GLOBAL GOVERNANCE AND TRANSNATIONAL FINANCIAL CRIME: OPPORTUNITIES AND TENSIONS IN THE GLOBAL ANTI-MONEY LAUNDERING REGIME

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Abstract

This paper examines the global anti-money laundering regime, assesses its purpose and draws some conclusions with regards to its effectiveness as a tool for targeting transnational financial crime. The paper shows that targeting money laundering is presented as a means of strengthening the integrity of the financial system and tackling organised crime through a global approach, and contrasts official policies with actual (and potential) results in practice. The paper explains that at the core of the approach lies the tension of reconciling the cost of dealing with money laundering (to be borne primarily by the private sector) and the benefits of containing financial crime, which are, at best, difficult to determine. The paper analyses the relative input of (and interaction between) the various actors in the emerging anti-money laundering regime: specialised organisations, international financial institutions, law enforcement agencies, large, specialised and offshore financial centres and the private sector. It concludes that there is little evidence that the current regime leads to a systematic approach in addressing organised crime and argues that a similarly cosmetic exercise is evident in the inclusion of anti-terrorist financing measures in the anti-money laundering regime. Instead, the paper shows that regulation in the emerging anti-money laundering regime mostly serves (a) to address the need for 'public' action with respect to other types of public policy goals, (b) to relieve competitive pressures from specialised and offshore financial centres and (c) to produce increasingly sophisticated marketing techniques in private financial institutions.

Keywords

Money laundering, financial crime, Financial Action Task Force, terrorist financing

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The paper aims to analyse the conceptual, political, institutional and regulatory evolution of the anti-money laundering (AML) regime. It explains that a plethora of international, regional and national standards have emerged as a result of a drive to eradicate crime by targeting its proceeds and excluding those engaged in criminal activities from legitimate financial channels. The paper explains that while the emerging regime is increasingly focused and consistent in its aims, as well as global in its scope with respect to the national jurisdictions involved, it remains inefficient, not only because it is still developing but also, because several of its premises are questionable. The paper argues that in the face of significant public policy issues (corruption, drug trafficking, or terrorism), the AML regime serves the need for public action.

The paper is organised in four parts. In the first place, the paper presents the policy issues and subsequently analyses the emerging AML framework. The paper proceeds with identifying some of the inconsistencies within the regime and addresses the ensuing legitimacy gaps. Finally, the paper questions the effectiveness and legitimacy of a regime that is being designed in narrow terms, and the absence of linkages with associated global financial governance challenges such as tax evasion and even capital controls.

Why tackle money laundering? Defining the crime and the policy issues

What is money laundering?

The Financial Action Task Force (FATF), the international organisation responsible for standard-setting in AML offers the following definition: "The goal of a large number of criminal acts is to generate profit for the individual or group that carries out the act. Money laundering is the processing of these criminal proceeds to disguise their illegal origin". However, international harmonisation about which crimes are relevant under the above definition is only just starting to happen. Traditionally, rules and laws evolved from the drug trade but a diverse array of crimes have since been added to the list in different jurisdictions.[1]

How much of it is there?

It is extremely difficult to assess how much money is actually being laundered: the most often quoted figure comes from research by the International Monetary Fund (IMF) and estimates the total as a figure equal to between 2% and 5% of the world's GDP. This amounts to anything up to \$2 trillion. Another set of figures puts the amount of drug money laundering at 2% of total financial flows (The Banker, 2003). However, examining the methodology used in coming to such conclusions, one commentator, R.T. Naylor (1999: 30) remarks that "given the credibility of the methodology, the only thing that can be stated with certainty is that the actual figure is not likely to be less than 0% or more than 100%". This assessment is partly supported by the recent disclosure that an effort by FATF between 1996 and 2000 to calculate estimates failed (Reuter and Truman, 2004). These limitations are important, as it is difficult to know the significance of the money laundering problem but also, because

[1] FATF standards refer to the proceeds of all serious offences but there is a level of discretion with respect to the list of crimes most countries adopt. Indicative crimes include: drug trafficking, organised crime, racketeering, human trafficking, murder, robbery but also such white-collar crimes as fraud, corruption, bribery, insider trading and market manipulation. Some jurisdictions, most notably the UK have extended this list to include the proceeds of all crimes (Johnson and Abbott, 2005).

it is therefore difficult to judge the effectiveness of the emerging regime. Furthermore, there is no clear benchmark of what would constitute success or of what an 'acceptable' figure for global laundered funds might be.[2]

Why is money laundering a concern?

Ever since the policy community embarked on targeting money laundering in the 1980s, official explanations of these concerns have focused on political preoccupation with regards to the crimes that can eventually lead to money laundering. Public officials have presented the AML regime as a way of (i) tackling the drugs trade, the arms trade, people trafficking and other organised crime activities; (ii) supporting the integrity of the financial system, including supporting good governance and transparency; (iii) combating corruption and its economic and political consequences; (iv) promoting economic development and ensuring that funds are channelled to appropriate economic endeavours and allowing for adequate levels of tax revenue; and most recently, (v) targeting the financing of terrorist activities.

It is difficult to separate the above concerns, however, from more unofficial reasons why money laundering matters. The lines between money laundering and tax havens or banking secrecy are often blurred even though publicly, they are separate and distinct concerns because money laundering is illegal. The drive towards building an AML regime is nevertheless connected with questions of competitive pressure and establishing a regulatory level playing field. AML measures are also fast becoming a potent foreign policy tool with the introduction of an officially sanctioned focus on problem countries and politically exposed persons.[3]

While the above are all relevant concerns, how they are prioritised over time and which actors care most about what makes for a diverse set of interests that illuminates developments in the AML regime. Currently, combating terrorist financing appears to be the primary preoccupation (although whether it has a legitimate place in the list of concerns can, as will be subsequently shown, be disputed).

