreading scope of the regime to include lawyers, accountants and realtor; the dichotomy of regulation vs. enforcement are relevant but will not be addressed here.

The first chapter of this policy paper will be an informative exercise, providing context and background for the problem of money laundering and the regime built to combat it. This chapter will also discuss the goals of the policy, as well as the actors and institutions that form the AML regime. The second chapter is an analysis of the problems with the AML regime. This chapter is broken into three subparts, one addressing the criticism of an unproven policy suite, next section speaks to the role of private actors in the AML regime, and the last section addresses the process of diffusion relative to the developing world. The third chapter outlines three policy options in an attempt to address the critiques from chapter 2, provides policy goals and criteria for evaluating them. The final part of the paper is the recommendation and conclusion section.

Chapter 1- The Anti-Money Laundering Regime in Context

What is Money Laundering?

Most crime, especially organized crime, is fueled by a desire for profit. The average criminal acquires small sums of money, small enough that this money can be spent in cash to purchase a small ticket item or can be used to subsidize the criminal's lifestyle. However, if the criminal is receiving more money than he¹ can spend inconspicuously, he has to decide if he is going to begin to hoard cash or find a way to disguise the source of the funds. Hoarding cash can work for many but, in the long term (not to imply that there is a long-term - either perceptually or actually - for most criminals), it will likely become a problem for a myriad of reasons. The criminal is unable to consistently deposit cash in the bank or large sums of money. The large sums will require a declaration at the bank stating where the money came from. Consistent cash deposits will also show a paper trail that in the long term may cause concern at the bank or the tax office, or most likely will be used as evidence *post hoc* once the criminal is caught for another offense. A foresighted criminal making significant profit with a desire to keep his freedom will find the afore-mentioned options unattractive. He will require a way of disguising the origins of his ill-gotten revenue to bring it into the formal economy and

¹ The pronoun 'he' is used for simplicity and because the English language lacks a genderless pronoun appropriate for this context.

banking system. The act of disguising the origin of illicit funds is 'Money Laundering',^{2,3} i.e., cleaning dirty money so it can be used openly.

The Financial Action Task Force (FATF) offers this definition: "The goal of a large number of criminal acts is to generate profit for the individual or group that carries out the act. Money laundering is the process of these criminal proceeds to disguise their illegal origin."⁴

Tax havens and offshoring are sometimes conflated with money laundering or, at least, are often conceptually paired with money laundering. The lines may be somewhat blurred but the distinction is mostly a legal one. Money laundering is unequivocally illegal, as are the crimes that generate the proceeds that lead to the laundering. In contrast, putting large sums of money into offshore accounts and evading taxes are typically done within grey areas or loopholes of legal structures. Traditionally, there has been a belief that offshoring money was a way of hiding illicit sums or constituted an intermediary step in the laundering process.⁵ However, in the last 30 years, almost all of these jurisdictions have become part of the Anti-Money Laundering regime (AML), proliferated by the FATF, and now comply with many disclosure requirements that

² The term 'Money Laundering' is said to come from the early 20th century and the days of Al Capone, when he owned a series of businesses, in particular, self-service laundry facilities.

³ Laundromats and car washes were traditional businesses to own and run when disguising one's revenue. This is because it is very hard to audit daily transactions (water supply is close to the only per transaction item consumed). Therefore there are few ways to prove that invoices are fakes and the businesses largely operate in cash. Law enforcement would have to observe all transactions over an extended period of time.

⁴ Financial Action Task Force (FATF). "What Is Money Laundering", n.d. <http://www.fatf-gafi.org/pages/faq/moneylaundering/>.

⁵ Tsingou, Eleni. "Global Governance and Transnational Financial Crime: Opportunities and Tensions in the Global Anti-money Laundering Regime." *University of Warwick. Centre for the Study of Globalisation and Regionalisation*. Working Paper No 161/05 (2005): 4. ["Tsingou, 2005; pg. "]

serve to limit their engagement with illicit funds. Tax havens and off shore centers are contentious political and legal issues and will not be discussed in this paper.⁶

Why is Money Laundering a Concern?

Money laundering became a pressing issue in political and public policy circles in the 1980s. At that time, many of the industrialized Western nations, particularly the United States, were dealing with high crime rates and the proliferation of organized crime that centered on drug distribution. The focus on money laundering is best understood as a proxy effort to affect the 'predicated offenses', or the crimes that generate the money to be laundered. Since the 1990s, the scope of predicate offenses has exacerbated. Today, the list of offenses includes "robbery, fraud, the illegal trade in arms and people, kidnapping, extortion, bribery, smuggling, embezzlement, counterfeiting, price-fixing, insider trading", terrorist financing, and other offenses.⁷ The idea behind the AML regime is that many public policy goals linked to crime can be collectively addressed by targeting the common thread: the financial proceeds of successful crimes.

AML policy is designed to target the proceeds of crime. The AML regime has shifted somewhat away from focusing only on predicated crimes, as a lot of national legislation once did, to addressing broader public policy goals. Public officials have presented the AML regime as a way of "tackling the drug trade, the arms trade, people trafficking and

⁶ For more information on offshore financial centers and tax havens, see Levin 2002; Sharman 2006, Vleck 2009; and Palan et al 2010.

⁷ Sharman, Jason Campbell. *The Money Laundry: Regulating Criminal Finance in the Global Economy*. Kindle (ebook). Cornell University Press, 2011: Chapter 1, Paragraph 6. ["Sharman 2011a, "]

other organi[z]ed criminal activities; supporting the integrity of the financial system [...]; combating corruption and its economic and political consequences; promoting economic development,"⁸ in addition to ensuring adequate levels of tax revenue and targeting terrorist financing.

International money laundering can also be seen as an outgrowth of globalization, capital mobility, and an increasingly intermeshed system of global finance. AML can slow or try to deter this process but as long as there is free movement of capital, which is crucial for an international capitalist system, there will always be some degree of money laundering. A zero-tolerance policy on money laundering would be incompatible with capital mobility.⁹ Therefore, the AML regime is symbolic and/or a more general effort to address broader public policy goals, but it is decidedly not in place to eliminate money laundering.

Where did the Anti-Money Laundering Regime come from?

In 1989, at the Paris Economic Summit of the Group of 7 (G-7), France and the United States introduced a proposal to form a temporary body with a five-year mandate, the FATF. The FATF would be housed at the Organization for Economic Co-operation and Development (OECD) headquarters in Paris and would be separate from the OECD. Within this agreement was an explicit stipulation that the FATF would not address tax

⁸ Tsingou, 2005; pg. 4.

