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GATT and GATS: A Public Morals Attack on Money Laundering

*Matthew B. Comstock**

INTRODUCTION

Experts estimate current worldwide profits from organized crime at one trillion dollars.¹ By comparison, the aggregate profits of the top fifty *Fortune* 500 companies totaled \$33.923 billion in 1993.² These illegitimate profits derive from a new generation of international organized crime. Perhaps no one better symbolizes this new generation of transnational gangster than the slain leader of the Medellin drug cartel, Pablo Escobar. Mr. Escobar reaped hundreds of millions of dollars from his illicit drug sales. He then “laundered” his ill-gotten wealth in the world’s major financial centers via phones, fax machines, and computers located in his Colombian headquarters.³

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¹ Michael Elliot, et al., *The Global Mafia*, NEWSWEEK, Dec. 13, 1993, at 22 (citing Roy J. Godson of the National Strategy Information Center).

² Joseph Pivinski, et al., *The Fortune 500: The Largest U.S. Industrial Corporations*, FORTUNE, April 18, 1994, at 220. Those fifty companies are, in order from number one through number fifty: General Motors, Ford Motor, Exxon, International Business Machines, General Electric, Mobil, Philip Morris, Chrysler, Texaco, Du Pont, Chevron, Proctor & Gamble, Amoco, Boeing, Pepsico, Conagra, Shell Oil, United Technologies, Hewlett-Packard, Eastman Kodak, Dow Chemical, Atlantic Richfield, Motorola, USX, RJR Nabisco Holdings, Xerox, Sara Lee, McDonnell Douglas, Digital Equipment, Johnson & Johnson, Minnesota Mining & Mfg, Coca-Cola, International Paper, Tenneco, Lockheed, Georgia-Pacific, Phillips Petroleum, Alliedsignal, IBP, Goodyear Tire, Caterpillar, Westinghouse Electric, Anheuser-Busch, Bristol-Myers Squibb, Rockwell International, Merck, Coastal, Archer Daniels Midland, Ashland Oil, and Weyerhaeuser. *Id.*

³ Elliot, *supra* note 1, at 19-20.

Money laundering⁴ empowers crime. Criminal activities such as arms and drug trafficking generate large volumes of cash.⁵ However, these large volumes of cash are quite unwieldy.⁶ For example, one million dollars worth of twenty dollar bills weighs approximately one hundred and ten pounds.⁷ Moreover, in order to prevent detection and apprehension, criminals require access to funds which appear to be legitimate.⁸ Enter money laundering. This process anchors successful criminal operation because it facially legitimizes illegal revenue.

Part I provides a general overview of money laundering and its societal effects. Part II studies legislative responses of various nations to money laundering issues, as well as international attempts to combat it. Part III analyzes current international attempts to combat money laundering utilizing a game theoretic model. The analysis concludes that the attempts are less than effective. Game theory demonstrates that an unscrupulous nation will always cheat absent a disincentive to do so. Part IV advocates an international trade solution to what has historically been an international criminal issue. Specifically, Part IV posits that the Group of Seven industrialized nations ought to impose tariffs on certain goods and services of nations which refuse to criminalize money laundering. In the face of such tariffs, little incentive exists to "cheat" on international agreements which criminalize money laundering. Part V concludes the article.

I. MONEY LAUNDERING

A. Definition

"One goal of every criminal enterprise is to 'get away clean.'"⁹ Money laundering hides the trail of illegal profits and thus aids the

⁴ Money Laundering is "the process whereby one conceals the existence, illegal source, or illegal application of income, and then disguises that income to make it appear legitimate." PRESIDENT'S COMMISSION ON ORGANIZED CRIME, INTERIM REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL, THE CASH CONNECTION: ORGANIZED CRIME, FINANCIAL INSTITUTIONS, AND MONEY LAUNDERING iii (1984). Statement of Irving R. Kaufman, Chairman of the President's Commission on Organized Crime [hereinafter REPORT].

⁵ Laura M.L. Maroldy, *Recordkeeping and Reporting in an Attempt to Stop the Money Laundering Cycle: Why Blanket Recording and Reporting of Electronic Funds Transfers is Not the Answer*, 66 NOTRE DAME L. REV. 863, 865 (1991).

⁶ *Id.* at 866.

⁷ See Smith, *infra* note 29, at 126.

⁸ Maroldy, *supra* note 5, at 866.

⁹ Bradley O. Field, *Improving International Evidence-Gathering Methods: Piercing Bank Secrecy Laws From Switzerland to the Caribbean and Beyond*, 15 LOY. L.A. INT'L & COMP. L.J. 691, 692 (1993).

“getaway.”¹⁰ As noted, money laundering is “the process whereby one conceals the existence, illegal source, or illegal application of income and then disguises that income to make it appear legitimate.”¹¹

“Actual money laundering techniques can be very simple, such as exchanging cash for cashier’s checks, or very complex.”¹² All schemes, however, utilize the same general three step process. The first step is termed “placement.”¹³ Large sums of currency must be deposited in seemingly legitimate bank accounts. Funds are either commingled with legitimate business funds, or smuggled out of the country and deposited with foreign banks.¹⁴ Drug dealers often engage in a placement practice known as “smurfing.”¹⁵ The United States’ Bank Secrecy Act requires financial institutions to report transactions involving sums greater than ten thousand dollars to the Internal Revenue Service.¹⁶ “Smurfs,” who are generally couriers for drug dealers, make multiple deposits of less than ten thousand dollars in a number of banks.¹⁷ Deposits are usually in the form of non-traceable financial instruments such as money orders or cashiers checks.¹⁸ These kinds of structured transactions fail to initiate the reporting requirements of banks.

The second step of the laundering process is known as “layering.”¹⁹ Launderers aggregate the various placement accounts into one, or possibly a few, large bank accounts.²⁰ The criminal then electronically transfers funds from the main account to other financial institutions.²¹ The layering process creates multiple accounts in banks

¹⁰ *Id.*

¹¹ REPORT, *supra* note 4, at 7.

¹² Maroldy, *supra* note 5, at 866.

¹³ Bruce Zagaris, *Money Laundering: An International Control Problem*, in INTERNATIONAL HANDBOOK ON DRUG CONTROL 19 (Scott B. MacDonald and Bruce Zagaris, eds., 1992). Zagaris formally defines placement as “the physical disposal of cash proceeds derived from illegal activity.” *Id.*

¹⁴ Gerard Wyrsh, *Treasury Regulation of International Wire Transfer and Money Laundering: A Case For A Permanent Moratorium*, 20 DENV. J. INT’L L. & POL’Y 515, 516 (1992).

¹⁵ *Id.* at 523.

¹⁶ Amendments to the Federal Deposit Insurance Act Titles I and III, Pub. L. 91-508, 84 Stat. 1114-1124 (1970) [hereinafter Bank Secrecy Act].

¹⁷ Wyrsh, *supra* note 14, at 523.

¹⁸ Wyrsh, *supra* note 14, at 523.

¹⁹ Zagaris, *supra* note 13, at 19. Zagaris formally defines layering as “the separation of the illicit proceeds from their source by designing complex lawyers [sic - Freudian slip?] of financial transactions designed to disguise the audit trail and to provide anonymity.” *Id.*

²⁰ Wyrsh, *supra* note 14, at 524.

²¹ Wyrsh, *supra* note 14, at 524.

in numerous foreign countries. Consequently, the source of the funds in any one account becomes difficult to trace.²²

“Integration” comprises the third step of the laundering process.²³ The criminal enterprise injects “laundered” funds, funds which seemingly emanate from legitimate bank accounts into the legitimate economy.²⁴ Real estate ranks as one of the favorite integration vehicles of the money launderer.²⁵ For example, a launderer purchases property for two million dollars, an amount which represents its fair market value. The new owner then sells the property. The launderer/seller gives the buyer one million dollars. In turn, the buyer purchases the property for three million - two million represents the fair market value, but the other one million dollars is simply the return of the money that the seller gave to the buyer.²⁶ In this way, the launderer/seller appears to legitimately make one million dollars in profit on the real estate deal.²⁷ The launderer/seller may then replace the “phantom” profit with one million dollars of criminal proceeds.

B. The Money Laundering Process

This section provides a brief overview of the three step money laundering process. The system described follows a typical drug proceeds laundering process.

The first step is placement of the illicit drug proceeds.²⁸ During this portion of the process, couriers gather the revenue from “street sales,” which are in the form of small denomination currency, and ex-

²² Maroldy writes:

Launderers often use financial institutions that have their headquarters or branches in foreign jurisdictions. They choose particular foreign jurisdictions on the basis of their bank secrecy laws. These laws typically favor the privacy of the account owner over the law enforcement interest of other sovereignties that try to obtain access to banking records. The convenience of “offshore” banking is enhanced by the fact that many jurisdictions allow funds to be held in the currency of the deposit-holder’s choice.

Maroldy, *supra* note 5, at 867 n.12.

²³ Zagaris, *supra* note 13, at 20. Zagaris formally defines integration as follows:

[Integration is] the provision of apparent legitimacy to criminally derived wealth. If the layering process has succeeded, integration mechanisms place the laundered proceeds back into the economy so that they reenter the financial system appearing to be normal business funds.

Zagaris, *supra* note 13, at 20.

²⁴ Wyrsh, *supra* note 14, at 524.

²⁵ BARBARA WEBSTER AND MICHAEL S. MCCAMPBELL, NATIONAL INSTITUTE OF JUSTICE, INTERNATIONAL MONEY LAUNDERING: RESEARCH AND INVESTIGATION JOIN FORCES 6 (1992).

²⁶ *Id.*

²⁷ *Id.*

²⁸ Zagaris, *supra* note 13, at 19.

change these small bills for larger denomination currency.²⁹ In street parlance, this exchange, as noted, is known as “smurfing.”³⁰ “The ‘smurf’ changes the small denomination bills into large denomination bills, cashier’s checks, or money orders by repetitively visiting bank after bank with amounts insufficient to arouse suspicion.”³¹

During the placement³² phase, launderers transport the “placed” drug profits to a jurisdiction which permits, explicitly or implicitly, money laundering.³³ Criminals either physically transport the cash to the jurisdiction via courier, or establish a “shell” corporation (a fictitious corporation established solely as vessel for illicit proceeds).³⁴ Drug traffickers deposit their revenue in the account(s) of the shell corporation(s) and then electronically transfer money from those accounts to accounts in money haven jurisdictions (those with strong bank secrecy laws).³⁵

With profits safely “laundered” in money haven bank accounts, drug traffickers freely engage in the final phase of the laundering process, integration.³⁶ Often, the criminals transfer funds from these safe accounts to other accounts around the world, or make “loans” from

²⁹ Geoffrey W. Smith, *Competition in the European Financial Services Industry: The Free Movement of Capital Versus the Regulation of Money Laundering*, 13 U. PA. J. INT’L BUS. L. 101, 110 (1992).