The AML framework

The AML regime is developing on two fronts, prevention and enforcement, and at three levels: national, regional and international (global).[4] Prevention is mostly about sanctions, regulation and supervision, reporting and customer due diligence; enforcement is about confiscation, prosecution and punishment and investigations. In essence, however, despite the criminalisation of money laundering and the recent prominent and public role of enforcement agencies in the AML regime, the process appears to be mostly a regulatory one. In this context, Lutz's (2004) analysis of three types of relationship between levels of regulation is illuminating. Lutz outlines three types of process to explain how regulation is generated: (i) regulatory models are downloaded from the global or the regional level; (ii) regulatory models are uploaded

[2] In a study by Transparency International (2003), dirty money in the UK is estimated to be equivalent to a quarter of the UK government's VAT revenue. Such a comparison appears meaningful; however, it is still unclear what would constitute 'too much' or 'too little' for the authorities or the financial system as a whole.

[3] The Office of Foreign Assets Control (OFAC) of the US Treasury has initiated a sanctions programme – there are currently over 200 pages of lists of designated countries and blocked persons affected by this programme. Countries affected include Myanmar, Cuba, Iran, Iraq, Liberia, Libya, North Korea, Sudan, Syria and Zimbabwe.

[4] For an overview of the different features of the regime, see Appendix I.

to the global level; and (iii) regulation is diffused in a horizontal manner (e.g. through imitation of best practice). Subsequent analysis will indicate that all three types are relevant in the emerging AML. Enforcement processes, on the other hand, are less developed, both in terms of visible results but also as an institutional framework, especially at the international level.

The global level

Money laundering became a pertinent global issue in the 1980s, culminating in the establishment of the FATF in 1989. Comprised of sixteen members in the early days, it reached a membership of twenty-eight by 1992 and now counts thirty-three members.[5] FATF's role is to issue recommendations, which are regularly updated. The forty recommendations are addressed to countries and deal with an extensive range of themes: the adoption of background policies that facilitate the fight against money laundering, ensuring banking secrecy laws do not impede detection, and participating in multilateral initiatives and solutions; the criminalisation of money laundering; the establishment of laws that allow for the seizure and confiscation of funds generated from criminal activity; the implementation of customer identification and record-keeping rules; the adoption of increased diligence of financial institutions, including the development of internal policies and controls; the strengthening of international cooperation, including the exchange of information and the legal facilitation of mutual assistance. The recommendations were reviewed and revised in 2003 to create a "comprehensive, consistent and substantially strengthened international framework for combating money laundering and terrorist financing." Changes include tougher provisions for high-risk customers, the extension of anti-money laundering measures to several non-financial businesses, the explicit extension to existing requirements to cover terrorist financing and the prohibition of shell banks. Following the terrorist attacks of 11 September 2001, FATF issued a further nine recommendations focusing on the combating of terrorist financing.[6]

Monitoring of the implementation of the recommendations takes two forms. All member countries carry out a self-assessment exercise and FATF has a mutual evaluation procedure in place, whereby on-site visits by legal, financial and law enforcement experts from other member governments are conducted. FATF also has provisions for dealing with non-compliant members, although to this date, only Austria and Turkey have been in any way reprimanded. Since 1999, FATF has taken a further step, engaging in a "naming and shaming" campaign and identifying countries guilty of non-cooperation. The first NCCTs report was made public in 2000 and is regularly reviewed.[7]

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[5] FATF member countries are: Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong – China, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. Additionally, the European Commission (EC) and the Gulf Co-operation Council (GCC) are counted as members. China became an observer in 2005.

[6] For comprehensive information on the forty + nine recommendations, see the FATF website, www.fatf-gafi.org.

[7] In the NCCT reviews of 2000 and 2001, twenty-three countries were placed on the NCCT list (and an addition twenty-one surveyed for this purpose). Only Myanmar and Nigeria remain on the list in early 2006.

FATF efforts are supplemented by a variety of groups and policies, ranging from regional task forces, the Egmont Group of Financial Intelligence Units, which annually brings together representatives of the relevant national agencies and the United Nations Global Programme against Money Laundering. Most importantly, the IMF, as part of its work on financial integrity, is now examining AML standards in its financial sector reviews and, where appropriate, offers technical assistance (Johnston and Abbott, 2005).

Against this highly ambitious global regime of standard setting and prevention, international coordination in law enforcement is a relatively underdeveloped and slow process. Limited inter-state cooperation is taking place in the context of Interpol (and Europol), and FATF is involved in some of those activities. It remains unclear, however, whether actual changes in the practices of law enforcement agencies have occurred as a result of the AML regime or whether effective communication channels are being established.

