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Money Laundering Legislation Would Discourage International Cooperation in the Fight Against Crime

Since September 11, the President and Congress have been waging a war on terrorism. Besides a military campaign, lawmakers are seeking ways to track down the money used to fund the attacks on America, both to help to identify the guilty and to stop the funding of any new terrorist strikes. Two potential solutions have emerged. On one side are those who believe lawmakers should expand the network of mutual legal assistance treaties (MLATs) and other international agreements to fight crime. These MLATs have proven to be successful, and could be even more beneficial if new procedures are developed to ensure prompt and effective action in the case of serious offenses like terrorism. The other approach is to expand money laundering laws and “know-your-customer” regulations and apply them on an extraterritorial basis. Senator Carl Levin (D-MI) and Senator John Kerry (D-MA) are leading supporters of this approach. This analysis finds that there is little evidence that domestic money laundering laws have helped law enforcement in the U.S. and that this approach would be similarly ineffective on a global basis. The cost of such an approach far exceeds the benefits and would make U.S. banks and financial institutions less competitive. American policy should seek to make other nations allies in the war against crime and terrorism, not hinder the U.S. financial services industry.

By Andrew F. Quinlan¹

In response to the recent terror attacks, lawmakers have been investigating every possible option to help punish the guilty and deter future attacks. One potential weapon in the war against terrorism is the ability to “follow the money” that financed the attacks. In addition to helping track down the terrorists that launched the September 11 attacks, this type of ability hopefully would allow law enforcement to investigate the “money trail” of those suspected of planning new attacks.

While there is widespread agreement on these goals, there is not agreement on the tools to achieve these goals. On one side are those who believe lawmakers should seek to expand the network of mutual legal assistance treaties (MLATs) and other international agreements to fight crime. This cooperative approach would create an international alliance, with members committed to aiding in the investigation and prosecution of universally recognized crimes like terrorism, murder, fraud, and drug running. Existing MLATs have proven to be successful, and would be even more beneficial if new procedures are developed to ensure prompt and effective action in the case of serious offenses like terrorism.

This approach also will reveal nations that are unwilling to help and deserving of sanctions, either because they refuse to negotiate a MLAT or because they fail to comply with one that is in force.

¹ The author would like to thank Bruce Zagaris of Berliner Corcoran & Rowe and Daniel Mitchell of the Heritage Foundation for their assistance in the preparation of this paper.

The other approach is to expand money laundering laws and apply them on an extraterritorial basis. Senator Carl Levin (D-MI) and Senator John Kerry (D-MA) are leading supporters of this approach. Levin's legislation, S. 1371, the so-called Money Laundering Abatement Act, prohibits U.S. financial institutions from dealing with certain foreign banks and imposes heavy regulation on other international transactions. Kerry's bill, S. 398, entitled the International Counter Money Laundering Act, is perhaps even more extreme. It grants the Secretary of the Treasury broad and unchecked powers to impose regulations and even to sever ties – or at least threaten to sever ties – with many countries' financial service industries.

The Levin and Kerry legislation are being portrayed as weapons in the fight against terrorism. But the bills are more likely to undermine international cooperation against crime by reducing political and economic ties with other nations. While some provisions of the Levin and Kerry bills are worth exploring, the core focus of the legislation is misguided. Most importantly, nations will have little reason to cooperate if American policy targets their financial services industries.

But this is not just a debate over how best to combat crime. Adding insult to injury, the proposals would impose costly regulations on the U.S. financial services industry, drive capital out of the U.S. economy, and harm the competitiveness of American banks. The legislation requires that U.S. banks must undertake burdensome new tasks if a foreign bank and/or its accounts fall into certain categories. These rules probably violate national treatment and possibly most favored nation provisions in bilateral investment treaties and the WTO. Combined with the recent Qualified Intermediary Regulations, the laws would impair the flow of foreign capital to the American economy.

Similar legislation, backed by the Clinton administration last year, did not obtain sufficient support in the 106th Congress. Opponents included privacy advocates, banks and other financial institutions, and Republican legislators. The legislation failed, in part, because it represented the "internationalization" of the infamous know-your-customer (KYC) rules that federal regulators attempted to impose back in 1999. These regulations would have required private financial institutions to spy on their customers, in complete disregard for due process legal protections and Constitutional protections. Ordinary Americans, the financial industry, and civil rights groups vehemently opposed the regulations, which led to their withdrawal. Congress later ratified that decision, unanimously voting to disapprove the anti-privacy measures.

Threat to American Interests

Because lawmakers are anxious to do everything possible in response to the terrorist attacks, these proposals have been given a new lease on life, and Senators Levin and Kerry are now seeking to attach their legislation to a broader anti-terrorism package. If approved, however, these bills likely will boomerang against the United States because we are trying to impose regulations for the rest of the world that are costlier than the ones that apply domestically.