“The advantage of consolidating the small bills received in street transactions into larger denominations can be seen by comparing the value of a given weight of bills: 1 pound of \$20 bills equals \$9,080, 1 pound of \$100 bills equals \$45,400; 100 pounds of \$20 bills equals \$908,000, 100 pounds of \$100 bills equals \$4,540,000.” *Id.* at 126 n.91.

See also Crime and Secrecy: The Use of Offshore Banks and Companies, HEARINGS BEFORE THE PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE SENATE COMM. ON GOVERNMENTAL AFFAIRS, 90th Cong., 1st Sess. 181, at 312 (1983).

³⁰ Smith, *supra* note 29, at 126-27.

³¹ Smith, *supra* note 29, at 127.

³² Zagaris, *supra* note 13, at 19.

³³ Smith, *supra* note 29, at 126-27. Bank secrecy laws play an essential role in money laundering. For example, the Swiss Civil Code forbids banks, attorneys and notaries from disclosing information about the holders of Swiss bank accounts to third parties. Because money in such accounts is essentially immune from criminal investigation, Swiss banks, among others provide ideal havens for illicit profits. Rebecca G. Peters, *Money Laundering and Its Current Status in Switzerland: New Disincentives For Financial Tourism*, 11 Nw. J. INT’L L. & BUS. 104, 109 (1990). *See also* Swiss Civil Code (Schweizerisches Zivilgesetzbuch vom 10. Dezember 1907), arts. 27 & 28.

³⁴ Smith, *supra* note 29, at 124-25.

³⁵ Smith, *supra* note 29, at 124-25. Three systems, the Federal Reserve Communications System (Fedwire), the Clearing House Interbank Payments System (CHIPS), and the Society for Worldwide Interbank Financial Telecommunications (SWIFT), engage in daily electronic funds transaction in excess of \$1.2 trillion dollars. Such systems provide ideal mechanisms for illegal profits transfers. Wyrsh, *supra* note 14, at 518.

³⁶ Zagaris, *supra* note 13, at 20.

shell corporations to legitimate business enterprises.³⁷ Launderers also favor real estate purchases, as described in the previous section.³⁸

Thus the money laundering process crosses many borders. Consequently, efforts to track any particular laundering scheme require the cooperation of law enforcement officials in multiple countries. Jurisdictional issues greatly hamper any investigation. Moreover, even the laws of cooperative countries differ on definitions of money laundering, appropriate penalties, and proper investigative procedures.

C. Societal Consequences of Money Laundering

The mechanism of money laundering permits profitable criminal activity. "Without laundering, the risk/reward ratio for the underlying crime is unattractive. . . . Efficient laundering renders the underlying crime lucrative, and therefore perpetuates it."³⁹ Thus money laundering represents the keystone to successful organized crime.

Legitimizing illegal profits also poses a threat to the licit economy. First, as noted previously, organized criminals view real estate as the injection method of choice.⁴⁰ In the real estate example given, the buyer paid three million dollars for property with a fair market value of two million dollars.⁴¹ Such a scheme effectively "legitimizes" criminal profits by making them appear to be real estate profits; however, the scheme also inflates local real estate values.⁴² Banks approve loans which utilize inflated property as collateral. Often, borrowers purchase additional real estate, given that the market appears to be lucrative. In economic terms, an inflated market such as this is known as a "speculative bubble." Speculative bubbles inevitably burst. Money laundering, therefore, may lead to a real estate market crash.

Second, use of legitimate financial institutions to "wash" illicit profits threatens the integrity of the entire system. "The fear of financial regulators is that when credit and financial institutions are used to launder proceeds from criminal activities . . . the soundness and stability of the [particular] institution concerned and confidence in the financial system as a whole could be seriously jeopardized."⁴³ When a

³⁷ Smith, *supra* note 29, at 127.

³⁸ Wyrsh, *supra* note 14, at 522.

³⁹ Sarah N. Welling, *Smurfs, Money Laundering, and the Federal Criminal Law: The Crime of Structuring Transactions*, 41 FLA. L. REV. 287, 291 (1989).

⁴⁰ WEBSTER AND McCAMPBELL, *supra* note 25, at 6.

⁴¹ WEBSTER AND McCAMPBELL, *supra* note 25, at 6.

⁴² WEBSTER AND McCAMPBELL, *supra* note 25, at 6.

⁴³ Smith, *supra* note 29, at 111.

legitimate financial institution launders illegal profits, knowingly or not, that institution supports illegal drug trafficking, prostitution, and illegal arms sales throughout the world.

II. LEGISLATIVE RESPONSES TO MONEY LAUNDERING

The following passages outline the anti-laundering initiatives of the United States, the European Community, and the international community to date.

A. The United States

The watershed money laundering statute of the United States is the Bank Secrecy Act (BSA).⁴⁴ The BSA primarily requires financial institutions to collect and report data.⁴⁵

The BSA requires financial institutions to file the Currency Transaction Report (CTR) and the Report of International Transportation of Currency or Monetary Instruments (CMIR) with the Treasury Department.⁴⁶ Financial institutions must file these reports when customers engage in transactions of ten thousand dollars or more.⁴⁷ CTRs apply to domestic transactions, and CMIRs to transnational transactions in which persons transport currency or financial instruments of any kind into or out of the United States.⁴⁸ These provisions apply only to domestic financial institutions and foreign financial institutions which conduct business in the United States (that is, United States branches of foreign banks).⁴⁹

Despite enactment of the BSA, federal law failed to criminalize money laundering until 1986. In that year, Congress enacted the Anti-Drug Abuse Act of 1986 ('86 Act).⁵⁰ The '86 Act not only criminal-

⁴⁴ Bank Secrecy Act, *supra* note 16.

⁴⁵ Bank Secrecy Act, *supra* note 16. Law enforcement officials within the United States Custom Service, Internal Revenue Service, Office of Financial Enforcement, the Department of Justice and the Office of Financial Crime Enforcement Network (FINCEN) are the primary consumers of data gathered as a result of BSA data compilation requirements. Wyrsh, *supra* note 14, at 525.

⁴⁶ Bank Secrecy Act, *supra* note 16, at 31 U.S.C. §§ 321, 5311-5314, 5316-5322 (1988).

⁴⁷ Bank Secrecy Act, *supra* note 16, at 31 U.S.C. § 5316.

⁴⁸ Wyrsh, *supra* note 14, at 526.

⁴⁹ Wyrsh, *supra* note 14, at 527. The BSA requires financial institutions to provide the identification and occupation of any individual who engages in a transaction of ten thousand dollars or more, the identification of the individual or entity on whose behalf the transaction was conducted, the account number involved in the transaction, and a description of the transaction. Wyrsh, *supra* note 14, at 527.

⁵⁰ Money Laundering Control Act of 1986, Pub. L. No. 99-570, §§ 1351-1367, 100 Stat. 3207, 3218-39 [hereinafter '86 Act]. Various portions of the '86 Act are codified at 12 U.S.C., 18 U.S.C., and 31 U.S.C..

izes money laundering but also prohibits structured transactions which avoid the ten thousand dollars limit (that is, "smurfing").⁵¹ Additionally, the '86 Act requires economic sanctions against foreign nations which support laundering.⁵²

Congress next enacted the Anti-Drug Abuse Act of 1988 ('88 Act).⁵³ The '88 Act enhances United States efforts against money laundering in several important aspects. First, in an effort to combat smurfing, the '88 Act forbids financial institutions to sell cashier's checks, money orders, bank checks, or traveler's checks in amounts greater than three thousand dollars unless the purchaser meets certain criteria.⁵⁴ The purchaser of such a monetary instrument must (1) have an account with the financial institution and (a) establish that fact via a signature card or (b) by other means of identification which the Department of Treasury may establish, or (2) establish identity to the financial institution by other means which the Secretary of Treasury may prescribe.⁵⁵ Second, the '88 Act permits the Department of Treasury to impose additional recordkeeping requirements for currency transactions which exceed an amount set by the Department of Treasury.⁵⁶ Third, financial institutions may "provide the financial records of any major borrower, officer, director, employee, or controlling shareholder of such institution whenever there is reason to believe that the records are relevant to show possible criminal activity by such individuals against the institution. . . ."⁵⁷ Fourth, the '88 Act requires the Secretary of the Treasury to negotiate an international currency control agency with foreign finance ministers.⁵⁸ Finally, the '88 Act requires the Secretary to request that foreign countries keep records of large United States currency transactions taking place within their borders.⁵⁹

Both the '86 and '88 Acts impose civil and criminal liability for violations by financial institutions and would be money launderers. Civil penalties include fines of up to one hundred thousand dollars, or the amount involved in the transaction in the case of a single viola-

⁵¹ 18 U.S.C. § 1956 (Supp. V 1987). Bruce Zagaris, *Dollar Diplomacy: International Enforcement of Money Movement and Related Matters — A United States Perspective*, 22 GEO. WASH J. INT'L L. & ECON. 465, 469 n.17 (1989).

⁵² 18 U.S.C. § 1956 (Supp. V 1987).

⁵³ Pub. L. No. 100-690, 102 Stat. 4181 (1988).

⁵⁴ Zagaris, *supra* note 51, at 471.

⁵⁵ Zagaris, *supra* note 51, at 471.

⁵⁶ Zagaris, *supra* note 51, at 472.

⁵⁷ Zagaris, *supra* note 51, at 473.

⁵⁸ 31 U.S.C. § 5311 (1988).

⁵⁹ *Id.*

tion.⁶⁰ In the case of willful violations, the legislation imposes criminal penalties of five hundred thousand dollars in fines and/or ten years in prison.⁶¹

United States money laundering laws rank among the strictest in the world. However, capital follows the path of least resistance. Consequently, illicit profits inevitably flow out of the United States to money havens. Without similar legislation in other states, or laws which are at least similar in effect, the United States laundering regime has only minor impact.