⁹ Tsingou, Eleni. "Global Financial Governance and the Developing Anti-money Laundering Regime: What Lessons for International Political Economy?" *International Politics* 47, no. 6 (2010): 629. ["Tsingou, 2010; pg. "]

issues.^{10,11} The FATF's initial role was to assess the cooperative efforts thus far regarding money laundering and to recommend additional preventative efforts. In 1990, the FATF released "forty recommendations", which provided a framework and international best practice for international harmonization and cooperation around money laundering. In 1996, there was a slight revision to the "forty recommendations" and, in 2003, a comprehensive revision called the "Anti Money Laundering and Combatting Terrorist Financing 40+9 Recommendations" (AML/CTF 40+9) was approved. The comprehensive revision to the framework came after a review of money laundering trends, which encompassed financial and non-financial sectors, as well as "gatekeeper" professions "through such methods as [Customer] [D]ue [D]iligence (CDD), reporting, regulation and supervision, international cooperation,"¹² and 'Know Your Customer' (KYC).¹³ The term "+9" relates to another new area covered, "Combating Terrorist Financing" (CTF). Post 9/11, the financing of terrorism was an issue that spurred diffusion and international cooperation. In February 2012, the FATF completed a thorough review of their standards and 40 recommendations. The FATF stated that the revised recommendations incorporated the financing of weapons of mass destruction, were tougher on corruption, and concentrated on transparency. They state that the 9 special recommendations on terrorist financing had been fully integrated into the framework.¹⁴

¹⁰ Reuter, Peter, and Edwin M. Truman. *Chasing Dirty Money: The Fight Against Money Laundering*. Peterson Institute for International Economics, 2004: 81. ["Reuter and Truman, 2004; pg. "]

¹¹ The inception of the FATF came at a time of public outcry in the United States around the drug trade and international drug cartels, and at a time when the enforcement attempts of the "War on Drugs" was seen to be failing.

¹² Reuter and Truman, 2004; pg. 81.

¹³ For more information on gatekeeper compliance, see Basel Committee on Banking Supervision 2001 (both guidelines and final document).

¹⁴ See Financial Action Task Force. "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations", 2012

The FATF provides a regulatory and legislative framework that curbs the behavior of private finance firms and prescribes legal provisions that allow for criminal prosecutions and confiscations.¹⁵ In the beginning of the AML regime, the FATF was flexible in their guidance and the implementation of their framework, but the organization has evolved. The recommendations are now more precise and prescriptive.¹⁶

In 1999, the FATF began to publish a list called the “Non-Cooperative Countries and Territories” (NCCT), which is also informally called the FATF blacklist. The blacklist was regularly reviewed and updated until 2006. The NCCT program currently lies dormant. In 2007 the International Monetary Fund (IMF), succumbing to political pressure, endorsed the FATF recommendations. As part of the IMF’s endorsement, the FATF had to stop the NCCT program, emphasize consensus and cooperation, and publish a transparent methodology for country compliance review.¹⁷ The IMF began to aid the FATF in their “Mutual Evaluations.”¹⁸ The inclusion of the IMF in the regime addressed political pressure regarding the selective western membership of the FATF.¹⁹

¹⁵ Tsingou, 2010; pg. 619

¹⁶ *id.*

¹⁷ *id.*, pg.624

¹⁸ Mutual evaluations are a voluntary process by which a country subscribing to the AML standards requests to be evaluated. That country’s evaluation is performed by two parties: another country in the AML family and either the IMF or the World Bank.

¹⁹ Tsingou, 2010; pg. 624

The Anti-Money Laundering Regime: Framework and Diffusion

The AML regime developed on two fronts and three levels. The two fronts of the AML regime are Prevention and Enforcement. Prevention is designed around four major areas: sanctions, regulation and supervision, reporting, and customer due diligence (also known as KYC). Enforcement is designed around three major areas: confiscation, prosecution and punishment, and investigation.^{20,21,22} The AML regime also takes steps to ensure cooperation between Financial Intelligence Units (FIUs), financial regulators, and law enforcement, as well as facilitating international cooperation with investigations.^{23,24}

On the prevention front, the KYC regulation most affects the general public. It compels financial institutions to ensure that customers are really who they claim to be; they do this by requiring documentation and verifying the client's identity.²⁵ Any suspicions – whether related to transactions, clients or companies – must be reported to the particular country's FIU. The FIU is tasked with receiving, collating, and analyzing reports, and either investigating or passing along the reports to the particular domestic institution that is tasked with investigations.²⁶ Firms are barred from alerting the customer that a report was lodged and are legally indemnified against lawsuits by the client.²⁷ FIUs are also responsible for auditing the procedures of private firms,

²⁰ Tsingou, 2005; pg. 4

²¹ Sharman 2011a, Chapter 1, Section 5, Paragraph 1

²² For a good overview and detailed breakdown of the Enforcement and Prevention pillars, see Reuters and Truman 2004 Chapter 4.

²³ Sharman 2011a, Chapter 1, Section 5, Paragraph 6

²⁴ Countries must sign the 'Vienna Convention' and the 'Palmero Convention.'

²⁵ Sharman 2011a, Chapter 1, Section 5, Paragraph 1

²⁶ *id.*, Paragraph 3

²⁷ *id.*

conducting trainings, and setting standards regarding the internal compliance mechanisms of financial institutions. FIUs also advise financial institutions on firms and countries to pay special attention to, such as those firms or countries that do not implement the AML regime.²⁸ FIUs wield the power to punish firms that fail to comply with direction. They can issue public reprimands, impose administrative penalties, engage in civil actions, or conduct criminal prosecutions.²⁹

The enforcement front was initially limited to investigating and confiscating revenues from drug crimes but, over time, the predicated crimes (discussed earlier) have been expanded. The FATF standards state that punishment for money laundering should be “effective, proportionate, and dissuasive” and should include imprisonment, as well as confiscation and the return of the seized proceeds to the original jurisdiction.³⁰ Under the AML, FIUs and law enforcement bodies can compel financial institutions to disclose records and relevant information despite domestic bank secrecy laws; countries are required to facilitate effective cooperation between regulators, FIUs, and law enforcement; and countries are required to facilitate international investigative cooperation.³¹ Perhaps the most revolutionary measure implemented under the AML regime, which was first pioneered by the United States but has since spread to other countries, is the ability to take legal or civil action against the *asset* instead of the person.³² This measure reverses the legal burden of proof; the individual must provide evidence that his assets or funds were not the proceeds of a crime, rather than the standard rule that places the burden on the authorities to prove that the assets or funds

²⁸ *id.*, Paragraph 4

²⁹ *id.*

³⁰ *id.*, Paragraph 5

³¹ *id.*

³² Sharman 2011a, Chapter 1, Section 5, Paragraph 1

are the proceeds of a crime.³³ Although money laundering has been criminalized in most jurisdictions, and enforcement agencies possess a decidedly public role, the AML process is primarily a regulatory one that is less developed both in terms of visible results and institutional framework, particularly at the global level.³⁴

AML best practice is diffused at two levels, the international level and the regional level, and is implemented at the national level. The international level includes actors such as the FATF (which currently has 34 member nations), the Egmont Group of Financial Intelligence Units (an informal consortium of 115 national FIUs and the United Nations Global Program against Money Laundering), and the IMF, which aids in performing mutual evaluations, offering technical assistance and links with the FATF on matters regarding global financial integrity.³⁵ The World Bank also plays a role in lending technical expertise by participating in mutual evaluations.³⁶

There are six regional bodies that were set up to diffuse AML policy from the regional to the national levels. These six bodies hold associate membership with the FATF: Asia/Pacific Group on Money Laundering (APG); Caribbean Financial Action Task Force (CFATF); Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL); Eurasian Group (EAG); Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG); Financial Action Task Force on Money Laundering in South America (GAFISUD); Inter Governmental Action Group against Money Laundering in West Africa (GIABA); Middle

³³ *id.*

³⁴ Tsingou, 2005; pg. 4

³⁵ *id.*, pg. 5

³⁶ Reuter and Truman, 2004; pg. 87

East and North Africa Financial Action Task Force (MENAFATF).³⁷ The regional level is where much of the monitoring and promotion takes place.³⁸ These regional bodies provide technical expertise and framework assessment, and serve as a discussion and learning forum for diffusing AML standards to the national level. The actors at the national level were been enumerated in the discussion of the prevention and enforcement aspects of the AML standard. The enforcement power is held exclusively at the national level.