The regional level

There is extensive regional support of the AML regime both in regulatory terms and with respect to technical assistance. In the first place, Europe has long been interested in these issues, with an early initiative by the Council of Europe (1980). The European Union (EU) has, through three Money Laundering Directives (1991, 2001 and 2005), has also brought a certain degree of harmonisation to practice and standards in member countries. This has been a topic of some tension among member states and there are several discerning trends in the EU AML drive: (i) the linkage with FATF standards and discussions is both strong and in many ways, binding; (ii) G7 members such as the United Kingdom and France are at the forefront of proposals and more eager to push for comprehensive regional standards; (iii) countries with long established offshore status, most notably Luxembourg, are experiencing intense pressure (at the political and regulatory levels but also in the media) to address potential weaknesses.[8]

The regional level is also where much monitoring and promotion work is taking place as manifested by the plethora of regional groupings that have formed over the past decade to provide a discussion and learning forum for a larger number of countries as well as technical expertise and a framework for assessment. Aside from FATF members EC and GCC (Gulf Cooperation Council), regional bodies include the

[8] Observations on trends based on a series of interviews with regulators and practitioners in Europe (United Kingdom, Luxembourg and Switzerland) and the United States in 2004 and 2005. In the case of Luxembourg, consistent pressure by other EU member states has led to reports on practices produced by the French National Assembly (Montebourg Report, 2002) as well as intense media coverage of the 'Clearstream affair' as discussed in 'Revelation$' (Robert and Backes, 2001); the latter, though sensational, did not lead to criminal charges. The Great Duchy was also unfavourably targeted for its late adoption of legislation transposing the second Money Laundering Directive, even though legislation went further than the directive itself. In general, there is a strong feeling of unfairness among financial market participants, especially considering professed efforts to keep Luxembourg at the 'top of the class' for reputational reasons (reflections based on a series of interviews with officials in the private sector, the bankers' association and the supervisory authority, Luxembourg, March-April and October 2004).

Eastern and Southern Africa Anti-Money Laundering Group, The Regional Anti-Money Laundering Task Force, Latin America, the Eurasia Group, the North Africa and Middle East Group, the Asia-pacific Group, the West African Group, the Caribbean Financial Action Task Force as well as the Offshore Group of Banking Supervisors.

The national level

The main actor and initiator at the national level is the United States. There are good reasons for this interest: a 2001 report by the Federal Bureau of Investigation claims that approximately fifty percent of total money laundered goes through the US financial system while the US Treasury estimates that 99.9 per cent of such funds are laundered successfully (Mitchell, 2003). The criminalisation of money laundering in the 1980s and a series of high-profile scandals[9] brought attention to the issue but there was little interest in pursuing matters beyond the FATF framework or in a way that would lead to additional legislation or reinforced AML functions for regulators. In fact, there was no impetus for additional regulation or legislation prior to the terrorist attacks of 2001. The US Senate Permanent Subcommittee on Investigation of the Committee on Governmental Affairs had repeatedly pushed for legislation (US Senate 1999 and 2001) but its efforts had mostly been ignored. After September 2001, however, there was "real momentum for these languishing bills"[10] and the AML package was ready for inclusion in the US Patriot Act, Title III. The United States approach remains far from uniform as a plethora of agencies (including FinCen, the dedicated Treasury Department authority and the new Department of Homeland Security) have been trying to determine both 'who does what' and 'who should be doing what', with regulators and supervisors rather unenthusiastic participants.[11]
The United States is still, however, where most AML initiatives originate and, as will be subsequently discussed, where the inclusion of terrorist financing in the regime was instigated.

[9] Indeed, the track record of US authorities is patchy. A review of the Bank of Credit and Commerce International (BCCI) case showed failure of the authorities to investigate allegations of irregularity, a blurred set of policy objectives (BCCI had dealings with Panamanian dictator Manuel Noriega and played a part in the Iran-Contra affair), an undue private sector influence on the policy process and legal constraints in the pursuit of transnational offenders (Passas and Groskin, 2001). Later (in 1996), Citibank was investigated in relation to the money laundering of illegal funds held by Raul Salinas, brother of former Mexican President Carlos Salinas. Little of essence had changed in the tackling of money laundering by the time the Bank of New York (BONY) scandal erupted in 2000. BONY had entered into several corresponding relations with Russian banks, after it had been documented in Congressional testimony that up to forty percent of Russian Banks were controlled by organised crime (Robinson and Burger, 2000). This may suggest that anti-money laundering requirements needed strengthening but it also implies that banks were prepared to overlook the measures in place.
[10] The words of Dan Stipano, Deputy Chief Counsel at the Office of the Comptroller of the Currency; interview, Washington DC, June 2004.
[11] The problems of Riggs bank, the Washington DC-based favourite of embassy officials highlighted some of the institutional coordination issues of the US system. Essentially under the supervision of the Office of the Comptroller of the Currency, which was widely viewed as having 'failed' in its task, it brought to the fore turf issues and difficulties of coordination, especially with law enforcement agencies (US Senate, 2004 and Economist, 2005). The relatively large fine ($25 million) was intended to send a strong message but the wider banking community saw Riggs as a special case because of the unusual concentration of foreign embassy accounts and high risk customers.