B. The European Community

As of July 1, 1990 capital movements throughout the European Union are fully liberalized.⁶² The Capital Movements Directive (CMD) abolishes foreign exchange restrictions and removes "all obstacles to the execution of the capital transactions themselves."⁶³ "In short, the Directive gives financial service firms free access to the financial system of any Member State whether this access be in the form of a multi-billion [European Currency Unit] bond or a simple checking account."⁶⁴ The CMD is mandatory; that is, Member States must remove obstacles to the free flow capital among European Union Member States.⁶⁵ Europe's financial system, therefore, appears to facilitate money laundering schemes.

In 1990, however, the European Union proposed legislation which requests Member States to criminalize money laundering.⁶⁶ Article 2 of the Money Laundering Proposal specifically requires Member States to prohibit money laundering.⁶⁷

Article 3 is the "Know-your-customer" provision. This provision requires financial institutions to identify customers through supporting evidence where the amount of the transaction equals or exceeds

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Directive of 24 June 1988 For The Implementation of Article 67 of The Treaty, Council Directive 88/361, 1988 O.J. (L 178) 5 [hereinafter Capital Movements Directive].

⁶³ Capital Movements Directive, *supra* note 62.

⁶⁴ Smith, *supra* note 29, at 103.

⁶⁵ Capital Movements Directive, *supra* note 62.

⁶⁶ Proposal for a Council Directive on Prevention of Use of the Financial System for the Purpose of Money Laundering, 90/C 1990 O.J. (C 106) 6 [hereinafter Money Laundering Proposal].

⁶⁷ *Id.* France, Italy, Luxembourg & the U.K. have criminalized money laundering; Belgium and Germany are considering such laws; and Spain and the Netherlands have adopted no legislation. Smith, *supra* note 29, at 111.

ECU 15,000.⁶⁸ Future compliance of Member States with the Money Laundering Proposal, as well as the affects of the Money Laundering Proposal on the CMD remain uncertain.

C. International Efforts

Nations now recognize that efforts to combat money laundering require international cooperation. The following section examines international efforts to date.

1. *The Drug Convention*

The United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Drug Convention)⁶⁹ represents the watershed international money laundering agreement. Contracting parties to the Drug Convention agree to criminalize money laundering and cooperate on international law enforcement issues.⁷⁰ In addition, contracting states may obtain evidence from other contracting parties to be used for arrest and prosecution of money launderers under the Drug Convention.⁷¹ Article 6 of the convention provides for extradition of launderers,⁷² and Article 5 provides for forfeiture of assets.⁷³ In fact, "each party is obligated to adopt national measures necessary to empower domestic authorities to confiscate drug proceeds and property purchased with drug proceeds."⁷⁴

In addition, and perhaps most importantly, the Drug Convention defines several key offenses.⁷⁵ First, it defines drug trafficking offenses.⁷⁶ Second, the Drug Convention establishes money laundering and aiding and abetting money laundering as crimes.⁷⁷ Consequently,

⁶⁸ Money Laundering Proposal, *supra* note 66, art. 3. The provision also requires financial institutions to report transactions below the ECU 15,000 level if they appear suspicious. *Id.* art. 4.

⁶⁹ *Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*, Dec. 20, 1989, UN Doc. E/CONF.82/15, 28 I.L.M. 493 (1989) [hereinafter *Drug Convention*].

⁷⁰ Zagaris, *supra* note 13, at 32. More than one hundred countries are contracting parties to the Drug Convention, which went into effect on November 1, 1990. *Id.*

The "ratifying nations are required to implement legislation and administrative measures to monitor and enforce the provisions of the [Drug] Convention." Scott E. Mortman, *Putting Starch in European Efforts to Combat Money Laundering*, 60 *FORDAM L. REV.* 429, 440 n.85 (1992).

⁷¹ *Drug Convention*, *supra* note 69, art. 7.

⁷² *Drug Convention*, *supra* note 69, at 507.

⁷³ *Drug Convention*, *supra* note 69, at 504.

⁷⁴ Mortman, *supra* note 70, 440.

⁷⁵ Zagaris, *supra* note 24, at 32.

⁷⁶ Zagaris, *supra* note 24, at 32.

⁷⁷ Zagaris, *supra* note 24, at 32.

the Drug Convention represents the most comprehensive international agreement to combat money laundering to date.

2. *The Basle Statement*

The Basle Supervisory Committee⁷⁸ has formulated a five-part plan which establishes “an ethical code of conduct for central bank supervisors to implement [in regard to prevention of money laundering] and monitor.”⁷⁹ The Committee believes that Banks must prevent their institutions from associating with criminal activity to ensure the integrity of the banking system.⁸⁰ “The [S]atement encourages banks to know their customers, to spot suspicious transactions, and to cooperate fully with law enforcement authorities.”⁸¹ In addition, if financial institutions reasonably believe deposits or financial transactions to be of criminal origin, the Basle Statement encourages these institutions to take legal action.⁸²

Although the Basle Statement lacks binding legal effect, banks often voluntarily implement its tenets.⁸³ Thus, the organizations which serve as conduits for money laundering attempt to combat the problem through the Basle Statement.

3. *G-7 Task Force Report*

The Group of Seven Industrialized Nations⁸⁴ (G-7) recognizes “the threat of money laundering to the world’s banking and financial system.”⁸⁵ The G-7’s Financial Action Task Force⁸⁶ (Task Force) com-

⁷⁸ The heads of the central banks of the world’s industrialized nations comprise the Basle Committee on Banking Regulations and Supervisory Practices. Zagaris, *supra* note 13, at 35.

The nations of Belgium, Canada, France, Germany, Great Britain, Italy, Japan, the Netherlands, Switzerland, the United States, Luxembourg, and Sweden comprised the Committee. Mortman, *supra* note 70, at 433 n.71 (citing *TRENDS AND FORCES IN INTERNATIONAL BANKING LAW* 113-117 (W. Park ed., 1990)).

⁷⁹ Lowell Quillen, *The International Attack on Money Laundering: European Initiatives*, 1991 DUKE J. COMP. & INT’L L. 213, 217 (1991).

⁸⁰ Mortman, *supra* note 70, at 440.

⁸¹ Zagaris, *supra* note 13, at 37. “For example, banks should deny assistance, sever relations with the customer, and close or freeze accounts in connection with suspicious activity. It also provides specific means to ensure implementation of the measures.” *Id.*

⁸² Zagaris, *supra* note 13, at 37.

⁸³ Quillen, *supra* note 79, at 225 n.24.

⁸⁴ John W. Head, *Suspension of Debtor Countries’ Voting Rights in the IMF: An Assessment of the Third Amendment to the IMF Charter*, 33 VA. J. INT’L L. 591, 637 n.207 (1993). Bruce Zagaris & Elizabeth Kingma, *Asset Forfeiture International and Foreign Law: An Emerging Regime*, 5 EMORY INT’L L. REV. 445, 460 n. 63 (1991).

⁸⁵ Quillen, *supra* note 79, at 217-18.

piled significant research and put forth "forty recommendations directed at stopping money laundering."⁸⁷

The Task Force recommends 1) that national legislatures criminalize money laundering;⁸⁸ 2) that legislatures hold "corporations and their employees criminally liable for money-laundering activities;"⁸⁹ and 3) calls upon financial institutions to "improve their monitoring systems for cash transactions and report all suspected drug-related transactions."⁹⁰

These recommendations (G-7 Task Force Report) lack binding legal effect but seek to influence the legislatures of the international community.

4. European Community Council Directive

European Community Council Directive 91/308⁹¹ (Directive), like most other money laundering efforts to date, requires members of the European Union to criminalize money laundering.⁹² The Directive likewise requires members to cooperate in the investigation and prosecution of launderers (the Directive is the successor to the Money Laundering Proposal noted in Part II).⁹³

The Directive obligates European Union financial institutions as well. Transactions in excess of \$18,500 require the institution to procure proper identification from the customer.⁹⁴ Where a transaction falls below \$18,500, financial institutions may request identification if the transaction appears to be suspicious.⁹⁵ Where the customer acts

⁸⁶ "The FATF [Task Force] was created in July 1989 at the Economic Summit of Industrialized Countries in Paris in an effort to develop an international approach to controlling money laundering." Mortman, *supra* note 70, at 436.

⁸⁷ Quillen, *supra* note 79, at 218 (citing Task Force Report).

⁸⁸ Mortman, *supra* note 70, at 437.

⁸⁹ Mortman, *supra* note 70, at 437.

⁹⁰ Mortman, *supra* note 70, at 437.

⁹¹ Council Directive 91/308, 1991 O.J. (L 166) 77.

⁹² The Directive defines money laundering "as intentional conversion or transfer of property while knowing that the property is derived from criminal activity 'for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such to evade the legal consequences of his action.'" Zagaris, *supra* note 13, at 38.

⁹³ Mortman, *supra* note 70, at 431. "The directive prohibits money laundering of funds derived from drug trafficking and other criminal offenses. . . ." Zagaris, *supra* note 13, at 37.

⁹⁴ Mortman, *supra* note 70, at 433.

⁹⁵ Mortman, *supra* note 70, at 434.

In addition, financial institutions are "required to examine carefully any transaction which, by its nature, they believe is likely to involve money laundering. Institutions in member states are required to inform the appropriate authorities of any suspected money-laundering transaction and to provide the authorities with the information necessary for their investigations."

on behalf of another party, the institution must take steps to obtain the identification of that other party.⁹⁶ The Directive presents the most comprehensive attempt by the European Union to deal with money laundering to date.

5. *Draft Convention of Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (European Convention)*

The twenty-three members of the Council of Europe⁹⁷ have negotiated the European Convention.⁹⁸ The European Convention aims to facilitate international cooperation in money laundering and asset forfeiture.⁹⁹ It specifically requests contracting parties to enact forfeiture legislation, as well as legislation to pierce bank secrecy.¹⁰⁰ The Drug Convention serves as the basis for the European Convention; however, the European Convention permits criminalization of money laundering related to non-drug offenses.¹⁰¹

Because the Council represents a greater number of European nations, its impact is likely to be greater than that of the proposed Money Laundering Directive of the European Union. Moreover, the European Convention permits the Council to propose criminal laws "and recognizes the need to pursue a common criminal policy in this [money laundering] area."¹⁰² The Council also believes that the former Soviet states will soon join the Council of Europe.¹⁰³ The Council

Mortman, *supra* note 70, at 434.

⁹⁶ Mortman, *supra* note 70, at 434.