³⁷ For a complete list of all members and to access information about them, see <http://www.fatf-gafi.org/pages/aboutus/membersandobservers/>

³⁸ Tsingou, 2005; pg. 6

Chapter 2- Problem Description

There is no shortage of criticism for the global anti-money laundering regime. Much of this critique coalesces around a few central issues: effectiveness; proving effectiveness; cost; the role of private financial institutions; the political nature of the FATF; and the impact on the developing world. This section will deal with critiques of the regime and not the intricacies of the individual policy prescription. The construction of AML best practice is performed by a small group of western technocrats but is diffused to almost every country in the world, most of which are not represented in the production of policy. The FATF is not a body that is capable or willing to deliberate. The institutions on the front lines of monitoring transactions and detecting money laundering are private. In many, if not most, countries the state is ill prepared to monitor compliance of these firms. The diffusion of these policies is informal but ubiquitous. The ubiquity is particularly interesting considering the high costs of implementing and complying with AML policies and the complete lack of evidence to prove, or even suggest, that there is any utility in incurring these costs. Ultimately, money laundering and capital mobility go hand in hand and with no evidence to prove the regime effective one must begin to tally the negative externalities of its existence.

Difficulties in baseline and efficiency measures in Anti-Money Laundering

The most consistent and irrefutable critique of the AML regime is that it offers no empirical foundation for understanding the scope of the money laundering problem, and similarly that the regime does not offer, and does not attempt to offer, any gauge of policy effectiveness. In truth, there have been few published empirics by national or international institutions to justify the efforts and expenses in anti-money laundering efforts.

One academic estimates the quantity of illicit funds moving through the global financial system as ranging between US\$ 1.0 and 1.6 trillion in 2000/2001, which became the estimate adopted by the World Bank.³⁹ The IMF estimates the quantity of money laundered to be between US\$ 800 billion and 2 trillion, or 2-5 percent of world Gross Domestic Product (GDP).⁴⁰ The FATF disclosed that between 1996 and 2000 they attempted to calculate an estimate of illicit funds moving through the global economy and failed. They were unable to find or develop a robust enough method to give credibility to any estimate. The literature is highly critical of money laundering estimates and of many of the methods used. There is no consensus on an appropriate method and no consensus on any figure estimating the quantity of illicit flows, which has led a prominent author in the field to conclude:

" Given the credibility of the methodology, the only thing that can be stated with certainty is that the actual figure is not likely to be less than

³⁹ Baker, Raymond W. *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System*. John Wiley & Sons, 2005: 163

⁴⁰ Schneider, F. "The Financial Flows of the Transnational Crime: Some Preliminary Empirical Results." : *Maklu Publ. Comp*, #53:215–232. Economics of Security Working Paper Series. European Commission's Seventh Framework Programme, 2011: 3 ["Schneider, 2011; pg. "]

0 percent or more than 100 percent [of global gross domestic product]."^{41,42}

The limitation of not being able to obtain a baseline measure for the quantity of money laundered makes an attempt to assess the effectiveness of any policy within the AML regime difficult. Without the ability to judge effectiveness within anti-money laundering policy, there is no way to form a benchmark for success. This also implies that there is no empirical way to prove that the regime is failing to address the public policy needs that it was put in place to impact.⁴³ Without a clear cost-benefit analysis institution, actors and advocates of the regime are unable to defend against consistent criticism.

Criticism focuses on the large price of the AML regime and the unclear benefits. Some argue that it has done little more than complicate and inconvenience criminals, and has not affected the nature of either money laundering or the crimes that belie it.⁴⁴ The FATF and domestic FIUs have no evidence that AML policy is either effective in an absolute sense or cost-effective, particularly for poor countries.⁴⁵ Many libertarians and economists argue that the private sector is burdened with large costs in the anti-money laundering regime, including a plethora of anti-money laundering reporting requirements that when correctly measured will prove far from cost effective.⁴⁶ The AML regime is operated without any gauge of effectiveness and seemingly without any compunction to prove its effectiveness. The proliferation and prominence of AML

⁴¹ Naylor, R.T. "Wash-out: A Critique of Follow-the-money Methods in Crime Control Policy." *Crime, Law and Social Change* 32, no. 1 (September 1, 1999): 1–58: 30

⁴² For a comprehensive discussion of contemporary methods of quantifying the amount of money laundered, see Unger (2009).

⁴³ This was a significant reason for the macro scope of this paper.

⁴⁴ Reuter and Truman, 2004; pg. 60

⁴⁵ Sharman 2011a, Introduction, Paragraph 13

⁴⁶ Rahn, Richard W. "Follow the Money: Confusion at Treasury". The Cato Institute, n.d. <http://www.cato.org/publications/commentary/follow-money-confusion-treasury>.

policies in combination with the absence of a yardstick places a discursive burden on the critics to prove that it is ineffective.

There are inherent difficulties in gathering quantitative data and developing a method to measure money laundering, yet the national and international agencies responsible for this policy are “curiously uninterested in measuring the results of their labor.”⁴⁷ The regime requires an assessment of impact, or at least achievement. In a period in history where performance assessments are ubiquitous it is unacceptable to further expand the regime without evidence of its utility. Although, even if a measurement were possible, what would be good enough? The ultimate goal of the AML regime is not compatible with global finance as it stands today because the control measures necessary to eradicate money laundering would affect the nature of the global financial system.⁴⁸ To truly eliminate money laundering would mean drastically restricting capital mobility, which would stifle the growth of the financialized OECD countries; therefore, the ultimate goal of the AML regime is not to eliminate money laundering. The honest aim is to serve a “range of public policy goals without threatening the core of the financial system”.⁴⁹ The inclusion of some dirty money within the system appears to be an acceptable tradeoff for efficient and adaptable financial markets.⁵⁰ Therefore, the regime could be argued to be symbolic: a public policy regime designed to address a public outcry regarding drug cartels, organized crime and, in later years, terrorism. This more symbolic goal may be another reason why the global institutions and FIUs seem woefully unconcerned with demonstrating that AML policies have impact.