A very different national environment is observed in Switzerland, where a tradition of self-regulation has been challenged in the context of a strengthening AML regime. Due to its banking secrecy provisions, Switzerland is particularly exposed and closely watched by competitors and the AML community as a whole. As a result, financial market actors both in the private and the public sector are keen to set the example and following UBS' reprimand for dealing with funds suspected to have links to Sani Abacha, the former Nigerian dictator, have been at the forefront of the adoption of global standards.[12] It is important to note, however, that though Switzerland has been involved in the FATF process from the outset, and while it has thus far withstood pressures to link money laundering to banking secrecy issues in ways that would significantly affect the financial industry, while not simply reacting, it is essentially following global trends in AML.[13]

Yet another set of issues emerges when examining offshore centres that are not members of FATF. As the FATF focus on NCCTs has shown, an important part of the global strategy against money laundering revolves around improving practices and promoting transparency in offshore centres. These represent 1.2 percent of the world population and account for 3.1 percent of the world's GDP yet handle a quarter of the world's financial assets (Levin, 2002). Offshore centers are traditionally seen as having the following characteristics: "minimal or no personal or corporate taxation; effective bank secrecy laws; few, preferably no, restrictions or regulations concerning financial transactions; and protection of the secrecy of transactions" (Palan, 2002: 155). Some analysts tend to view offshore centers and tax havens in general in terms of "parasitic state strategies," "where a state deliberately designs its policies to try to attract business and achieve self-enrichment in ways that are detrimental to global welfare and the rule of law" (Tranøy, 2002: 5-6). Offshore centres are seen to be "abusing the system of sovereignty to advance parochial interests" (Palan, 2002: 157).[14] In the case of developing nations, they may also be reluctant to adopt strict anti-money laundering rules as they might consider them damaging to their development strategy. As a result, some countries have few incentives to enthusiastically join the fight against money laundering and only strong leadership from other countries and the embarrassment of being blacklisted may persuade them otherwise (Simmons, 2001: 605-607).[15]

The preceding schematic overview of the global, regional and national levels of the emerging AML regime indicates that while the global and institutional character of the regime encourages regulatory diffusion, the priorities of certain actors in the G7

[12] For example, earlier in 2006, the Swiss authorities created a new watchdog body, the Federal Financial Market Supervisory Authority that grouped the former Federal Banking Commission, the Federal Office of Public Insurance and the Money Laundering Control Authority. The authorities expect that this new body will "carry more weight internationally" and that it will "help improve the image abroad of Switzerland as a financial centre" (eStandards Forum, 2006)

[13] Observations based on interviews with officials at the Swiss Banking Association, Basel, June 2004.

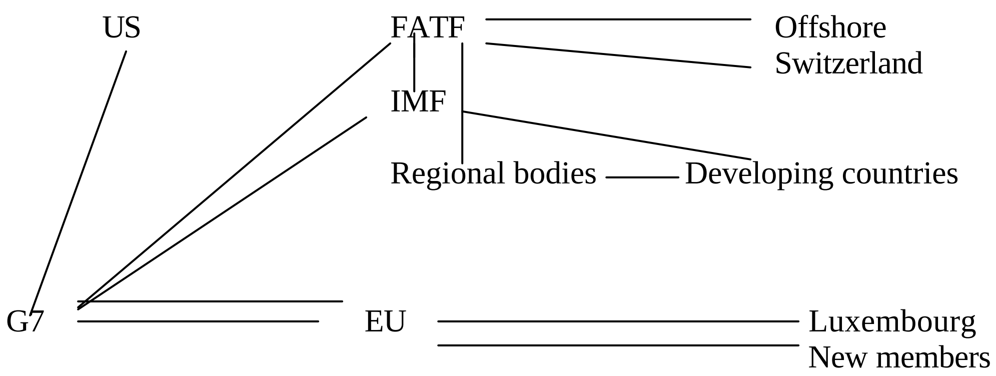
[14] Palan moves away from conventional explanations of tax havens and disputes that parochial interest is their original *raison d'être*. He argues that tax havens could not be abolished without seriously challenging the Westphalian notions of sovereignty but does not reject that tax havens do actually take advantage of loopholes (Palan, 2002).

[15] Sharman (2004) has examined the effect of blacklisting on the adoption of AML standards and legislation and has found it a potent coercive tool. Leadership and institutional dynamics such as IMF involvement are in all likelihood factors in the continuing globalising trend of the AML regime since the winding down of the NCCT list.

are predominantly defining these standards; offshore centres and the many developing countries who are members of the regional anti-money laundering bodies on the other hand, are mostly 'downloading' regulation.[16] Figure 1 illustrates regulatory influence channels; these will be further examined in the subsequent discussion on the legitimacy of the regime.

Figure 1: 3 levels of regulation generation:

Uploading	Diffusion	Downloading



The legitimacy test

Having established the principal characteristics of the AML regime, it is possible to assess the sources of its legitimacy as well as the legitimacy gaps in the process. Clark (2003) distinguishes between two discourses of legitimacy. One relates to the systems of rule while the other focuses on the normative principles that determine who is included: concerns should not only focus on who governs but also, whose voices are heard. When examining the legitimacy of global financial governance arrangements, therefore, we need to look at the legitimacy of policy priorities, of the actors and of the structure as a whole.

Policy priorities

As indicated in earlier sections of this paper, much of the political drive in building a robust AML regime stems, at least in public in the importance of dealing with a series of crucial public policy issues. The first set of reasons for addressing money laundering are its effects on the economy and the financial system. Involvement in money laundering activities can affect public confidence in the financial system (Helleiner, 1999: 59) and affect legitimate entities in the private sector. Launderers regularly use front operations such as shops and restaurants, which primarily rely on illegal activities for profit. In this context, legitimate businesses often find themselves undercut and find it difficult to compete. Another consequence is the distortion of

[16] Donaghy and Clarke (2003) offer useful conceptual tools that help understand offshore centres' adaptation to the regime: they focus on monetary ambience, onshore patronage, legal culture, regulatory jingoism and local embeddedness. In their work, these tools help explain the differences between four distinct type of offshore centre: Monaco, Switzerland, the Isle of Man and Cayman Islands.

financial market operations, as large sums of money may enter and leave the system suddenly, thus affecting the liquidity of financial institutions. A more drastic set of effects could lead to loss of control of economic policy, as in some developing countries, the sums laundered may correspond to a substantial part of national wealth. Money laundering activities can also alter investment patterns as funds are allocated to sectors where they do not risk detection and not necessarily to ones that are profitable or in need of investment. Developing countries may also see their privatisation policies hampered should launderers become the main beneficiaries of such schemes and also, suffer reputation damage, if they are seen to tolerate such activities on their territory. Finally, states everywhere are affected through loss of tax revenue (McDowell and Novis, 2001).