⁹⁷ The Council of Europe formed on May 5, 1949. The Council (which includes both European Union and non-European Union and non-European Union members) strives to achieve unity on a variety of European economic and social issues through "agreements and common action." J.A. Andrews, *The European Jurisprudence of Human Rights*, 43 MD. L. REV. 463, 464 (citing Statute of the Council of Europe, art. 1(a)-(b), *reprinted* in MANUAL OF THE COUNCIL OF EUROPE at 299, app. 1 (1970)).

⁹⁸ ILM 148 (1991). The European Convention will enter into force three months after three states have ratified. The European Convention was opened for signature on November 8, 1990 in Strasbourg, France. Mortman, *supra* note 70, at 432.

Currently, fifteen nations are contracting parties to the European Convention, including Austria, Belgium, Cyprus, Denmark, Finland, Germany, Iceland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom. Mortman, *supra* note 70, at 437.

⁹⁹ Mortman, *supra* note 70, at 432.

¹⁰⁰ Mortman, *supra* note 70, at 432.

¹⁰¹ Zagaris, *supra* note 13, at 36.

¹⁰² Quillen, *supra* note 79, at 220.

¹⁰³ Quillen, *supra* note 79, at 220.

thereby hopes to lessen the flood of illegal money into those states, which generally lack criminal money laundering laws.¹⁰⁴

Each of the above agreements represents a significant step in ridding the world financial system of money laundering. Although many states currently criminalize the washing of illegal profits, many others do not. Those states which choose not to criminalize such use of the world's financial system hope to gain economic value from their stance. The most appropriate way to remove the incentive to permit money laundering is to remove its potential economic value. The remainder of this article proposes an economic solution to an economic problem.

III. A GAME THEORETIC ANALYSIS

A. The Prisoner's Dilemma

This article has presented a basic outline of what money laundering is, why it poses a threat to the world economy, and how states combat it. Unfortunately, not all nations choose to become contracting parties to anti-money laundering efforts, or to fulfill their obligations pursuant to such efforts. Moreover, no agreement will entice unscrupulous nations to comply with money laundering agreements. Game theory explains why current initiatives ineffectively combat money laundering.

Game theory¹⁰⁵ in general exhibits the following characteristics:

1) The game is usually played within a 2 X 2 payoff matrix (the matrix illustrates the outcome which results from the players' choices).

2) Player 1, in the examples that follow, plays the rows: the "play" is the choice between the top or bottom row.

3) Player 2 plays the columns, and chooses between the left or the right column.

4) Each of the numbered squares represents a combination of choices.

5) The combination which results from the choices determines the payoff to the players.¹⁰⁶

¹⁰⁴ Quillen, *supra* note 79, at 220.

¹⁰⁵ Game theory analyzes strategic interaction. HAL R. VARIAN, *INTERMEDIATE MICRO-ECONOMICS: A MODERN APPROACH* 466 (1987). Examples best illustrate the functioning of game theory.

¹⁰⁶ Kenneth W. Abbott, *The Trading Nations Dilemma: The Functions of the Law of International Trade*, 26 HARV. INT'L L.J. 501, 504-05 (1985). See also Varian, *supra* note 105, at 466.

The classic example of game theory is the prisoner's dilemma.¹⁰⁷ In this example, the police incarcerate two persons involved in a crime but place each person in a separate room.¹⁰⁸ As a result of their separation, the prisoners cannot communicate with each other. Consequently, each person must decide on his or her own what strategy will result in an optimal outcome — that is, what statements to the police will result in the most lenient punishment.

Each of the prisoners may deny the crime or confess to the crime.¹⁰⁹ The police attempt to extract a confession from one of the prisoners. If one prisoner confesses but the other denies, the confessor will be set free (Diagram 1 - a payoff matrix - represents freedom by "0," which signifies no prison term). The other prisoner, however will receive the maximum sentence because confession necessarily implicates the other prisoner ("7" in Diagram 1, which indicates a seven year prison term).¹¹⁰

Refer to Diagram 1. If Player 1 (prisoner 1) confesses, he or she is set free. Player 2 (prisoner 2), however, receives the maximum sentence of seven years, assuming he or she denies the crime. Box 2 of the diagram demonstrates this scenario. Box 3 shows the same result, only Player 2 confesses and Player 1 denies the crime.¹¹¹

If both Players confess, both receive a five year prison sentence, as Box 4 demonstrates. If both players deny the crime, both players will receive one year sentences.¹¹² Box 1 represents this outcome.

For each *individual* player, confession provides the most advantageous choice, regardless of the choice of the other player.¹¹³ Take, for example, the situation which confronts Player 1. If Player 2 chooses to deny the crime, Player 1 ought to confess. Player 1 will go free in that situation (Box 2).¹¹⁴ Likewise, if Player 2 confesses, Player 1 ought to confess. If Player 1 confesses, she receives a five year prison sentence rather than the seven year prison sentence she would receive for a denial, given Player 2's confession.¹¹⁵ Consequently, confession provides the "dominant strategy" for each player.¹¹⁶ A dominant

¹⁰⁷ Varian, *supra* note 105, at 470.

¹⁰⁸ Varian, *supra* note 105, at 470.

¹⁰⁹ Varian, *supra* note 105, at 470.

¹¹⁰ Varian, *supra* note 105, at 470-71.

¹¹¹ Varian, *supra* note 105, at 470.

¹¹² Varian, *supra* note 105, at 471.

¹¹³ Varian, *supra* note 105, at 471. *See also* Abbott, *supra* note 105, at 506.

¹¹⁴ Varian, *supra* note 105, at 471.

¹¹⁵ Varian, *supra* note 105, at 470.

¹¹⁶ Abbott, *supra* note 106, at 506.

strategy arises where one optimal choice exists for each player independent of the other player's choice.¹¹⁷

The dominant strategy of confession creates the prisoner's dilemma. Each player is likely to choose confession. The payoff which results is Box 4 of Diagram 1. Both players receive a five year sentence. Both prisoners, therefore, are worse off as a result of following the dominant strategy, which is the likely scenario.

The amount by which a player may improve his or her predicament by confession is termed the "temptation differential."¹¹⁸ The higher the differential, the more likely the player to confess.¹¹⁹ In the case at hand, the temptation differential for confession is seven years if the other player denies, and two years if the other player confesses. Thus a strong temptation to confess exists. The best strategy, the one which improves the position of both players, is denial on the part both players.¹²⁰ A strategy which improves the lot of both players is Pareto efficient. A "situation is PARETO EFFICIENT if there is no way to make any person better off without hurting anybody else [emphasis in original]."¹²¹ In other words, if both players deny the crime, the aggregate prison time for the two players is two years. For one denial and one confession, the aggregate prison time is seven years. For two confessions, aggregate prison time is ten years (see Diagram 1 for payoffs). Acquiescence to the dominant strategy, therefore, is the worst possible (Pareto inefficient) strategy for both players.

¹¹⁷ Varian, *supra* note 105, at 467.

¹¹⁸ Abbott, *supra* note 106, at 506.

¹¹⁹ Abbott, *supra* note 106, at 506.

¹²⁰ Although confession may lead to freedom for one player if the other denies the crime, denial is the only strategy which improves the plight of *both* players.

¹²¹ Varian, *supra* note 105, at 305.

DIAGRAM 1

The Prisoner's Dilemma

Player 2

		Player 2	
		Deny	Confess
Player 1	Deny	1 -1,-1	3 -7,0
	Confess	2 0,-7	4 -5,-5

In summary, three relationships develop from the prisoner's dilemma diagram:

1) Confession is the dominant strategy for each player, regardless of what choice the other player makes.

2) For each player, the higher payoff results if the other player chooses denial.

3) The Pareto efficient strategy occurs when both players deny the crime. If both confess, the worst payoff results.¹²²

B. International Trade and the Prisoner's Dilemma

The prisoner's dilemma adapts well to the realm of international trade. In the case of international trade, the players choose between cooperation (remaining open to free trade) and denial (granting protection to certain industries).¹²³

Refer to Diagram 2. "B" represents the optimal outcome, "S" the second best outcome, "T" the third best outcome, and "W" the worst outcome for any individual player.¹²⁴ The individual players are trading nations which may or may not decide that free trade is in the best interests of national welfare.

Box 2 demonstrates that if Player 1 protects its domestic industries and Player 2 cooperates (remains open to free trade), the result is the optimal outcome for Player 1 but the worst outcome for Player 2.¹²⁵ Box 3 illustrates essentially the same outcome, except that

¹²² Abbott, *supra* note 106, at 506.

¹²³ Abbott, *supra* note 106, at 505.

¹²⁴ Abbott, *supra* note 106, at 505.

¹²⁵ Abbott, *supra* note 106, at 506.

Player 2 attains optimal results, while Player 1 receives the worst outcome.¹²⁶

Denial is the dominant strategy for each player.¹²⁷ For example, if Player 2 chooses cooperation, Player 1 ought to choose denial. That choice, as Box 2 illustrates, leaves Player 1 with the optimal outcome. Likewise, should Player 2 choose denial, Player 1 ought to choose denial as well. Denial leaves Player 1 with the third best outcome (see Box 4), whereas cooperation would leave Player 1 with the worst outcome (see Box 3).¹²⁸

The situation is analogous to the prisoner's dilemma. The dominant strategy for each player is denial. However, cooperation provides the Pareto efficient strategy. In other words, cooperation improves the situation of both players (see Box 1).¹²⁹ Cooperation results in the second best outcome for both players. Thus cooperation improves the lot of both players as compared with denial.

DIAGRAM 2

International Trade

Player 2

		Player 2	
		Cooperate (Remain Open)	Deny (Grant Protection)
Player 1	Cooperate (Remain Open)	1 S,S	3 W,B
	Deny (Grant Protection)	2 B,W	4 T,T

The question arises as to why cooperation, that is, free trade, represents the Pareto efficient strategy. Comparative advantage answers that question.

¹²⁶ Abbott, *supra* note 106, at 506.

¹²⁷ Abbott, *supra* note 106, at 506.

¹²⁸ Abbott, *supra* note 106, at 506.

¹²⁹ Abbott, *supra* note 106, at 506.

David Ricardo posited the classic theory of free trade known as comparative advantage.¹³⁰ “A country has comparative advantage in a good if the product has a lower pretrade relative price than is found elsewhere in the world.”¹³¹ To state the law in clearer terms, a country ought to specialize in that good which it can produce more efficiently than any other good.