⁴⁷ Sharman 2011a, Introduction, Paragraph 11

⁴⁸ Tsingou, 2010; pg. 629-630

⁴⁹ id., pg. 629

⁵⁰ id., pg. 627

Private Actors within the Anti-Money Laundering Regime

Role of Private Actors

Although most of the dialogue, literature and policy language within the AML refers primarily to state actors, the institutions on the frontlines implementing, monitoring and developing standards are private. Private actors, such as financial institutions and banks, have been delegated the lion's share of the responsibility in detecting and combating money laundering. The private sector has by and large been willing to adopt AML procedures and comply with AML regulations. These measures have included 'Customer Due Diligence' and 'Know Your Customer' regulations, which include: scrutiny of clients' identities to determine the beneficial ownership of funds, assets and corporate vehicles; an internal monitoring process and protocols for dealing with suspicious activities; internal training programs; auditing procedures; accountability measures; setting up specialized AML units; and legal commitments by senior management.⁵¹

The task of identifying and screening out criminal money is technical and difficult to implement. For multiple reasons, the public sector has passed compliance responsibilities and the legal role of 'capable guardian' to the private sector.⁵² Although governments have been clear on formal legal incentives such as administrative, civil and criminal penalties, they have given very little direction and expertise to financial firms in distinguishing dirty money from clean.⁵³ Financial institutions also have the more informal incentive of reputational legitimacy to encourage compliance with AML

⁵¹ Vitale, Anne T. "US Banking: An Industry's View on Money Laundering." *Economic Perspectives* 6, no. 2 (2001): 24–26; in Tsingou, 2010; pg. 621.

⁵² Tsingou, 2010; pg. 621

⁵³ Sharman 2011a, Introduction, Paragraph 18

policy.^{54,55} To deter uncertainty and undercut potentially harmful occurrences that may erode the institution's reputation, firms tend to engage in preemptive AML policy, which contributes to a regulatory creep as well as increasing costs.⁵⁶ Most governments rely completely on the expertise of financial institutions to identify suspicious transactions.

High Costs to Banks

The role of private actors in anti-money laundering efforts comes with a considerably high cost and much of that cost is borne directly by the financial institutions. The American Bankers Association placed bank secrecy and AML requirements first in compliance costs for banks.⁵⁷ A KPMG 2007 survey and report on global anti-money laundering indicates that 224 banks in 55 countries cite 'transaction monitoring' and 'staff training' as their top compliance costs. KPMG indicates that costs are continuing to increase.⁵⁸ Costs of the AML regime differ across countries. For example, in the United States,⁵⁹ estimates for 2003 suggest a total cost of US\$ 7 billion a year. The same estimate indicates that US\$ 3 billion is borne by the government, US\$ 3 billion by private sector institutions and another US\$ 1 billion in additional costs for the private sector. This figure is .06 percent of the 2003 GDP of the United States, or approximately \$25 per man, woman and child.⁶⁰ Legal responsibility for the AML regime, as well as the financial costs of compliance and monitoring, falls on the private sector, yet private sector institutions have no direct say in AML policy formation.

⁵⁴ Tsingou, 2010; pg. 620

⁵⁵ For a detailed explanation see Basel Committee on Banking Supervision 2001 (both guidelines and final document).

⁵⁶ Tsingou, 2010; pg. 621

⁵⁷ American Bankers Association Banking Journal 2003; 35-38: in Tsingou, 2010; pg. 621

⁵⁸ KPMG. *Global Anti-Money Laundering Survey 2007: How Banks Are Facing up to the Challenge*. Anti-Money Laundering Survey. KPMG, 2007.

⁵⁹ The United States is used as an example because of their hegemonic position in determining much of the regime's policies.

⁶⁰ Reuter and Truman, 2004; pg. 70-75

Reporting, Over-reporting, and Compliance

In the last 10 years, many OECD countries have shifted compliance and reporting strategies from a rule-based standard, in which the state set strictly defined criteria of what conduct was suspicious and warranted reporting, to a risk-based standard that utilizes the expertise of the financial institutions in deciding which transactions are suspicious.⁶¹ This shift changed the incentive structure for the private sector. Financial institutions face higher fines if they fail to report money laundering. These 'excessive' fines force banks to report transactions that may be less suspicious. In turn, this excessive reporting dilutes private sector reporting.⁶² Financial institutions over-report for several reasons: because transactions that seem to be legal may turn out to be illicit; because of concerns for reputation; and because of a fear of fines and legal action if institutions did not report what is later uncovered to be money laundering.⁶³ Uncertainty and excessive punishment lead to over-reporting.⁶⁴ The amount of reported information is exacerbated by ever evolving private best practice standards.

It is not clear whether public agencies have the capacity to effectively monitor compliance, which leaves private incentives as the major guiding force for the developing AML regime. It is also unclear whether public agencies are equipped to analyze the incredibly large amount of information that is forwarded to them. The capability of states to oversee the largely privately led detecting and reporting scheme

⁶¹ Unger, Brigitte. "Money Laundering-a Newly Emerging Topic on the International Agenda." *Review of Law & Economics* 5, no. 2 (2009): 819

⁶² Takáts, Előd. "A Theory of 'Crying Wolf': The Economics of Money Laundering Enforcement." *Journal of Law, Economics, and Organization* 27, no. 1 (April 1, 2011): 5-6. ["Takáts, 2005; pg. "]

⁶³ Takáts, 2005; pg. 5

⁶⁴ *id.*

within the AML regime depends greatly on the individual state. Implementation of the AML regime can be broken down into two pillars: enforcement and prevention. Western countries vary in their legal and institutional focus regarding these pillars.⁶⁵ For example, the Swiss are more preventative, focusing on cooperation between financial institutions and government authorities. Few reports are generated and the government acts promptly on those reports, tending to freeze assets rather than incarcerating offenders. In the United States, there is fairly weak regulation and the government is decidedly enforcement-oriented. Many reports are generated that contain little information but the criminal offender is under threat of heavy penalty if caught.⁶⁶ For many countries, the ability of the states to oversee how well private firms perform their roles is questionable at best. The AML regime is important enough to implement across the world but does not impel many governments, such as the United States, to develop institutions capable of monitoring the for-profit actors that are responsible for nearly all AML detection.

Consolidation of Power by Private Actors

The cost of complying with AML standards disproportionately affects small and large financial institutions. The reactive role of financial institutions in the risk-based approach has a greater and more costly effect on small institutions. These small institutions are less capable of interpreting intelligence, providing input into standards, and forming productive relationships with examiners and law enforcement.⁶⁷ For

⁶⁵ A separate paper is required to discuss the intricacies between the enforcement and prevention pillars. For a detailed discussion see Reuter and Truman 2004, Chapter 4; Tsingou 2010; Croall 2004

⁶⁶ Reuter and Truman, 2004; pg. 58

⁶⁷ Tsingou, 2010; pg. 629

smaller institutions, meeting the 'Know Your Customer' regulation and reporting requirements are less automated and therefore more costly.

Many large private stakeholders are developing complex compliance programs. They are forming automated and streamlined analysis and reporting procedures and developing analytical statistical modeling. Although the programs have a high initial cost, the automation allows for lower long-term compliance and reporting costs.⁶⁸ Some large firms have formed entities such as the "Wolfsberg Group of Banks", which harmonize guidelines and best practice for screening and monitoring clients and transactions to increase the reputations and credibility of member financial institutions.⁶⁹ Membership in this group is restricted and it is comprised of many of the world's largest banks. Many of these complex techniques are feeding back into the updated AML compliance standards, which influence the competitiveness of small firms and create significant entry barriers.