The second set of grounds focuses on corruption in the developing world, whereby criminal groups can use laundered money to consolidate their place in the political system and further contaminate the local private sector. In some cases, such criminal organisations can use their position to exercise coercive power and intimidate through violent activities and also, damage the institutions of the state by utilising their wealth to corrupt public and private officials (Williams and Baudin-O'Hayon, 2002). It is understood that the long- term development of such states is harmed by these corruptive elements.

The third set of incentives for targeting money laundering activities is defined in terms of social costs, from policing and health costs in the countries that deal with the effects of drug use, to the wider implications of the "pay-offs" of crime for corruption in the public and private spheres (McDowell and Novis, 2001). In these cases, the focus is on law enforcement and public policy, dealing with the consequences of money laundering and of the activities that generate the illicit funds.

The fourth set of motives in the fight against money laundering deal with the eradication of the activities that produce the funds in the first place. Organised crime is most commonly manifested in drug trafficking, but illegal alien smuggling is also on the rise. At the same time, human trafficking, predominantly the trafficking of women and children for the purposes of the sex trade, is a source of substantial financial rewards for criminals, with most developed countries acting as recipients. Other activities that can lead to money being laundered include illegal business deals on cars, antiques, endangered species or arms (Williams and Baudin-O'Haydon, 2002: 131).

The final driving force for attacking money laundering practices is the extent to which the funds thus "cleaned" are used in ways that affect global stability. Until recently, such concerns concentrated on the political situation in countries in the developing world; drug-trafficking centers such as Colombia and Afghanistan have also been politically unstable and violent, whereas "blood diamonds" in Angola and Sierra Leone have helped finance civil wars (Williams and Baudin-O'Hayon, 2002: 133-134). The events of 11 September 2001 have, however, shifted the focus to a much more global scale, rendering the fight against money laundering synonymous to the "economic war on terror."

The above are all crucial public policy issues that legitimately require attention. It is unclear, however, that the AML regime is an efficient way in which to address them and whether they constitute more that political rhetoric; while 'doing the right thing' by making it more difficult for criminals to benefit financially from their crimes is a worthwhile pursuit, widespread concerns about the costs of the regime, especially for non-OECD countries, point to the severe shortcomings in the regime's potential with respect to these goals. Moreover, the less official reasons behind the AML regime, competitive pressures and foreign policy, are never far behind in the reasoning of officials at the forefront of AML developments.[17] These considerations, therefore, offer us a perception of legitimacy but do not make a convincing case for the need of an AML regime.

The principal actors

Looking at the actors involved in the AML regime offers further insights to its legitimacy. At the core of the regime, FATF promotes global standards but is essentially a political organisation in its membership and practices; while its scope is global, its website states that to qualify for membership a country has to be "strategically important". Russia, for example, joined FATF soon after being de-listed from the NCCT list, and this is often seen as indicative of the political character of FATF, as well as the organisation's emphasis on form rather than practice.[18] Attempts to broaden participation in the AML regime have been restricted to the proliferation of regional agencies.[19] The narrow membership but also the peer review procedures and, to this date, limited reprimands mean that FATF's legitimacy can and has been questioned. Within FATF, the NCCT process has also been criticised, both for being wound down despite its effectiveness in changing regulatory and legislative frameworks and, most importantly, for being arbitrary and lacking a consistent methodology. For many commentators on the AML regime, it reinforced the political character of FATF and highlighted the influence of core G7 countries.[20]

The role of the IMF in the process has not been without controversy either. In the first place, the IMF started as a reluctant participant, succumbing to US and G7 campaigning, and 'piggy-backing' money laundering issues on top of the extending emphasis on its financial integrity work. Endorsement of the FATF recommendations was based on a narrow compromise that included winding down the NCCT list and

[17] In a series of interviews in the United States in the summer and autumn 2004, 'maintaining a level playing field', 'ensuring the competitiveness of the financial sector' and 'reducing unfair competitive advantage of inadequately regulated jurisdictions' were consistently cited as important reasons for the global scope of the AML regime (interviews with officials in the US Treasury -FinCen and FATF delegation-, the Office of the Comptroller of the Currency and the Federal Reserve Board). Officials in Congress and the General Accounting Office also explicitly inked the AML regime and FATF to US foreign policy priorities and national security.

[18] For an account of the status of AML policies in Russia, see Favarel-Garrigues (2003).

[19] At the UN crime conference in Bangkok in 2005, core countries blocked a drive by developing countries for a new UN AML treaty. The focus remained on existing FATF standards instead, despite concerns in many developing countries that the FATF recommendations were addressing mostly banking issues and were less effective in dealing with problems associated with real estate.