The law of comparative advantage actually derives from the law of absolute advantage promulgated in the eighteenth century by Adam Smith.¹³² A country maintains absolute advantage in a good where it “produce[s] a good using fewer production inputs than is possible anywhere else in the world.”¹³³ According to Smith, the most efficient global division of labor occurs when trading nations specialize in the production of those goods in which the nations maintain absolute advantage. The following tables illustrate absolute advantage.

TABLE 1
WORLD TRADE BASED ON ABSOLUTE ADVANTAGE¹³⁴

	Country	
	A	B
Soybeans (S)	3	12
Textiles (T)	6	4

* The numbers listed in the table represent labor hours necessary to produce one unit of S or T.

Country A possesses absolute advantage in the production of S (three labor hours per unit as opposed to twelve in Country B). Country B, on the other hand, possesses absolute advantage in the production of T (four hours per unit as opposed to six in Country A). Absolute advantage dictates that Country A specialize in the production of S, and that Country B specialize in the production of T.¹³⁵

If Country A reduces output of T by one unit, the reduction frees six hours of labor.¹³⁶ Assuming that T labor easily moves to the pro-

¹³⁰ STEVEN HUSTED AND MICHAEL MELVIN, INTERNATIONAL ECONOMICS 68 (1990). For an interesting narrative on the life and work of David Ricardo, see TODD G. BUCHHOLZ, NEW IDEAS FROM DEAD ECONOMISTS: AN INTRODUCTION TO MODERN ECONOMIC THOUGHT 62 (1989).

¹³¹ *Id.*

¹³² Husted, *supra* note 130, at 65. For an interesting narrative on the life and work of Adam Smith, see Buchholz, *supra* note 130, at 10.

¹³³ Husted, *supra* note 130, at 65.

¹³⁴ Husted, *supra* note 130, at 66.

¹³⁵ Husted, *supra* note 130, at 66.

¹³⁶ Husted, *supra* note 130, at 66.

duction of S, S producers utilize these six hours to produce two additional units of S.¹³⁷ If Country B reduces S production by one unit, the reduction frees twelve hours of labor.¹³⁸ T producers utilize these twelve hours of labor to produce three additional units of T.¹³⁹

Let P_s equal the price of S, P_T equal the price of T, W_A equal the wages paid to labor in country A, and W_B equal the wages paid to labor in Country B. The following equations calculate the price of S relative to T in each of the countries:

$$P_s/P_T \text{ in A} = (W_A \times 3)/(W_A \times 6) = 3/6 = 1/2$$

$$P_s/P_T \text{ in B} = (W_B \times 12)/(W_B \times 4) = 12/4 = 3^{140}$$

In autarky,¹⁴¹ S costs one-half unit of T in Country A, but three units of T in Country B. If the two countries agree to free trade, Country B's consumers will purchase soybeans from Country A rather than from domestic producers.¹⁴²

Under this condition of free trade, world (for purposes of this example, Countries A and B comprise the "world") production of S increases one unit. World production of T rises two units. Note that specialization and free trade accomplish this worldwide increase in output of both products without any increase in inputs.¹⁴³

TABLE 2
PER UNIT GAINS FROM SPECIALIZATION¹⁴⁴

	Per Unit Gain	
	In Production of S	In Production of T
In A	+2	-1
In B	-1	+3
In World	+1	+2

What if one country possesses absolute advantage in both goods? Comparative advantage governs this situation. A country should specialize in that good in which it attains the greatest absolute advantage (if the country in question has absolute advantage in both goods), or

¹³⁷ Husted, *supra* note 130, at 66.

¹³⁸ Husted, *supra* note 130, at 66.

¹³⁹ Husted, *supra* note 130, at 66.

¹⁴⁰ Husted, *supra* note 130, at 67.

¹⁴¹ Autarky refers to the absence of international trade.

¹⁴² Husted, *supra* note 130, at 66.

¹⁴³ Husted, *supra* note 130, at 66.

¹⁴⁴ Husted, *supra* note 130, at 66.

in that good where it maintains the least absolute disadvantage (if the country in question lacks absolute advantage in either good).¹⁴⁵

TABLE 3
WORLD TRADE BASED ON COMPARATIVE ADVANTAGE¹⁴⁶

	Country	
	A	B
Soybeans (S)	3	12
Textiles (T)	6	8

* The numbers listed in the table denote the number of labor hours required to produce one unit of the relevant good.

A produces S consuming one fourth of the inputs B requires and produces T using three fourths of the inputs B requires. Consequently, A retains absolute advantage in both goods. However, the table shows that A is four times more efficient in the production of S as compared to B but only four thirds more efficient in the production of T as compared to B.¹⁴⁷ Thus, Country A ought to produce S because A's greatest absolute advantage lies in the production of S. That is, A possesses comparative advantage in S production.¹⁴⁸ Country B ought to produce T, the good in which it possesses least absolute disadvantage. B holds comparative advantage in T production.¹⁴⁹

If Countries A and B function under a free trade regime, each should move to specialize in the production of its comparative advantage good.¹⁵⁰ Each country would export excess production of its comparative advantage good in return for the excess of the other country's comparative advantage good.¹⁵¹

¹⁴⁵ Husted, *supra* note 130, at 68.

¹⁴⁶ Husted, *supra* note 130, at 68.

¹⁴⁷ Husted, *supra* note 130, at 69.

¹⁴⁸ Husted, *supra* note 130, at 69.

¹⁴⁹ Husted, *supra* note 130, at 69.

¹⁵⁰ Husted, *supra* note 130, at 69.

¹⁵¹ Husted, *supra* note 130, at 69.

TABLE 4
PER UNIT GAINS FROM SPECIALIZATION¹⁵²

	Per Unit Gains	
	In Production of S	In Production of T
In A	+2	-1
In B	-1	+1.5
In World	+1	+0.5

If A reduces T production by one unit, the reduction frees six hours of labor. With these six hours, A produces two additional units of S (which requires three hours of labor per unit).¹⁵³ If B reduces S production by one unit, the reduction frees twelve labor hours. With these twelve hours, B produces one and one-half additional units of T (which requires eight hours of labor per unit).¹⁵⁴

Free trade therefore increases the welfare of both nations relative to autarky.¹⁵⁵ Moreover, welfare increases without additional inputs.¹⁵⁶ Free trade increases efficiency.

Return to the prisoner's dilemma and its application to international trade. Given the law of comparative advantage, which requires specialization and free trade, the choice of cooperation by each player clearly leads to the Pareto efficient outcome. Free trade increases the welfare of both players.¹⁵⁷ International trade laws ensure that con-

¹⁵² Husted, *supra* note 130, at 66. The per unit gains which this table illustrates result from the law of comparative advantage.

¹⁵³ Husted, *supra* note 130, at 69.

¹⁵⁴ Husted, *supra* note 130, at 69.

¹⁵⁵ Husted, *supra* note 130, at 69.

¹⁵⁶ Husted, *supra* note 130, at 69.

¹⁵⁷ If free trade increases global economic welfare without additional resources, the reader might logically ask why the outcome of Box 1 in Diagram 2 is not "B,B" rather than "S,S." Public choice theories suggest that the answer is more political than economic. Government leaders realize that free trade negatively impacts the inefficient segments of the national economy (the impacts are negative only to those who participate in the inefficient industries). Thus the government attempts to balance between long term interests of national economic welfare and the interests of those who bear the brunt of free trade. This maximizes the government officials' chances of reelection; unfortunately, the consumer pays the price of protection. Abbott, *supra* note 106, at 510.

Some economic theories also explain Diagram 2. One theory, known as the optimal tariff, holds that a large country which is the sole consumer (has monopsony power) of "a product can improve its welfare, at the expense of a greater reduction in world welfare, by taxing imports of that product (defecting) up to some optimal level." Abbott, *supra* note 106, at 508. The exporting nations will cut prices in order to retain market share. Thus the consumers of the monopsony nation suffer no price increases in the product.

Another popular theory is the infant industry argument. This theory asserts that a domestic industry which is not currently viable will become competitive if the government will protect it from competition until it is able to operate efficiently. Proponents of this theory believe that the

tracting parties to free trade agreements follow the path of comparative advantage to Pareto efficient outcomes.¹⁵⁸

C. Money Laundering and the Prisoner's Dilemma

The prisoner's dilemma also arises in the context of international money laundering agreements, with one modification. In the international agreements context, the contracting parties are able to communicate with each other.

Refer to Diagram 3. This diagram utilizes the same outcomes as the international trade diagram. The dominant strategy once again creates a dilemma. In this case, the dominant strategy for each player (nation) is denial (legalization/tolerance of money laundering by the nation's financial institutions). For example, if Player 2 chooses cooperation (criminalization of money laundering), the optimal choice for Player 1 is denial. Box 2 shows the outcome of this choice (the net result is that Player 1's financial institutions realize all of the profits from money laundering, which leaves Player 2 to bear a greater portion of the costs of fighting international criminal activity).¹⁵⁹ Likewise, if Player 2 chooses denial, denial represents the optimal choice for Player 1. If Player 1 were to choose to cooperate, Player 2's financial institutions would gain the profits from money laundering, while Player 1 would bear the burden of combating money laundering. Thus, whatever option Player 2 chooses, Player 1 ought to choose denial. The same analysis applies to Player 2's choice. Its dominant strategy, regardless of what choice Player 1 makes, is denial. How-

short run costs are more than outweighed by the long term benefits that this infant industry will bring in the form of jobs. Abbott, *supra* note 106, at 511.

Both arguments possess considerable shortcomings. The optimal tariff inevitably invites retaliation on other products, and therefore poses the danger of a trade war. In the case of the second theory, infant industries often remain protected long after maturity. Moreover, protection of infant industries diverts resources from existing viable industries. Government saves infant industries at the cost of presently viable industries.

Given, however, that government falls prey to public choice considerations and protectionist economic theories, Diagram 2 most accurately reflects the prisoner's dilemma as it applies to international trade.

¹⁵⁸ Abbott, *supra* note 106, at 522. International trade law aids public officials in making the choice for free trade, which raises world economic welfare. First, a public official must obey the law, trade law, rather than grant protection. Second, public officials can blame international trade laws for adverse effects on constituents rather than shoulder the blame personally. Abbott, *supra* note 106, at 522.