Large firms are using the information gathered from the KYC regulation for its marketing value. This information allows these institutions to tailor products and services to meet the clients' needs more effectively, and use a more informed client profile to market products and services directly to the client.⁷⁰

The AML regime strengthens the position of larger institutions and consolidates the power of larger actors within financial sectors. The regime also serves to consolidate the power of the developed financial sectors of many OECD countries. Compliance

⁶⁸ Tsingou, 2010; pg. 629

⁶⁹ id., pg. 628

⁷⁰ id., pg. 638

requirements become significant entry barriers to financial markets. Some argue that the internationalization of the AML standard was done intentionally to affect the competitiveness of non-OECD financial centers, tax havens and offshore financial centers.^{71,72}

Power and Coercion in Policy Diffusion: North to South

Power and the FATF

The FATF is designed as an informal grouping of executives intended to promote technical standards, a global best practice, in combating money laundering; however it is a distinctly political organization. The FATF does not have open enrollment for all countries. In fact, their website indicates that a country has to be strategically important to be considered for membership. OECD states constitute the significant majority of FATF member countries. Many of these countries, such as the United States and the United Kingdom, show a strong trend of simply not complying with the international AML standards that they collectively create. These hegemonic core states introduce measures for other less powerful states to follow while not following the measures themselves.⁷³ Public and private institutions in developing countries regard AML policy as a prerequisite for dealing with the outside world, i.e. as a cost of doing business.⁷⁴

⁷¹ id., pg. 630

⁷² Footnote – for more information on offshore financial centers and tax havens, see Levin 2002; Sharman 2006, Vlcek 2009; and Palan et al 2010.

⁷³ Sharman, Jason Campbell. "Testing the Global Financial Transparency Regime." *International Studies Quarterly* 55, no. 4 (2011): 999

⁷⁴ Sharman 2011a, Chapter 5, Section: Private Actors and Structural Power, Paragraph 12

Unger (2007) argues that the largest financial centers are both hubs for blending illicit funds into the financial system and the countries least likely to abide by the AML policies that they had the strongest hand in crafting. The presumption of lax regulations for offshore and developing financial centers is counterfactual; in fact, they tend to be more diligent and above board than countries like the United States and the United Kingdom.⁷⁵ A 2001 report by the Federal Bureau of Investigation in the United States claims that 50 percent of the world's laundered money is laundered in the United States, while a United States Treasury Department report estimates that 99.9 percent of funds laundered in the United States go undetected.⁷⁶ The United States is the country with the best FATF evaluations and the country with more money laundering than any other.⁷⁷

Sharman performed interviews with the British government regarding its advocacy of AML policy diffusion to the developing world. He stated that the first line of reasoning was that "AML policy provided important benefits for developing countries."⁷⁸ When pressed for evidence of the benefits, the response was that "although there might not currently be evidence that AML policy is providing benefits for developing countries, it will in the future."⁷⁹ When pressed for an indicator that would suggest such, the respondent indicated that "regardless of any local benefits now or later, AML standards were an essential prerequisite for membership in the global economy, and thus every

⁷⁵ Sharman 2011a, Chapter 3, Section: Results, Paragraph 18

⁷⁶ Mitchell, Daniel J. "US Government Agencies Confirm That Low-tax Jurisdictions Are Not Money-laundering Havens." *Journal of Financial Crime* 11, no. 2 (2004): 128

⁷⁷ Unger, Brigitte. "Money Laundering-a Newly Emerging Topic on the International Agenda." *Review of Law & Economics* 5, no. 2 (2009): 827

⁷⁸ Sharman 2011a, Chapter 5, Section: Private Actors and Structural Power, Paragraph 9

⁷⁹ *id.*

country must have them”.⁸⁰ Sharman went on to indicate that the British government perceives any attempt at cost-benefit measures of AML policies to be pointless and potentially dangerous, because the attempt to measure could give the impression that developing countries had a choice in conforming or not conforming to the international standard.⁸¹

The costs associated with investing in AML standards are felt disproportionately by non-OECD and developing countries. This potentially unnecessary burden has not been proven to be necessary by the FATF, but there is no mechanism to contest the FATF’s discourse. In 2005, at the United Nations crime conference in Bangkok, a core group of OECD countries blocked an attempt by a large group of developing countries to bring the AML policy regime under the United Nations umbrella. These countries were attempting to take the FATF framework into a deliberative space to address broader issues that concern the developing world, which are not addressed in the FATF recommendations.⁸²

The FATF is an informal body, whose membership is constituted by wealthy nations. It is not tied to any formal global governance system, such as the United Nations,⁸³ and there are no mechanisms for debate, deliberation or contestation regarding its policies. Therefore, the discourse that extols the utility of AML policies and holds that financial centers in developing countries are weak, vulnerable and full of money laundering has no space to be debated.

⁸⁰ Id., Paragraph 21

⁸¹ id., Paragraph 22

⁸² Tsingou, 2010; pg. 631

⁸³ Since the early 2000s, the FATF has had a loose affiliation with the World Bank and the IMF. Together, they help perform country evaluations. However, the World Bank and IMF boards of governors do not and cannot control policy, procedure or the administration of the FATF.

Coercive Diffusion

AML policy diffusion to countries outside of the West has been indirectly driven through power exercised by international organizations, private firms and regulatory networks.⁸⁴ Developing countries have very few incentives to adopt AML/CFT policies. Only coercive leadership from stronger countries and the outgrowth of blacklisting encourages them.⁸⁵ The blacklisting of the late 90s and early 2000s stigmatized many developing countries and, in many cases, was correlated with significant capital flight. The threat of blacklisting, and actual blacklisting, provided pressure from public and private sides to adopt the standard AML policy measures.⁸⁶ This brought national officials into transnational AML networks and the FATF regional bodies. In these developing countries the banks used the presence of AML policy as a proxy indicator of a propensity for risk. Developing states without an AML policy face difficulties and greater expenses in accessing foreign direct investment and loans from private institutions and funds.⁸⁷ AML policy became a necessity for engaging in international transactions and the global economy. To not engage in international transactions and the global economy would cause fledgling sectors to wither and the countries' economic development to slow down. The direct or indirect exclusion of a country from the global economy and access to finance is no different than the more direct measure of economic sanctions. Developing countries began to see AML policy as the price of doing business. The process became a self-reinforcing process of diffusion: the more countries that came into the fold, the greater the pressure on those countries stamped

⁸⁴ Sharman 2011a, Introduction, paragraph 10

⁸⁵ Simmons, Beth A. "The International Politics of Harmonization: The Case of Capital Market Regulation." *International Organization* 55, no. 3 (2001): 605-607

⁸⁶ Sharman 2011a, Introduction, Paragraph 16

⁸⁷ *id.*, Paragraph 18

as deviant and the greater their isolation. The diffusion of the AML policy regime outside of the west has been a power driven process.⁸⁸

Impact on Developing Countries

Despite differing financial sectors and domestic priorities, many developing countries never-the-less have come to adopt the AML policies designed for western countries to combat a problem that is not apparent, or perhaps does not exist.⁸⁹ The limited resources of developing countries, specifically financial and human capital, are being diverted to AML compliance.^{90,91} AML requirements are often in conflict with reality as well as anti-corruption measures and needs in developing states.⁹² When officials argue that AML policy is 'better than nothing', they fail to recognize the opportunity costs at play in developing countries. The citizens and economies of these countries require substantially more investment than in most developed nations.⁹³ AML policy investment comes at the expense of many whose needs go unmet. It also ignores the idea that a policy should have a provable positive benefit to society that is greater than the cost imposed. Yet, today there are more developing countries with AML policies than there are developed ones.⁹⁴

Many developing countries don't have financial systems with the capacity to handle enough financial flows to mask significant laundered sums of money. In fact, it is surmised that most money laundering occurs through major financial centers and

⁸⁸ Sharman 2011a, Introduction, Paragraph 9

⁸⁹ id., Paragraph 17

⁹⁰ Tsingou, 2010; pg. 631

⁹¹ For further discussion on resource allocation effects in developing countries, see Rodrick (1998).