The Financial Action Task Force (FATF), for instance, has rated the U.S. at the bottom of many anti-money laundering regulations. The FATF does not look at costs and benefits of regulations, so this is not necessarily a bad thing, but it does illustrate that any global effort to impose more onerous regulations almost certainly will result in attacks on American laws. Indeed a number of persons have already cited a GAO 2000 report that shows that U.S.-based corporations have been used for anonymous accounts and money laundering, especially by Russians. And while U.S. lawmakers are seeking to penalize foreign financial service providers, Montana and Colorado have

created offshore banking centers. These institutions are advertising secrecy and regulatory flexibility, much to the dismay of foreign governments, which understandingly view the U.S. as having a double standard.

Ironically, many of the jurisdictions targeted by supporters of the Levin and Kerry bills already have imposed stringent regulations on their financial services industries in reaction to international pressure. As a result, these jurisdictions have lost a significant share of international financial services. Yet their policies – such as abolishing bearer shares and subjecting non-financial professionals to broad anti-money laundering laws – are measures lacking in the U.S.

Little wonder, then the many nations are considering reciprocal protectionism if the Levin and/or Kerry legislation is approved. This will compound the damage resulting from foreign investors, already angry about the loss of privacy and/or rising costs of complying with the Qualified Intermediary regulations and other unilateral and extraterritorial U.S. reporting laws, deciding to withdraw capital from the U.S.

Weighing Costs and Benefits

Instead of rushing to enact legislation that will hinder the fight against international crime, lawmakers should move carefully. They should review whether current laws are effective before enacting broad new measures. To quote a recent editorial in the London Times:

Sifting through millions of financial transactions or placing onerous burdens on banks, accountants and lawyers to report “suspicious” activity is of questionable efficacy in the fight against money-laundering. It makes the obligation of public authorities passive: in this model they await reports from bank managers, accountants, lawyers and other professionals, rather than taking active steps to deploy crime-fighters to identify, pursue and indict criminals.²

The Heritage Foundation has reached similar conclusions. In a report last year on international tax competition, the Foundation wrote:

Also missing from the discussion is any cost-benefit analysis of money laundering laws. There are 700,000 daily electronic money transfers involving \$2 trillion. With this magnitude of transactions, trying to find criminal money by asking customers personal questions may be like looking for a needle in a haystack. In any event, it is not very successful. The Treasury Department has estimated that 99.9 percent of the criminal money coming into the United States is successfully laundered. Other countries such as Germany have reached similar conclusions about their own financial systems. “Dirty money,” therefore, is not a problem unique to low-tax nations and it is not necessarily associated with financial privacy. Indeed, as the U.N. reports, “Money laundering can proceed very easily without bank secrecy; in fact, it may well be that launderers avoid it precisely because it acts as a red flag.”³

Finally, it is worth pointing out that money laundering statutes and regulation also raise important issues about the rule of law, and the impact on privacy and civil rights. Specific concerns

² Graham Mather, “Money-laundering fight could hit the wrong targets,” *The Times* (UK), Tuesday, October 2, 2001. Available at <http://www.thetimes.co.uk/article/0,,37-2001341189.00.html>.

³ Daniel J. Mitchell, “An OECD Proposal To Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy,” Backgrounder No. 1395, The Heritage Foundation, Washington, DC, September 18, 2001. Available at <http://www.heritage.org/library/backgrounder/bg1395.html>.

include whether the laws unnecessarily and unfairly target persons and transactions from foreign jurisdictions and threaten the loss of property without evidence of criminal activity. The proposed laws – and existing laws and regulations – undermine the right to be free from unreasonable search and seizure. Money laundering regulations also undermine the Constitutionally guaranteed presumption of innocence.

Conclusion

The executive and legislative branches are right to be concerned about crime, and the profits that flow from illicit activity. This is why money laundering has received substantial attention and has been the subject of new federal and state criminal and regulatory laws. But the new anti-money laundering regime has come at the expense of privacy and there is little evidence that these regulations have had an impact on crime. Moreover, this approach has privatized law enforcement, making detectives of banks, financial institutions, and an increasing segment of our society. Counter-money laundering has become a sacred crusade under the auspices of fighting crime, one that has fueled the creation of a significant bureaucracy.

And now, even though there is scant evidence that domestic money laundering laws have helped law enforcement, some lawmakers want to impose these laws on a global basis. If there exist real money laundering abuses in foreign jurisdictions, then the best way to address them in a way that does not make U.S. banks and financial institutions uncompetitive. Mutual legal assistance treaties, combined with effective procedures to ensure timely and full compliance, are the way to act together with foreign jurisdictions in a cost-effective manner.

To eliminate a barrier to the expansion of MLATs, the tax harmonization initiatives of the European Union and Organization for Economic Cooperation and Development should be withdrawn. Many low-tax jurisdictions with financial service centers want MLATs with America and other nations, but they correctly refuse to be bullied into “information exchange” proposals that would force them to put the tax laws of other nations above their own.

This is particularly important considering the events of September 11. American policy should seek to make other nations allies in the war against crime and terrorism by extending the network of mutual legal assistance treaties and improving their effectiveness. Needless to say, America’s ability to make this happen will evaporate if misguided laws are approved.

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