¹⁵⁹ As noted previously, the money laundering process crosses many borders. Therefore, combating money laundering, which renders the underlying crime profitable, requires the cooperation of a multitude of nations. Moreover, fighting money laundering serves the mutual best interests of nations in that it protects the licit national economies of those nations. WEBSTER AND McCAMPBELL, *supra* note 25, at 6.

ever, if both players choose denial, the Pareto inefficient outcome results. Neither player's financial institutions profits as greatly as they would have had the other player cooperated. Moreover, the nations' policies towards money laundering drive the underlying criminal activity, which damages the licit economies of the nations.¹⁶⁰

Cooperation on the part of both players produces the Pareto efficient outcome, as Diagram 3 demonstrates. A concerted effort to combat money laundering inhibits profitability of the underlying criminal activity. Such cooperation also relieves domestic economies of the threat which money laundering poses to the licit economy.

International cooperative efforts endeavor to reach the Pareto efficient outcomes. As noted above, agreements (which are possible because the nations of the world are able to communicate, unlike the prisoners) such as the Drug Convention require contracting parties to criminalize money laundering. For the reasons that follow, however, these cooperative efforts fail.

Refer again to Diagram 3. Contracting parties to an international agreement place themselves in Box 1, the Pareto efficient outcome. However, a nation may choose not to become a contracting party to such an agreement, or may choose to revoke its consent to be bound by such an agreement.¹⁶¹ In addition, this unscrupulous nation knows with near certainty that many other nations will continue to bind themselves by the agreement. In other words, these other contracting parties will assuredly cooperate.

In the context of Diagram 3, Player 2 represents the contracting parties to an international agreement which criminalizes money laundering. Player 1 is the unscrupulous nation which refuses to become a contracting party to the agreement. With full knowledge of Player 2's cooperation, Player 1 chooses denial, its dominant strategy. Box 2 shows the outcome. Player 1 profits at the expense of Player 2. Its financial institutions reap the profits of money laundering, the costs of which Player 2 bears.

What causes this outcome? Cooperation generates an incentive for some nations to cheat. Such nations see the potential for short term profits, and know that other nations are willing to bear the

¹⁶⁰ WEBSTER AND McCAMPBELL, *supra* note 25, at 6.

¹⁶¹ Consent is the basis of international law. "The rules of law binding upon States . . . emanate from their own free will expressed in conventions or by usage generally accepted as expressing principles of law." S.S. Lotus (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 10, at 18 (Sept. 7). See also Vienna Convention on the Law of Treaties, art. 24, U.N. Doc. A/Conf. 39/127 (1969) (done at Vienna, May 23, 1969; entered into force Jan. 27, 1980).

costs.¹⁶² In the absence of penalties for denial, some nations will refuse to criminalize money laundering.

DIAGRAM 3
Money Laundering
Player 2

		Player 2	
		Cooperate (Criminalize)	Deny (Legalize)
Player 1	Cooperate (Criminalize)	1 S,S	3 W,B
	Deny (Legalize)	2 B,W	4 T,T

The section which follows argues that cooperative states ought to impose penalties, through the international trade regime, on states which refuse to criminalize money laundering.

IV. USE OF THE MULTILATERAL TRADE ORGANIZATION AND THE GENERAL AGREEMENT ON TARIFFS AND TRADE TO COMBAT MONEY LAUNDERING

A. Application of GATS and GATT to Money Laundering Initiatives

On December 15, 1993, the contracting parties to the General Agreement on Tariffs and Trade (GATT) completed the Uruguay Round of GATT negotiations.¹⁶³ These negotiations produced a new international trade liberalization body termed the Multilateral Trade Organization, now the World Trade Organization (WTO).¹⁶⁴

¹⁶² The situation described is closely analogous to a cartel. In the case of a cartel, a group of companies collude to fix prices and thereby ensure a certain level of profits for each member of the cartel. However, if each firm thought that the other would keep its price fixed, each would find it profitable to underprice the other firms. Varian, *supra* note 105, at 473.

¹⁶³ Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Dec. 15, 1993, 33 I.L.M. 1 [hereinafter MTO].

¹⁶⁴ *Id.* The MTO incorporates the existing provisions of the GATT and includes new trade liberalization agreements. States who wish to become contracting parties to the MTO must ratify or otherwise accede to the agreement, which supersedes the GATT. However, contracting states who wish to become contracting parties to the MTO must first become contracting parties to the GATT.

One of the most significant new agreements of the WTO is the General Agreement on Trade and Services (GATS).¹⁶⁵ The GATS liberalizes the international services industry. Article I reads, in pertinent part:

1. This Agreement applies to measures by Members affecting trade in services.
2. For the purposes of this Agreement, trade in services is defined as the supply of a service;
 - (a) from the territory of one Member into the territory of any other Member;
 - (b) in the territory of one Member to the service of any other Member;
 - (c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
 - (d) by a service supplier of one Member through presence of natural persons of a Member in the territory of any other Member.
3. For the purposes of the Agreement:
 - (b) "services" includes any service in any sector except services supplied in the exercise of government authority.¹⁶⁶

In addition, Article II of the GATS provides most-favored nation treatment for contracting parties to the GATS.¹⁶⁷

Financial institutions such as banks and brokerage houses meet the definitions of services set out in Article I of the GATS. Such status entitles these institutions to most favored nation treatment. For example, if the United States permits Barclays Bank, a British concern (Britain is assumedly an WTO contracting party), to establish operations in the United States, the United States must permit DeutscheBank, a German concern (Germany is likewise assumedly an WTO contracting party), to establish the same type of operations in the United States.

The GATT likewise provides most-favored nation treatment for goods which originate from GATT contracting parties.¹⁶⁸ Thus, if the United States grants favorable tariff rates to goods which originate from one GATT contracting party, it must provide the same tariff rates to goods which originate from all other GATT contracting parties.

Although the GATS and the GATT strive to liberalize trade in goods and services, the United States and its trading partners ought to impose tariffs on the goods and services (comparative advantage

¹⁶⁵ General Agreement on Trade and Services, December 15, 1993, 33 I.L.M. 45 [hereinafter GATS].

¹⁶⁶ *Id.* art. I.

¹⁶⁷ *Id.* art. II.

¹⁶⁸ General Agreement on Tariffs and Trade, Oct. 30, 1947, T.I.A.S. No. 1700, 55 U.N.T.S. 194, 196-201 (entered into force on January 12, 1948) [hereinafter GATT]. See *infra* note 188.

goods and services) of any country that refuses to criminalize money laundering. Trade sanctions pursuant to Article XIV(a) of the GATS and Article XX(a) of the GATT remedy the game theory problems which plague international agreements on money laundering. If WTO contracting parties which enact money laundering laws impose economic sanctions on those nations who do not enact such laws, the lure of lax money laundering laws disappears. The non-complying party realizes no gain by failing to criminalize money laundering laws. Rather, sanctions sever the umbilical cord of international trade from recalcitrant states. Profits from laundering are unlikely to compensate for lost profits from international trade.

Take the example of Luxembourg, which is a contracting party to the GATT, and for the sake of this example, a contracting party to the WTO. Free trade grants Luxembourg's goods and services most-favored nation status.¹⁶⁹ In the context of Diagram 2, where Luxembourg is Player 1 and the other contracting parties comprise Player 2, both players cooperate. The outcome is Box 1, the Pareto efficient outcome.

Unfortunately, while Luxembourg derives the benefits of free trade through the world trading regime, it refuses to become a contracting party to any international agreement on money laundering.¹⁷⁰ Luxembourg's financial institutions thereby derive money laundering profits at the expense of its trading partners which choose to criminalize money laundering.

¹⁶⁹ GATT, *supra* note 168, art. I(1), T.I.A.S. No. 1700 at 8, 55 U.N.T.S. at 196-98; GATS, *supra* note 165, art. II(1), 33 I.L.M. at 49. Article I(1) states:

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or export, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 1 and 2 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

GATT, *supra* note 168, art. I(1), T.I.A.S. No. 1700 at 8, 55 U.N.T.S. at 196-98. Article II(1) reads as follows:

With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member, treatment no less favourable than that it accords to like services and service suppliers of any other countries.

GATS, *supra* note 165, art. II, 33 I.L.M. at 49.

¹⁷⁰ Luxembourg is a known money laundering haven. C. Todd Jones, *Compulsion over Comity: The United States' Assault on Foreign Bank Secrecy*, 12 *Nw. J. INT'L L. & Bus.* 454, 456 n.7 (1992).

In response to this "cheating" problem, the United States, in conjunction with the G-7¹⁷¹ ought to invoke the public morals exception to both the GATS¹⁷² and the GATT.¹⁷³ Specifically, the G-7 should deny favorable access to G-7 markets by the financial institutions of nations which refuse to become contracting parties to international money laundering agreements, or otherwise criminalize money laundering practices. The denial would come in the form of increased tariffs¹⁷⁴ on the financial services¹⁷⁵ of offending nations. Likewise, the G-7 ought to target strategic goods of offending nations for increased tariff rates. On its face, such actions appear to violate the most favored nation treatment required by Article II of the GATS and Article I of the GATT. However, the public morals exception grants authority for such actions.

For example, Article XIV(a) permits a contracting party to the GATS to adopt measures "necessary to protect public morals or to maintain public order. . . ."¹⁷⁶ Footnote 5 of Article XIV provides that "[t]he public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society."¹⁷⁷

¹⁷¹ For a discussion of the G-7, see *supra* text accompanying note 84.

¹⁷² GATS, *supra* note 165, art. XIV(a), 33 I.L.M. at 57-58. Article XIV(a) reads:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:

(a) necessary to protect public morals. . . .

Id.

¹⁷³ GATT, *supra* note 168, art. XX(a), T.I.A.S. No. 1700 at 56-57, 55 U.N.T.S. at 262. Article XX(a) reads:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(a) necessary to protect public morals. . . .

¹⁷⁴ Where trade barriers are necessary, tariffs are the preferred barriers under the GATT. GATT, *supra* note 168, art. XX(1). For a detailed explanation of the welfare effects of trade barriers, See appendices A and B, *infra*.

¹⁷⁵ The GATS defines financial services as follows:

A financial services is any service of a financial nature offered by a financial service supplier of a Member [contracting party to GATS]. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance).

GATS, *supra* note 165, ANNEX ON FINANCIAL SERVICES, 5.1, 33 I.L.M. at 71.

The tariffs placed on financial services would be placed on all financial services of all offending nations, including those who are not contracting parties to the GATS.

¹⁷⁶ GATS, *supra* note 165, art. XIV(a), 33 I.L.M. at 58.

¹⁷⁷ GATS, *supra* note 165, art. XIV n.5.