⁹² Id.

⁹³ Sharman 2011a, Introduction, Paragraph 12

⁹⁴ id.

through off-shore hubs with large banking sectors.⁹⁵ In some developing countries, the AML regime can also serve to exclude large portions of the population from participating in the formal banking system. Many individuals lack the documentation that is required by AML standards to participate in banking. This can have a secondary effect of increasing the size of the informal economy and draining tax revenues from the states. These revenues are required for the development of state capacity and economic growth. Additionally, remittance systems are also being closed down. AML standards are cutting into the slight profit margins of the money service businesses⁹⁶. Their relationships with financial institutions are being eroded by the liability concerns that banks face relative to their slight profit margins. The erosion of formal remittance channels causes more movement of funds through informal channels, which inevitably increases the size of the black economy. For many developing countries, remittances are a significant portion of GDP, which further erodes state capacity and economic growth. Ultimately the impact of this best practice technocratic standard is felt by developing populations.

Conclusion

The absence of data prevents a discussion of the efficiency of the AML regime. The same lack of evidence also prevents any evaluation through a cost-benefit analysis. Yet, the development, diffusion, legitimacy, and purpose of the AML regime goes forward relatively unquestioned. Despite the significant costs (financial, regulatory and legal) to both the public and private sectors, the FATF and national FIUs are decidedly unconcerned with demonstrating the effectiveness of their policies or any impact that

⁹⁵ Unger, Brigitte. *The Scale and Impacts of Money Laundering*. Edward Elgar Pub, 2007.

⁹⁶ Sharman 2011a, Introduction, Paragraph 10

the policies might have on the public policy issues that they are trying to address. The regime has diffused a western-centric best practice standard, deliberately or not, through a coercive process resembling economic sanctioning to isolate and strongly encourage delinquent countries to come into the fold.

Private actors are at the forefront of this regime. They are responsible for the detection of dirty money under the penalty of fines and legal recourse, with little direction as to how to perform this task. Many large financial institutions, however, have used the compliance requirements to consolidate their expertise and market position. This conduct has reinforced the place of western financial centers in the global economy and created greater market entry barriers for smaller firms.

The FATF is a decidedly political organization with no formal ties to any international governmental organization, except for shared evaluation procedures with the IMF and World Bank in response to blacklisting policy backlash. The organization is only accountable to its members and countries can only become members if they are of strategic importance to the organization. Many FATF western member countries have prevented efforts to bring the AML policy regime into an accountable global governance space. A majority of the countries implementing AML policies, and almost all developing countries, have no say in the AML best practice standards. Additionally, developing countries have very little choice in adopting the policy regime. If developing countries do not adopt the policy regime, they will not have access to financial markets, which will cause exceptional trouble with receiving foreign investments and will lead to the countries being *de facto* cut off from the global economy. This isolation would

disproportionately impact fledgling public and private sectors and the relatively at-risk citizens of developing countries.

Ultimately, and ironically, the eradication of money laundering is in contradiction with the global financial system. A truly effective zero-tolerance AML regime would be incompatible with free flowing capital, and thus is likely destined to remain a symbolic public policy effort.⁹⁷

⁹⁷ Tsingou, 2010; pg. 633

Chapter 3- Policy Options

This section is intended to propose possible policy options to the problems detailed in section 2. When crafting possible policy solutions there are several considerations that must be taken into account. The first is a consideration of scope: the most appropriate degree of change, if any, to pursue. The second consideration is to articulate the policy goals that the policy options, and ultimately the recommended policy, will ideally be able to address to some degree. The third consideration is which criteria are appropriate for the analysis of the policy options. Following a discussion of scope, policy goals and analytical criteria, this section will articulate three policy options, analyze the options with the criteria provided, and examine these policy options relative to the considered policy goals.

In considering the appropriate and feasible scope of potential change, three roughly-hewn possibilities stand out: (1) staying the course (change is not necessary or not possible), (2) evolution (moderate change to the existing structure) or (3) revolution (revocation of the entire regime). Despite the criticisms of the regime – its expense, lack of effectiveness, unproven cost-to-benefit advantage, coercive diffusion, the influence of private actors, and misappropriation and misapplication to the developing world – AML policy has become entrenched as result of the investments in institutions and compliance structures by most nations and the support from powerful national and international actors. It is difficult to resist proposing an ivory tower solution, such as a ground-up reevaluation of the policy regime or starting from scratch, but this is not a feasible option. The evolution of the AML regime through modest augmentation seems

the most politically and financially feasible, and the likely option to pursue. The task is to make the best of the current situation. The options discussed in this section are proposed with consideration toward the meta-level regime problems discussed in section 2 and with modest augmentation to the current policy regime in mind.

Policy Goals

Addressing the policy regime critiques from the previous section, there are three policy goals that, to some degree, will be reflected in the policy options and which guided their construction. The first policy goal is that the developing world benefits from the regime. The utility of AML policies should increase broadly in the developing world. The developing world should have a stronger voice in the AML regime. This should include a say in policy sculpting, which would aid in tailoring AML policy to the context of the developing world. Developing countries should also have a say in the implementation of AML policy in the diverse developing contexts. A developing country should be partners in a discussion about AML and their unique context and not have generic best practice dictated to them. The second policy goal is the research and development of measures of efficiency and effectiveness in the AML regime. The value of the AML regime or specific AML policies cannot be assessed or even discussed without effective measures. The third policy goal is to decrease the influence of private actors in the AML regime and, by proxy, on developing countries, with particular focus on their role in coercive policy diffusion. It is unlikely that all of these goals can be satisfied by a single policy, but these are the goals that will be considered when examining the proposed policy options.

Criteria

Six criteria are used for analysis of the three policy options:

- (1) *Efficiency*: Is the option financially feasible or tenable? What will this option deliver in comparison to what it costs to deliver? What is the cost-to-benefit ratio?
- (2) *Equity*: Who will be the winners and losers if this option is implemented? Are there particular groups who would lose a lot with this option?
- (3) *Effectiveness*: How effective is this option likely to be relative to the policy's objective? Is it a short term fix or a tenable solution?
- (4) *Time Horizon*: How quickly can the option be put into place? Will it be effective in the short, medium or long term?
- (5) *Political Feasibility*: How acceptable will this option be to different stakeholders? Is its implementation politically tenable?
- (6) *Foreseeable Obstacles*: Is the option legal? Do those who will deliver the solution have the knowledge and skills to do so? Is there money available to deliver this solution? Are there any other foreseeable obstacles?