[20] One often cited example is Dubai; the United Arab Emirates were reviewed in the last round of NCCT reviews in 2002 and were found to be in line with the AML regime. Yet anecdotal evidence, in both the private and public sectors, suggests that while not formally on the list (or indeed on unofficial lists used by private institutions in their risk assessments), Dubai is seen by many regime participants as 'problematic' (anecdotal evidence discussed in several interviews with public and private sector officials in the United States, summer 2004).

emphasising consensus, cooperation and a fair and transparent methodology instead. The inclusion of the IMF in the regime addressed some of the membership shortcomings of FATF, however, it also raised the question of whether financial assessments can deal with standards closely linked to criminal justice in an efficient and legitimate manner.[21] The 'baggage' of the IMF also worried some money laundering activists who do not believe that its 'soft touch' can produce results.[22]

The structure

As the nature of regulation generation indicates, the structure of the AML regime is defined by asymmetries of influence and standard formulation. The structure, however, is also characterised by an unbalanced process of coordination and cooperation between regulators and supervisors on the one hand, and law enforcement agencies on the other. The relationship of regulators and of the financial institutions of which they are in charge with law enforcement is patchy, often adversarial or inconsequential. Tensions can arise from the lack of established procedures but also, from different interpretations of the results of anti-money laundering efforts; while the financial sector assesses success in terms of lack of problematic instances, law enforcement bodies concentrate on quantifiable confiscated sums and convictions. The strategies of regulators and law enforcement agents are indeed rather different; while the first group focuses on the process, including persuasion, cooperation, self-regulation, risk-based discretion and sometimes, "private remedies", the second stresses prosecution, external regulation, and public justice and punishment (Croall, 2003: 46). In essence, the AML regime is trying to reconcile two rather different goals: compliance and results. This brings about contradictions and further hampers the effectiveness and by extension, the legitimacy of the emerging regime.[23]

Introducing terrorism

Another dimension of the AML regime, and a controversial one, at least in academic circles, is the inclusion, post-9/11, of provisions for the combating of terrorist financing (CFT). Indeed, fighting terrorist financing was an "uncontroversial" early measure by the international community and brought about immediate effects with the freezing of assets (Navias, 2002: 58-59). FATF responded by designing eight "Special Recommendations on Terrorist Financing", which included the criminalisation of the financing of terrorism, the creation of provisions for freezing and confiscating assets, the requirement to report suspicious transactions with potential criminal links, the imposition of anti-money laundering requirements on alternative remittance systems and the review of laws dealing with non-profit organisations. These efforts were mirrored in the adoption of related standards at the regional level and were further

[21] This assessment of the role of the IMF is partly based on an interview with John Abbott, Technical Assistance Advisor in the Monetary and Financial Systems Department of the IMF, Washington DC, June 2004.

[22] Elise Bean, Staff Director and Chief Counsel to the Minority Permanent Subcommittee on Investigations of the US Senate called the IMF's prospects in the AML regime "pathetic", suggesting a history of tolerating corruption. Interview in Washington DC, June 2004.

[23] It is interesting to note that the question 'is the regime effective?' does not appear to be popular in standard-setting circles; the consensus emerging from interviews with public sector officials is that the question is not relevant or worth addressing in the first place.

consolidated through national regulation and legislation, most notably the U.S. Patriot Act.[24]

In practice, however, these measures can only have limited effect and are not guaranteed to achieve the aim of reducing the financing of terrorism. When the U.S. Federal Bureau of Investigation attempted to design a profile of the way terrorists may use banks, it highlighted the practice of making a large deposit and withdrawing small amounts of cash at frequent intervals; yet practitioners say that this profile is consistent with that of approximately a quarter of a bank's customers (The Economist, 2002). Forensic work by FinCen on the 9/11 terrorists has also shown that money laundering tools cannot pro-actively spot the financing of terrorism.[25] An additional problem is one of methodology: the funding of terrorism is often based on resources that are legitimate, requiring banks to essentially make value judgments about future use of money, as well the potential of a customer who has not to this day acted unlawfully to do so in the future. This is a subjective and time-consuming strategy that can also lead to discrimination on the basis of ethnic background and create biases linked to personal characteristics; it is also one that requires consistent and up-to-date intelligence information. Charities are also put in the spotlight and though many have been targeted with regards to their knowing or unknowing support of al-Qaeda terrorists, other than encouraging charity verification field trips, standards remain vague and cannot produce a comprehensive approach (The Economist, 2003). Alternative remittance systems have also been targeted, most notably *hawala*,[26] which avoids wire transfers, paper trails and formal banking (Biersteker, 2002; de Goede, 2003). Finally, the sums involved in the financing of terrorism are relatively small, even in comparison to other activities that are related to money laundering. It is often commented that the attacks of 11 September 2001 may have cost less than $500,000; this amount could be raised with relative ease, as transactions not exceeding $10,000 do not require the same level of scrutiny.

It is still early to assess the impact of the terrorist attacks on long-term money laundering measures and practices. Nevertheless, a renewed impetus has put anti-money laundering firmly on policy and regulatory agendas, and public authorities in developed financial centres are taking the subject very seriously. The pattern of incentives for the private sector has also been adapted, and the shift reflects the "patriotic" element of the "economic war on terror." Significantly, early indications are that most of the measures taken since the terrorist attacks of 2001 will have little impact on the financing of terrorism; in fact, its is argued that they have failed to "create positive economic incentives for compliance in order to counteract the

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[24] The speed with which such a fundamental shift took place is quite astonishing; FATF and other relevant bodies promptly produced CFT recommendations (despite FATF agreement prior to 9/11 of not addressing such issues within the FATF framework) and the Patriot Act was passed in three weeks.
[25] John Byrne of the American Bankers Association goes further in stating that "no system in the world can detect that"; remarks made during an interview, Washington DC, June 2004.
[26] *Hawala* is the Arabic word for trust; the system consists of global money transfers based on a telephone call and the trust between *hawala* dealers. A customer in Country A goes to the dealer with an amount of cash – the dealer telephones a counterpart in Country B, who proceeds to give an equivalent amount of cash to the customer's designated recipient. Money does not exchange hands and a "debit" system operates between dealers; the dealer in Country A will in time operate an opposite deal. *Hawala* provides a "rapid, reliable and relatively cheap means for migrant workers to remit cash to poor and illiterate families" (FitzGerald, 2004).

existing disincentives for disclosure experienced by financial intermediaries and regulation jurisdictions" (FitzGerald, 2004).