Trade sanctions against nations which permit money laundering are “necessary to protect public morals. . .,”¹⁷⁸ both in the context of the GATS and the GATT. Money laundering “renders the underlying crime lucrative, and therefore perpetuates it.”¹⁷⁹ In other words, money laundering supports drug trafficking, illegal arms sales, prostitution, trafficking in human body parts, and numerous other activities in which organized crime engages. Thus fighting crime justifies invocation of the public morals exception to free trade. As noted, worldwide illicit profits approach one trillion dollars.¹⁸⁰ Nations which permit or even encourage money laundering facilitate criminal activity the world over. Thus, money laundering activity in Luxembourg fans crime in the United States. The public morals exception thus protects countries which criminalize money laundering from crime generated by cheating nations.

Because economic theory holds that international trade increases the wealth of nations (thus the rationale for trade liberalization agreements), states which do not enact criminal money laundering laws extract benefit from international trade. However, these states likewise benefit from the profits of money laundering. Their trading partners, while undeniably benefiting from trade, must bear the cost of the crime that money laundering perpetuates. The United States must spend enormous sums of money on law enforcement efforts to combat drug trafficking, prostitution, and illegal arms sales. Consequently, trade with partners who refuse to criminalize money laundering threatens the public morals of the United States.

Tariffs provide the necessary disincentive to cheat. That is, tariffs punish nations which refuse to criminalize money laundering. In the context of Diagram 2 (international trade), the G-7 (Player 1) chooses denial as to those nations which refuse to criminalize money laundering. If the offending nations (which comprise Player 2) choose to remain open to trade in the face of tariffs on their financial services and goods, the Box 2 outcome results. Player 1 gains the optimal outcome (free markets for their goods and services, and treasury revenue in the form of tariffs), while Player 2 faces the worst outcome (unfavorable market conditions for their goods and services). If Player 2 chooses to retaliate (denial), the Box 4 outcome results. This outcome is Pareto inefficient. The tariffs effectively penalize recalcitrant nations.

¹⁷⁸ GATS, *supra* note 165, art. XIV.

¹⁷⁹ Smith, *supra* note 29, at 110.

¹⁸⁰ Elliot, *supra* note 1, at 22.

A Pareto inefficient outcome appears to penalize the G-7 nations as well. To a certain extent, the outcome penalizes G-7 consumers of goods and services in the form of higher prices.¹⁸¹ However, trade remains free among the G-7 nations and contracting parties to the GATT and the GATS which criminalize money laundering. Given that the G-7 nations provide the largest markets for the world's goods and services, and therefore the most lucrative markets for the goods and services of offending nations, the effect of the trade barriers are likely to have a far greater negative impact on the offending nations than on the G-7 nations.

The purpose of the tariffs is to penalize those nations which profit from money laundering, that is, to ensure that profits from money laundering are more than offset by the decrease in international trade. Once offending nations criminalize money laundering,¹⁸² however, the tariffs imposed ought to be eliminated. In fact, legislation which imposes tariffs on offending nations ought to be written so as to expire when each offending nation criminalizes money laundering.

In addition, invocation of GATS Article XIV(a) minimizes the adverse effects of such laws as the European Union's Capital Movement Directive (CMD). Critics of the CMD charge that the directive represents "competitive lawmaking."¹⁸³ A competitive lawmaking regime removes all barriers to trade (in the case of the CMD, all barriers to capital movement), then forces the nations subject to the regime to compete for survival after their removal.¹⁸⁴ Such a regime poses two problems. First, it may provoke a race to the bottom. In the case of free capital movement, the state which enacts the most lax banking regulations will attract much of the capital.¹⁸⁵ Second, if one state does attract much of the capital, the other Member States may band together to defeat the competitive advantage of that other state. This sort of behavior defeats the rationale of free capital movements.¹⁸⁶

The current situation in the European Union supports the race to the bottom theory. Several Member States have enacted the Money Laundering Proposal (MLP), or are considering its enactment.¹⁸⁷

¹⁸¹ See *infra* Appendix A.

¹⁸² Offending nations ought to be permitted to enact whatever statutes they deem appropriate to criminalize money laundering. The only requirement ought to be that money laundering is no longer tolerated by any nation. Both United States and European initiatives provide models which offending nations should feel free to follow.

¹⁸³ Smith, *supra* note 29, at 113.

¹⁸⁴ Smith, *supra* note 29, at 113.

¹⁸⁵ Smith, *supra* note 29, at 113.

¹⁸⁶ Smith, *supra* note 29, at 113.

¹⁸⁷ See Money Laundering Proposal, *supra* note 66.

Luxembourg, however, has enacted legislation which makes its financial institutions more attractive to money laundering. This legislation, coupled with the enactment of the MLP in other Member States, has led to massive inflows of capital to Luxembourg banks.

Invocation of Article XIV(a) could largely nullify this profitability, as the above game theory analysis demonstrates. If Luxembourg's trading partners refuse to trade in financial services with Luxembourg, it is likely to lose more from such an embargo than it would gain from money laundering profits. Faced with the choice of uncompetitive goods and services in the global marketplace, Luxembourg is likely to criminalize money laundering. Thus, Article XIV(a) may be used to curtail the profitability of money laundering. That is, the Article may act as a disincentive to participate in the race to the bottom.

The Treaty of Rome (Treaty) offers Member States protection from tariffs on financial services.¹⁸⁸ Article 73b prohibits "all restrictions on the movement of capital between Member States and between Member States and third countries. . . ."¹⁸⁹ Tariffs on the financial services of Member States such as Luxembourg restrict capital movement among states. Tariffs on Luxembourg's financial services increase the costs of the state's financial services. Consequently, capital flow into Luxembourg will abate. The G-7's tariff penalties appear to violate the treaty obligations of its European Union members.

However, Article 73d permits Member States "to take measures which are justified on grounds of public policy or public security."¹⁹⁰ The G-7 justifies its actions in regard to money laundering on the basis of public policy. The Treaty therefore provides European Union members of the G-7 the tools to implement G-7 policy as it relates to the criminalization of money laundering.

B. Dispute Settlement Issues

As noted, a system of tariffs placed on the goods and services of those nations which permit money laundering violates the most favored nation clauses of the GATS¹⁹¹ and the GATT¹⁹² on its face. The G-7 nations would treat goods and services of offending nations

¹⁸⁸ Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 7, 298 U.N.T.S. 42 [hereinafter Treaty of Rome].

¹⁸⁹ *Id.* art. 73b.

¹⁹⁰ *Id.* art. 73d.

¹⁹¹ GATS, *supra* note 165, art. II, 33 I.L.M. at 49.

¹⁹² GATT, *supra* note 168, art. I, T.I.A.S. No. 1700 at 8-13, 55 U.N.T.S. at 196-201.

less favorably than goods and services of other contracting parties (assuming the offending nations were contracting parties to the GATT and GATS (WTO)). The G-7, of course, justifies the tariff regime on the basis of the public moral exceptions of the two relevant agreements.

Nations subject to the tariffs, however, would likely bring a complaint before the WTO.¹⁹³ First, pursuant to the original GATT agreements, the nations subject to tariffs could demand consultations with the G-7.¹⁹⁴ Thus the G-7 must consider the complaints of the offending nations as to the tariffs imposed upon them. Moreover, the offending nations may propose a compromise or other resolution to the tariff/money laundering dispute, to which the G-7 must give sympathetic consideration.¹⁹⁵ If the adverse parties are unable to come to an agreement, the offending nations may request that other contracting parties to the GATT investigate the matter (because these dispute mechanisms arise under the auspices of the GATT, the offending nations may raise their concerns only to goods which have been impaired by tariffs).¹⁹⁶

Articles XXII and XXIII force the G-7 to consider the offending nations complaints. In addition, the G-7 might face an investigation

¹⁹³ The MTO of December 15, 1993 provides an international regime to administer all trade agreements among its Members. MTO, *supra* note 163, art. II, 33 I.L.M. at 15.

The MTO aids in dispute negotiations among Members and administers the Dispute Settlement Understanding. MTO, *supra* note 163, art. III(3).

¹⁹⁴ GATT, *supra* note 168, art. XXII, T.I.A.S. No. 1700 at 60, U.N.T.S. at 266. Article XXII provides:

1. Each contracting party shall accord sympathetic consideration to, and shall afford adequate opportunity for consultation regarding, such representations as may be made by another contracting party with respect to any matter affecting the operation of the Agreement.
2. The CONTRACTING PARTIES may, at the request of a contracting party, consult with any contracting party or parties in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1.

¹⁹⁵ GATT, *supra* note 168, art. XXIII (1). Article XXIII(1) reads:

If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

(a) the failure of another contracting party to carry out its obligation under this Agreement, or

(b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(c) the existence of any other situation, the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.

¹⁹⁶ GATT, *supra* note 168, art. XXIII(2).

by the contracting parties to the GATT, the recommendations¹⁹⁷ of which may be adverse to the G-7. However, the offending nations may propose a compromise solution which restores free trade and criminalizes money laundering. In any event, the actions of the G-7 bring offending nations to the negotiating table. In the interim, the tariffs remain in place as a penalty until the parties reach a solution. Such a penalty increases the likelihood that offending nations will eventually capitulate.

Disputes over financial services fall under the auspices of the Dispute Settlement Understanding (DSU).¹⁹⁸ The DSU affirms the dispute settlement mechanisms of GATT, Articles XXII and XXIII.¹⁹⁹ The DSU also provides that

[b]efore bringing a case, a Member shall exercise its judgment as to whether action under these procedures would be fruitful. The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. *A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred* [emphasis added].²⁰⁰

The offending nations, therefore, may bring a complaint before the DSU in order to have the tariffs on its services (and goods) removed. Importantly, if these nations successfully demonstrate that the G-7 wrongfully erected tariff barriers on their goods and services, the DSU permits compensation and suspension of concessions (though in limited circumstances) at the request of the nations if the G-7 were to refuse to remove the tariffs.²⁰¹

Once again, however, the G-7 forces nations which refuse to criminalize money laundering (and are WTO contracting parties) to the bargaining table. The dispute settlement process is not instantaneous. As the proceedings linger, the goods and services of the offending nations continue to face G-7 tariffs. The financial institutions of these nations continue to lose profits. Inertia, therefore, increases the

¹⁹⁷ Article XXIII(2) permits the contracting parties to the GATT to investigate a concern brought to its attention, and permits recommendations as a result of those investigations. GATT, *supra* note 168, art. XXIII(2).