Policy Option 1- A collective independent research agenda⁹⁸

Option 1 is the launch of an international collective effort to sponsor research, to be performed by third party organizations. The sponsors would include the United Nations; the FATF; the WB; the IMF; the OECD; other United Nations subsidiaries such as the United Nations Office on Drugs and Crime and the United Nations Development

⁹⁸ The inception of this idea and parts of the proposal were taken from Reuter and Truman 2004 chapter 8.

Programme; and, potentially, regional organizations such as the Organization of American States, the European Union, and so forth. The objectives of the program would be three-fold: (1) to invest in the research and development of methodologies to form baseline measures of the amount of money laundered in national economies and the international economy, as well as a measure of effectiveness; (2) to tally regime costs and weigh them against determined impacts of AML policies at the national and the international levels to form a cost-benefit analysis and enable a discussion regarding utility and efficiency in the AML regime; and (3) to provide space for independent feedback on program design.

Efficiency:

The organizations proposed currently spend considerable amounts of money on research. The program has the potential of delivering results that far outstrip the cost of investing in the research. In fact, there is little possibility that the investment would be higher in cost than in benefit.

Equity:

The program would provide a measure that could denote appropriate financial assistance from wealthier countries to aid with AML standards compliance by developing countries. The information and methods gathered on national implementation would inform future implementation in diverse contexts. Developing countries could only benefit from this program. At the moment, there is no distinction in the implementation between countries, while there is an obvious difference in contexts. Any information would go far to informing more appropriate AML policies in terms of the context of the particular country and implementation within that context.

Effectiveness:

There is no guarantee that a method of measuring the amount of money laundered could be introduced that would satisfy all criticisms. This program is neither a fix nor a solution, but an investment in information and knowledge to guide future policy design.

Time Horizon:

The time horizon for implementation would depend on funding, but could be introduced and funded in the medium to short term. The effects of the knowledge and methods produced would be productive in the long term.

Political Feasibility:

This option has the potential of being politically untenable. The more powerful actors, those responsible for pushing the diffusion of the current regime, have little to gain from the investigation or measuring of the effectiveness of the AML regime. Such actions would seem only to hurt the legitimacy of the regime. Thus far, the best practice model has diffused prodigiously without any measurement of its utility, efficiency or effectiveness.

Foreseeable Obstacles:

The organizations proposed are responsible for a great deal of research; however, it is likely that investment in this research area would detract from other areas of research that may be close to the mandate of the organization. There is nothing in this proposal that would violate any legal framework at the international level or within the AML regime. This research is very unlikely to uphold a universal best practice model as

beneficial to all countries and would require investment by the international community and international organizations in differential models, which may cause opposition from developed countries. There are no other foreseeable obstacles.

How does Policy Option 1 relate to the policy goals?

This option would be a farsighted investment but has the potential to generate information that could change the face of the regime. This option also would inform future policy design. The knowledge uncovered could only be beneficial, which would significantly benefit the developing world. Researching the costs and benefits of AML implementation in diverse contexts will provide diverse results and will result in discretion and discrimination in implementation processes and in determining which policies are appropriate for which contexts. This program would be a direct investment in the second policy goal (developing measures of efficiency and effectiveness) and would put the research in the hands of independent researchers who are less guided by the path dependency that might steer institutional research. Independent research is more likely to be objective regarding the influence of private actors in guiding AML policy, diffusion, and implementation. Though current evidence indicates a coercive role by the private sector, further objective research would illuminate this role. This information, if utilized and if cost-effective, would guide future regime development. If one is to assume a degree of benevolence in international institutions, then it is logical that this option would also address the role of private actors. This option would be a long term program; the knowledge produced would need to be digested, integrated into, and utilized in future AML policy and regime design. This program does not assure change, but does greatly suggest it.

Policy Option 2 - The Anti-Money Laundering Regime into the United Nations⁹⁹

The creation of an Anti-Money Laundering treaty at the United Nations would undercut the legitimacy of the FATF framework. Such a treaty would contest the current AML regime and would suggest that either the AML standard be shifted under the United Nations umbrella and face review or operate as 'a' rather than 'the' AML framework. Countries who do not sign the treaty would not be bound to abide by it; it would take serious political pressure to shift the AML regime into a United Nations organization. This could be brought to fruition at the next United Nations General Assembly meeting, Crime Congress, or crime conference by introducing a resolution for a United Nations Anti-Money Laundering treaty.

Efficiency:

This initiative, assuming that the current framework is reviewed and not uprooted, will be of significant benefit. It will deliver equity for all countries that are part of the AML regime. Countries will have more influence in the policy-crafting and diffusion process than under the FATF, where only the 34 member countries have a voice. The cost-to-benefit ratio is equity versus the expense of setting up a new institution and the infrastructure that goes along with it.

Equity:

The winners in this scenario are every other country that is not currently a member of the FATF, and particularly developing countries. The process of AML review and

⁹⁹ The inception of this idea came from a report in Tsingou, 2010; pg. 631 on the 2005 United Nations crime conference in Bangkok.

recommendation will be more of a discussion than a dictation. The United Nations system offers space for deliberation and contestation that the FATF does not have. The losers in this arrangement will be most of the OECD countries.

Effectiveness:

This option is a solution to the technocratic policy that is dictated through the current regime. If passed, the treaty would be effective for the majority of the world, though there would be a considerable loss of power and effectiveness by the world's most developed nations.

Time Horizon:

The time horizon for the initiative is short to medium term, but, for an effective institution that would be capable of replacing the expertise of the FATF, the time horizon is long. This would not be a short term fix but a solution, though the results would most likely be measured in decades.

Political Feasibility:

This would be politically palatable to many countries, but not to the most powerful. The G-20/OECD nations would likely use their economic and political weight to attempt to defeat such an initiative. The benefit of the United Nations General Assembly is that every country has an equal vote. The World Bank and IMF could also be considered as institutions that might be capable of integrating the AML regime. While they would offer space for debating policy, these organizations have weighted voting systems and the measure would assuredly be defeated by the Western powers. Due to the proportional

voting system of the United Nations, this initiative is not completely politically infeasible, though it clearly would be difficult.

Foreseeable Obstacles:

There would be considerable economic and political coercion by the most developed economies to defeat such a treaty or, at the very least, not sign it. Not signing the treaty would not necessarily invalidate the treaty as it would still cause contestation for an AML standard. Pluralism may hurt the effectiveness of a single standard but it would encourage a burden of proof regarding utility, effectiveness and efficiency. A new and more bureaucratic institution would have to be built and expertise would have to be developed. This would take considerable time, effort, and cost, but it would ensure that countries have the opportunity to have a voice in the process. Money would be a problem. The developed member countries of the FATF would likely withhold funding of such an organization or program and, as these countries provide the vast majority of the United Nations' funding, this withholding may cause a problem. However, an organization in the image of the FATF is not vast and would not require billions of dollars to fund.

How does Option 2 relate to the policy goals?

A United Nations treaty would benefit the developing world, excluding the political and economic coercion that the OECD countries would utilize to stop such an effort. The United Nations system would open up space for debate, for the deliberation of appropriate AML policies for varying contexts, and for the contestation of ineffective policies. As a member of the United Nations family, impact assessments and cost-benefit analysis would be required. This additional research would not necessarily be

performed by independent researchers, but still has a greater chance of objectivity than if performed by a technocratic agency, or if not performed at all. This research would further illuminate the impact that private actors are having on the regime. As part of the United Nations family, AML standards would not be technocratic; therefore, it is unlikely that coercive diffusion would happen in a similar way.