It also remains unclear whether the AML regime is the appropriate setting for dealing with terrorist financing. This debate at the policy level may be closed but while in the United States, the link between money laundering, terrorist financing and national security is widely acknowledged, elsewhere, it is simply accepted as a political decision that everyone is learning to live with.

The role of the private sector

Financial institutions have some straightforward incentives to take AML measures seriously, mainly to do with reputational and legal issues (Basel Committee, 2001). Indeed, they have adopted a series of procedures to combat money laundering and comply with regulatory requirements. These include special identification measures, the "know your customer" mantra applied to all financial services; monitoring processes based on internal systems and a comprehensive system of dealing with suspicious activity; up-to-date training programs; the implementation of auditing procedures and accountability measures such as signed attestations of knowledge of anti-money laundering measures, and evaluations; the setting-up of specialized anti-money laundering units; and the full participation and commitment of senior management (Vitale, 2001).

Major banks have gone further and taken the initiative to create appropriate standards by establishing the Wolfsberg Group of Banks.[27] The group was created in 2000 and issues global AML and CFT guidelines for international private banks, focusing on correspondent banking relationships.[28] The reasoning behind such a voluntary code of conduct is the harmonisation of principles and the strengthening of private sector reputation and credibility (Pieth and Aiolfi, 2003).

Despite those efforts, some real problems remain. "When the total costs to the banking system of the myriad anti-money laundering reporting requirements are correctly measured, few anti-money laundering efforts are cost effective" (Rahn, 2003). This is indeed confirmed in a recent survey by the American Bankers Association, which places Bank Secrecy and Anti-Money Laundering requirements first in the ranking of compliance costs faced by banks (ABA Banking Journal, 2003: 35, 38). The Patriot Act has further increased requirements but it is claimed that financial institutions have yet to implement centralised customer-identification systems (or even come to decisions as to how to go about it) and that training staff and building compliance expertise is a costly and lengthy process. At the same time,

[27] The group consists of: ABN Amro, Banco Santander Central Hispano, Bank of Tokyo-Mitsubishi, Barclays, Citigroup, Credit Suisse Group, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan Chase, Société Générale and UBS. The anti-corruption non-governmental organisation Transparency International was also instrumental in the initiative. For more information, see www.wolfsberg-principles.com.

[28] Correspondent banking refers to the relationship banks have with other banks in places where they do not have branches, and consists of providing an account and related services to the other institution for payments and other financial services.

the Act does not provide for additional funding for enforcement agencies; this questions the effectiveness of the current system of private sector incentives.[29]

These private sector concerns emphasise the "private costs of a public policy" (Serrano and Kenny, 2003) and to some extent exemplify how some regulatory measures are technical and difficult to implement as well as the growing trend towards passing compliance responsibility to the private sector. They also highlight the less tangible costs associated with assigning the legal role of "capable guardian" to private sector officials (Levi and Maguire, 2004: 417). As a result, financial institutions are learning to focus on the process of compliance, with public agencies already complaining of the high volume of suspicious activity reports being filed.

Another interesting by-product of the AML/CFT regime, however, has been the development of global compliance programmes that also serve as sophisticated database and marketing tools for the major financial institutions. Indeed, at the 'high end' of the market, banks and securities firms are working with complex compliance programmes that produce consistent standards for their global business and allow for the identification of clients, the monitoring of their transactions, the reporting of suspicious activities and the regular update of global regulatory and legal requirements. The programmes are developed following a risk-based approach, where customers are categorised as high, medium or low risk at various stages in their dealings with the financial institution according to a variety of parameters, the most important of which seems to be the country factor. While the initial cost of such programmes is high, financial institutions admit that it has several valuable uses, including getting to know more about clients' needs and customise products accordingly, offer global consistency for clients (corporate and individuals) who have global financial relationships, and create sophisticated 'valuable customer' profiles.[30]

The burden of compliance is more significant for smaller, local institutions, where 'know your customer' and reporting requirements are less automated. While a risk-based approach is also in operation (for the private institutions and their regulators alike) it is unclear whether in the case of irregularity such considerations will carry weight with respect to fines and criminal investigations.[31] The reactive role of the private sector in the AML/CFT regime thus has a greater effect on small institutions, highlighting the legitimate concern of this part of the industry for policies that are proportionate to the effectiveness of the regime.

[29] Reuter and Truman (2004) of the Institute of International Economics estimated the gross financial costs of the US AML regime for 2003 at $7bn ($25 per capita): government/public sector $3bn; private sector compliance $4bn, general public (costs passed on by the private sector) $1bn.
[30] Observations based on confidential interviews with compliance officers in several banks and securities firms in Zurich and New York, May – June 2004.
[31] Hartsfield Capital Securities, a relatively modest broker-dealer registered in the US State of Georgia, faced fines amounting to half of its assets following irregularities in its AML provisions 2002-2003.