¹⁹⁸ The Dispute Settlement Understanding [hereinafter "DSU"] "shall . . . apply to consultations and the settlement of disputes between Members concerning their rights and obligations under the provisions of the Agreement Establishing the Multilateral Trade Organization (MTO). . . ." Understanding on Rules and Procedures Governing the Settlement of Disputes, GATT Doc. MTN/FIA 11-A2, Dec. 15, 1993, [hereinafter DSU], art.1.1.

¹⁹⁹ *Id.* art. 3.1.

²⁰⁰ *Id.* art. 3.7.

²⁰¹ *Id.* art. 22.1

probability of a mutually acceptable agreement on money laundering criminalization and with it the removable of painful trade barriers.

In summary, though the dispute settlement mechanisms of the world trade regime might well determine that tariff barriers imposed upon nations which refuse to criminalize money laundering violate G-7 trade obligations, the very same mechanisms will likely force a mutually acceptable solution to the money laundering problem.

Arguably, international law protects the G-7's imposition of tariffs on recalcitrant states. The Restatement (Revised) of the Foreign Relations Law of the United States (Restatement) holds that a rule of international law may derive from international agreement.²⁰² Thus international agreements which criminalize money laundering may establish a rule of international law. As noted above, a majority of states are contracting parties to the Drug Convention, an international agreement.²⁰³ In addition, the G-7, the world's most powerful group of industrialized nations, now agrees to criminalize money laundering (for purposes of this argument). Thus the G-7 enters into an international agreement.

Section 102(3) of the Restatement asserts that international agreements intended for states' general adherence, and which are widely accepted lead to the creation of customary international law.²⁰⁴ In this instance, the Drug Convention is intended for states' general adherence. The G-7's tariffs on nations which refuse to criminalize money laundering support the notion of general adherence. Moreover, because a majority of states are contracting parties to the Drug Convention, a majority of states indicate a belief that money laundering constitutes criminal behavior. Therefore, states widely accept the

²⁰² Restatement (Revised) of the Foreign Relations Law of the United States section 102(1)(b) [hereinafter Restatement]. § 102 reads:

Sources of International Law

(1) A rule of international law is one that has been accepted as such by the international community of states

(a) in the form of customary law;

(b) by international agreement; or

(c) by derivation from general principles common to the major legal systems of the world.

(2) Customary international law results from a general and consistent practice of states followed by them from a sense of legal obligation.

(3) International agreements create law for the states parties thereto and may lead to the creation of customary international law when such agreements are intended for adherence by states generally and are in fact widely accepted.

(4) General principles common to the major legal systems, even if not incorporated or reflected or reflected in customary law or international agreement, may be invoked as supplementary rules of international law where appropriate.

²⁰³ Drug Convention, *supra* note 69, at 493.

²⁰⁴ Restatement, *supra* note 202.

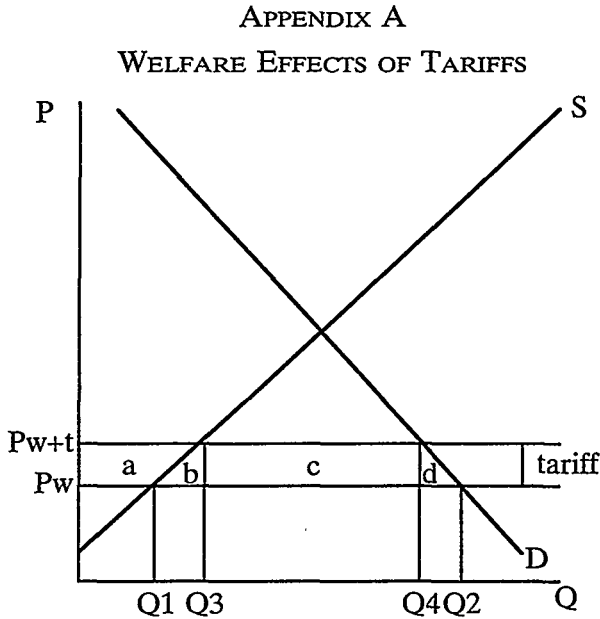
notion of money laundering as criminal conduct. These agreements thus form a rule of international law which criminalizes money laundering and provides for penalties for those states which choose to break the rule.

States which ignore the rule of international law necessarily violate international law. G-7 tariffs are therefore an attempt to enforce principles of international law, a concept consistent with the principles of GATT and GATS.

V. CONCLUSION

Money laundering perpetuates organized crime. To effectively combat crime, nations must combat money laundering. International efforts to criminalize money laundering are a logical genesis. However, such efforts provide an incentive for unscrupulous nations to permit money laundering by their financial institutions in order to gain an economic advantage for their citizens.

Trade sanctions present an effective means of dismantling the profit incentive that laundering provides. Although such sanctions seem to contradict the underlying purposes for which the GATT and the GATS were enacted, namely to bolster free trade, this course of action ensures the integrity of the world's financial system. Integrity in turn ensures that legitimate business profits can move freely throughout the international financial system. Finally, trade sanctions force trade among partners on an equal basis; one partner will not have to bear a disproportionate share of the law enforcement costs related to money laundering and underlying crime.



The above graph illustrates the welfare effects of a tariff. The point where the supply and demand curves meet establishes the domestic price for the good at issue. As the graph demonstrates, the world price, P_w , is substantially below the domestic price of the good.

At P_w , domestic producers of the good produce only Q_1 of the total amount of the good demanded by domestic consumers, Q_2 . Consequently, at the world price, domestic consumers would require $Q_2 - Q_1$ of the good in the form of imports.

If the domestic government, in an attempt to protect producers of the good, levies a tariff on the good, the domestic price rises to P_{w+t} . The amount of the tariff is the distance from P_w to P_{w+t} . As a result of the tariff, domestic producers of the good manufacture Q_3 , an increase over Q_1 . Domestic consumers demand Q_4 , a decrease from Q_2 . The new quantity of the good imported is $Q_4 - Q_3$.

The tariff redistributes resources. Producers of the good gain because of increased production and higher prices, represented by the area "a" in the graph (producer surplus). The government gains tariff revenue, represented by the area "c" in the graph.

Consumers, however, are the victims of the tariff. They lose an area, represented by $-(a+b+c+d)$ in the graph. Consumer surplus decreases. This decrease results from the higher prices consumers are forced to pay because of the tariff. As the graph illustrates, consumers now demand fewer units of the good because of the increase in price,

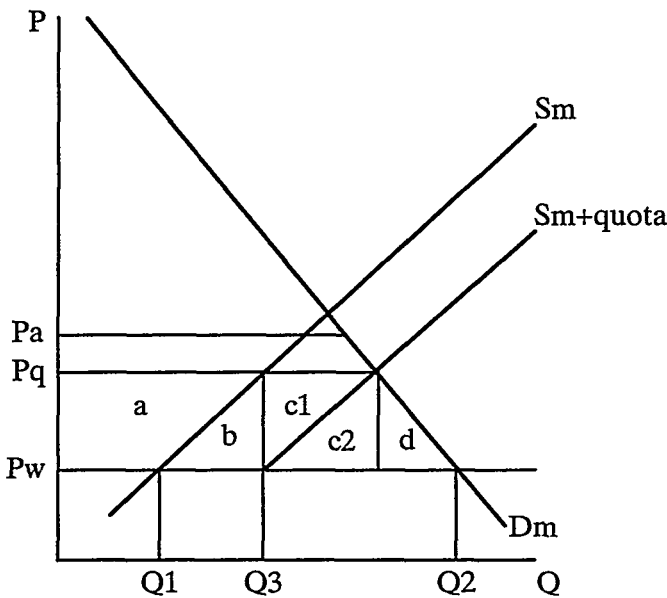
Q_4 as opposed to Q_2 . The following table shows the results of the tariff.

Welfare Costs of a Tariff

Change in Consumer Surplus	$-a-b-c-d$
Change in Producer Surplus	$+a$
Change in Government Revenue	$+c$
Net Welfare Change	$-b-d$

The table shows that a tariff results in a net welfare loss to society. Although the government and producers gain, “-b-d” represent the deadweight costs to society of a tariff. Deadweight costs result from resources devoted to expanded consumption of the goods. That is, consumers spend more now on this particular good; consequently, they have fewer dollars to spend on other goods (and services). Moreover, the tariff may force consumers to spend their scarce resources on less desirable substitutes for the good.²⁰⁵

APPENDIX B
WELFARE EFFECTS OF QUOTAS



²⁰⁵ See Husted, *supra* note 130, at 162-63.

This graph illustrates the welfare effects of a quota.²⁰⁶ In this case, rather than raising the price through a tariff, the government limits the amount of a good which may be imported into a country. Domestic producers of the good, in order to meet demand, increase production at a higher price. Because the number of goods which may enter the country is limited, the supply curve shifts to the right from S_m to $S_{m+quota}$ (a shortage of the good exists because the government artificially limits the amount of goods available from cheaper foreign sources.) Consequently, the domestic producer demands a higher price for its production of the good for all levels of demand.

P_a is the autarky price — the price at which domestic supply and demand for the good would be in equilibrium absent trade. P_w is the world price, and P_q is the price which results in the domestic economy as a result of the tariff.

Once again, consumers suffer the effects of protection. They again lose money equal to “ $-(a+b+c+d)$.” Producers gain. Producer surplus in this case equals area “a.” However, the government may not gain any revenue. This time, the government imposes no tariff, so area “c” does not necessarily represent government revenue. Only if the government chooses to auction off the right to import the quota amount of the good will it receive revenue, called quota rents. In the case of the United States, the government rarely chooses to auction off quota rights. Rather, it simply grants a particular organization a license to import. Consequently, society loses area “c” as well. The following table illustrates the welfare effects of a quota.

Welfare Effects of a Quota

Change in Consumer Surplus	$-a-b-c-d$
Change in Producer Surplus	$+a$
Change in Government Revenue	0
Net Welfare Change	$-b-c-d$

This table demonstrates that quotas produce negative welfare effects on society. In fact, consumers lose the area “ $-(b+c+d)$ ”, which is comprised of deadweight costs to society and a loss of government revenue, when the government chooses not to auction quota import rights. Therefore, quotas produce greater negative welfare impacts

²⁰⁶ Quotas are “government imposed limits on the quantity or valued of goods traded between countries.” Husted, *supra* note 130, at 189. This graph illustrates a limit on the quantity of a good traded between countries.

than tariffs produce.²⁰⁷ The economics of quotas explain GATT's preference for tariffs where trade barriers are necessary.

²⁰⁷ See Husted, *supra* note 130, at 191.