Policy Option 3 - Reorienting AML policy to focus on corruption¹⁰⁰

The AML regime required the implementation of a domestic FIU, KYC measures for private financial institutions, increased international cooperation between jurisdictions, and a legal framework for asset seizures. Although these measures are not terribly useful for fighting a nonexistent money laundering problem, in most developing countries they arguably could be used to root out serious corruption. Small forms of corruption, like small amounts of criminal money, are unlikely to impact the financial system, but funds from embezzlement, taking and giving bribes, or self-dealing will likely need to be laundered or at least sent offshore. The economic dealings of high-ranking government officials take place in the formal economy and they typically have to declare all assets, debts, and source of income.¹⁰¹ These transactions should be predictably transparent. With a baseline of declared assets and the AML regime measures, a developing country has sophisticated tools to uncover, track and enforce against grand corruption. The developing country only needs to change its focus.

¹⁰⁰ This is an explicitly recommended policy augmentation by Sharman in Sharman 2011a, Conclusion, Policy recommendations

¹⁰¹ Sharman 2011a, Conclusion, Section 5, Paragraph 5)

Efficiency:

The reorientation of the AML standards will have very low financial costs. Personnel will have to be trained but the legal framework, institutions and infrastructure are already in place. Relative to the potential benefits of recovering funds and deterring further embezzlement and bribery, the costs are minute. It is a definitively efficient reorientation.

Equity:

The citizens and governmental capacity of the developing country will be the winners of this policy augmentation. The only people that will not benefit from this option are the high-ranking government rentiers that are stripping their country's wealth, deterring growth, and profiting at the expense of their country's development. However, some of the losers in this arrangement would be in positions of power and may have a say in the reorientation of the policy. This policy would not encourage equity within the AML regime generally, or give developing countries any more say in the sculpting of policy or its implementation.

Effectiveness:

The effectiveness of this option depends on the political will within the country, the will of the government to root out corruption, and the power of those who are in power and who benefit from such practices.

Time Horizon:

This augmentation could be implemented in the short term and would likely be effective in the medium term. All institutions and actors are in place; the augmentation would only require a policy indicating corruption as its focus. At most, although this is unlikely, the augmentation may require some retraining of some of the FIU staff; however, corruption oriented offenses would have been within their purview previously.

Political Feasibility:

Those benefiting from grand corruption are those in power. The reorientation would not work in all countries, but for some it would be revolutionary. Countries that are controlled by a class of kleptocrats cannot be helped by this policy. Even if the countries instituted a refocusing on corruption, there would not be enforcement of the policy. For other developing countries, however, such a policy would be a powerful tool for legitimizing government, holding offenders accountable, and further encouraging economic, social and political development.

Foreseeable Obstacles:

The foreseeable domestic obstacles are political. Other foreseeable obstacles would be the potential for capacity issues; refocusing on domestic corruption may make requests from the international community a lesser priority. The institutional capacity for this focus would need to come from somewhere, unless there was previously unused capacity. This could generate some international pressure.

How does Option 3 relate to the policy goals?

The reorientation of the AML regime would focus on the pressing problem of corruption in many developing countries. In contrast, there is no concrete evidence to suggest that money laundering is a serious problem in the developing world. This policy would not, however, aid the developing world in becoming part of the discussion or debate around AML policy or its implementation. This policy is a short term fix but not a long term solution. It would give the AML regime some concrete utility and effectiveness but it would not address the broader AML inequities. This policy would also aid in developing measures of efficiency and effectiveness within the AML regime, though it would redirect the regime toward a clearly useful goal. This policy would not decrease the influence of private actors in the AML regime nor would it reduce private actors' roles in the coercive diffusion of the regime. However, private actors would become part of a process that would have positive benefits specifically for developing countries.

Policy Recommendation & Conclusion

The Anti-Money Laundering framework is a best practice standard that is developed by and is accountable to powerful developed Western countries. With AML framework implemented in approximately 150 countries, 34 are in a place to influence policy. At the forefront of the regime are private financial institutions tasked with the monitoring and detection of illicit funds. Their role is significant, but their input is slim. These large firms are reinforcing their positions in the market, setting up complex compliance systems that create significant market entry barriers, and privilege the developed financial centers in international markets. The FATF has produced one best practice model to be implemented indiscriminately onto diverse country contexts around the world, regardless of population size, GDP, the size of the financial sector, institutional framework, or political development. Many developing countries have come to implement the AML framework because if they do not, they will lose access to international financial markets, foreign investments, which would lead amount to *de facto* isolation from the global economy. The FATF and international community that support the diffusion of the AML framework seem disinterested in the lack of evidence demonstrating effectiveness of the regime. Particularly in developing countries where the cost of implementation is a significant opportunity cost, the AML supporters seem woefully unconcerned with evaluating the platforms policies. At a time in history when almost all programs go through a cost benefit analysis there are few efforts to undertake such, despite the staggering costs of implementation and compliance for many countries.

Chapter 2 outlined critiques of the AML policy regime; the broad critiques were translated into policy goals in the 3rd chapter. Meeting those policy goals is the objective of forming the policy options described and analyzed in that chapter. After examining the three proposed policy options through the six criteria and judging their value relative to the policy goals I recommend policy option 1. A collective independent research agenda coordinated by several international and regional bodies would significantly aid the AML field's knowledge base. Prior to any valuable policy augmentation or redirection it is invaluable that the field gain some understanding for the utility of many of the policies. This is particularly true for diverse contexts. The tallying of costs, with benefits will also enable a cost benefit analysis, which will give some value to the policies implemented. It would inform discretion and discrimination in implementation processes, and in determining which policies are appropriate for which contexts. The detached and dispassionate independent researchers would also investigate the role of private actors, which would aid in policy augmentation regarding their place in the framework. This policy option is efficient in that there organizations spend significant amounts of money on research each year, and would only need to redirect relatively small sums into the collective pool to fund significant research within the field. Independent and hopefully objective knowledge is the equity, and if the developing world is not benefiting from the current arrangement then significant research would aid in the discovery of such. The time horizon for benefits from this knowledge is medium to long term. There may be knowledge uncovered in the medium term but it would certainly be long term before that would translate into policy augmentation. I can think of only one obstacle to this policy option, other than apathy, and it will be discussed in this paper's concluding remarks. This policy option would be accomplished by communicating with the very people that this paper framed as

audience. This paper is designed to communicate the need for the research recommended.

There is perhaps a reason why this research has not been undertaken or published already. It can only serve to, in some degree, undermine the legitimacy of the singular best practice model. The diffusion process has been widespread and significant, all without any proven utility or measure of effectiveness. Therefore, the FATF standard only stands to lose from research in trying to prove effectiveness, utility or the cost to benefit of policies within their regime. At this point the non-elective diffusion to most of the world is ideal if the desire is ubiquitous implementation. From an academic point of view there is no reason why further research would not be warranted and encouraged. I can only surmise that power and control would be the reasons to not engage in the much-needed analysis of effectiveness.

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