The Politics of the AML/CFT regime: what lessons for IPE?

With few exceptions, and despite accepting the inevitability of the AML/CFT regime, most participants remain puzzled at the need to deal with these issues; this is a potent reminder that politics in IPE matters. Can the regime, however, still find legitimacy? For this, a number of questions need to be addressed.

1. Is money laundering a genuine threat to the financial system and do financial flows facilitate it? Is some money laundering an acceptable price to pay for efficient and adaptable financial markets and would the type of measures that would eradicate money laundering be counter-productive in that respect?

2. How is the AML/CFT regime linked to public policy goals? Beyond the political rhetoric, studies have shown that, especially in the developing world, money laundering and corruption are often linked with detrimental results.[32] Are the political will, and the associated incentives, however, strong enough to bring about lasting changes in practice? In using the AML regime as part of a development strategy, might there be political space for a discussion on capital controls?

3. Does the AML/CFT regime work and, indeed, can we ask this question? How can we best estimate success and assess the effectiveness of the measures? Are these the best possible measures and would we be better off without them? And finally, how much detection is enough detection?

4. Are we turning regulators and banks into law enforcers? How can law enforcement be best integrated in the institutional framework and at which level does policing best work? Guidance, feedback and cooperation are to be encouraged but the differing objectives of regulators and law enforcers need to be reconciled.

5. The marginalisation of distinct groups of individuals (students, migrants, black economy participants) through 'know your customer' banking practices, and the increasing criminalisation of cash, though addressed in academic circles (de Goede, 2003; Amoore and de Goede, 2005) remain outside the scope of official concerns. Can the AML/CFT still be redefined in less technologically deterministic terms?

6. Finally, if, despite the shortcomings of the approach, the link between AML and CFT is no longer questioned, could the opportunity to deal with financial crime in general be grabbed? Initial agreement on the establishment of FATF was reached on the basis that it would not address tax issues; could tax evasion, however, be considered as an associated issue in meaningful, information-sharing processes?

[32] See, for example, Duffy (2000) for an analysis of corruption and money laundering in the case of ecotourism in Belize.

Conclusions

Officials at the US General Accounting Office had the following assessment of the AML regime: "no one would actually design it as it is; but it would be counter-productive to introduce something new".[33] While this may be a sound procedural approach, the legitimacy failures of the drive against money laundering and terrorist financing call for a broader evaluation of the interests represented and promoted in the regime. The damning appraisal of the AML/CFT regime in this paper is based both on the apparent inefficiency of a 'proceeds of crime' and 'proceeds for crime' approach but also, on the parallel, unofficial concerns that are served by AML and CFT measures. There is a clear need to address complex public issues such as drug trafficking, corruption and terrorism; the resulting policy, however, amounts to little more than inflated rhetoric and offers bureaucratic solutions to ill-defined problems. Similarly, despite the emphasis on financial integrity, there is a strong perception of competitive pressures from specialised and offshore financial centres; the globalisation of AML/CFT standards appeases some of those worries. Finally, the private sector (or at least, segments of it), at the centre of the theoretical 'cost-benefit' analysis of the AML/CFT regime is ultimately, not a loser; the major players have used this opportunity to develop sophisticated marketing techniques and to consolidate their expertise. The final verdict on the regime is at best, 'much ado about nothing', at worse, an elaborate cosmetic exercise with detrimental effects on the weaker actors of the system.

[33] Remark made during an interview, Washington, DC, June 2004.

Appendix I
The global anti-money laundering regime: key measures and initiatives

	Global level	USA	Europe	Private Sector
1970		Bank Secrecy Act		
1980	Offshore Group of Banking Supervisors		Council of Europe: Measures Against the Transfer and Safekeeping of Funds of Criminal Origin	
1986		Money Laundering Control Act	UK: Drug Trafficking Offences Act	
1988	UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances			
1989	Financial Action Task Force –FATF			
1990	FATF Recommendations; Caribbean FATF			
1991			European Commission: First Money Laundering Directive	
1995	Egmont Group of Financial Intelligence Units		Europol	
1996	Revised FATF Recommendations			
1997	OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions			

	Global level	USA	Europe	Private Sector
1998	OECD Report on Harmful Tax Practices			
1999	Eastern and Southern Africa Anti-Money Laundering Group			
2000	FATF: List of Non-Cooperative Countries and Territories; OECD List of Tax Havens with Harmful Tax Practices; Regional Anti-Money Laundering Task Force, Latin America; UN Convention Against Transnational Organised Crime			Wolfsberg Principles
2001	FATF Special Recommendations on Combating the Financing of Terrorism; Basel Committee: Customer Due Diligence	US Patriot Act, Title III: International Money Laundering Abatement and Anti-Terrorist Financing Act	European Commission: Second Money Laundering Directive	
2002	FATF/IMF/World Bank Agreement on Anti-Money Laundering Pilot Project		Europol mandate expanded; UK: Proceeds of Crime Act	Wolfsberg Principles on Combating Terrorist Financing
2003	Revised FATF Recommendations; UN Convention Against Corruption			

	Global level	**USA**	**Europe**	**Private Sector**
2004	IMF/World Bank include FATF standards to their Financial Sector Assessment Programmes; Eurasia Group; North Africa and Middle East Group			
2005	UN Security Council Resolution 1617		European Commission: Third Money Laundering Directive	
2006		Patriot Act renewed		International Association of Money Transfer Networks

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