1. Introduction

1.1. MONEY LAUNDERING, RISK MANAGEMENT AND BANK SECRECY

ABN AMRO is one of the world’s largest banks. Incorporated in the Netherlands with its headquarters in Amsterdam, it has some 3000 branches and subsidiaries spread over 60 countries. It is valued at some US$830 billion. In December 2005 the US Federal Reserve Board, the New York Banking Department and the Illinois Department of Financial and Professional Regulation fined ABN AMRO, US$80 million for violating state and federal Anti Money Laundering (AML) rules and regulations (US Federal Reserve et al. 2005). US authorities, in conjunction with the Central Bank of the Netherlands, found that ABN AMRO lacked adequate risk management procedures and legal review methods; lacked effective systems of corporate governance and audit; transferred and cleared funds and issued letters of credit that contravened US laws; failed to adequately report suspicious activities; did not follow-up on negative findings from internal audits; failed to investigate enquiries referred to its New York branch and overstated its due diligence procedures when dealing with ‘high-risk’ correspondent banking customers (De Nederlandsche Bank NV, US Federal Reserve Board, State of Illinois and the New York Banking Department 2005, pp. 2–4). Dutch and US authorities found that ABN AMRO had engaged in ‘unsafe and unsound practices’ contravening the laws of both countries (De Nederlandsche Bank NV, US Federal Reserve Board, State of Illinois and the New York Banking Department 2005, p. 5).

In levying its US$80 million fine, US authorities found ABN AMRO to be in contravention of three out of the four AML compliance criteria. For example, in failing to maintain an adequate system of internal controls the bank also failed to integrate publicly available data regarding ‘shell companies’ into its automated monitoring systems. Between August 2002 and September 2003 the North American Regional Clearing Centre processed 20,000 wire transfers totaling US$3.2 billion for shell companies (which can be Special Purpose Entities [SPEs]) providing corporate vehicles for clients from Russia and the former Soviet Union. These shell companies incorporated in the US, not some exotic offshore ‘tax haven’ jurisdiction, could be used to conceal the beneficial identity of their shareholders, including criminals disguised as ‘investors’
seeking to launder funds (US Department of the Treasury Financial Crimes Enforcement Network 2005, p. 5). US regulators observed that:

The New York Branch of ABN AMRO failed to adequately evaluate this readily available information and implement sufficient transaction monitoring systems and controls for shell company activity. Instead, and only upon strong urging from regulators, the New York Branch of ABN AMRO commenced an analysis of the activity in August 2003 – one year after many of the transactions occurred (US Department of the Treasury Financial Crimes Enforcement Network 2005, p. 5).

The Financial Crimes Enforcement Network also reported that ABN AMRO’s New York branch failed to provide an adequate number of personnel to manage compliance with the US Bank Secrecy Act (BSA) and the staff that did work in this area received insufficient training. Staff ‘in critical positions’ appeared to ‘have a lack of knowledge on the detection and reporting of suspicious transactions – a deficiency especially serious considering the substantial risk of facilitating money laundering that confronted the New York Branch of ABN AMRO’ (US Department of the Treasury Financial Crimes Enforcement Network 2005, p. 6).

1.2. WIRING IRAN, SANCTION BUSTING WITH LIBYA

This volume seeks to estimate national (with case studies of the Netherlands and Australia) and global volumes of money laundering. Flows of laundered funds have definitive economic effects, particularly on growth and costs of crime. However, estimates of both the amounts and effects of money laundering need to be situated within their legal and regulatory contexts. What is money laundering in one country is not necessarily the same offence in another state. This has an impact on what and how money laundering is measured and how the amounts and effects are calculated. If anything shows more clearly the problems of defining money laundering and providing an accurate global base-line for measuring the amounts and effects of laundered funds, it was ABN AMRO’s dealings with Iran and Libya. Half of the US$80 million fine levied against the bank was authorised by the Office of Foreign Assets Control (OFAC), part of the Department of the Treasury. OFAC regulates and prohibits specified transactions between the US and Iran and Libya (US Federal Reserve et al. 2005). The US Libyan Sanctions Regulations gave force to United Nations (UN) resolutions imposing economics measures against Libya in response to past involvement with international terrorism. All countries agreed to these sanctions and therefore any violation of them could give rise to allegations of money laundering that would be valid across borders. The Iranian Transactions Regulations however, by which Washington imposes sanctions unilaterally on
Iran, are specific to the US. No other major trading nation imposes such measures against Iran. Therefore, a US company dealing surreptitiously with Iran and without approval of the OFAC could be charged with money laundering. Any non-US company in a third country however, is perfectly free to trade with state-owned and private Iranian firms. Because domestic laws govern these transactions as it applies in specific third countries, and not US laws, there are no money laundering charges to be answered. In other words, what constitutes money laundering under US law may not constitute money laundering anywhere else.

ABN AMRO is defined as a foreign bank in the US, including its New York and Chicago Branches. Despite this, OFAC regulations covering Iran and Libya apply to ABN AMRO regardless of whether or not transactions are routed through the US or a third country if they involve US individuals and/or corporate entities. These regulations effectively blur the boundaries between the US and third countries. Up until August 2004 ABN AMRO’s New York branch processed wire transfers remitted by Bank Meli Iran. It also honored Bank Meli’s letters of credit. These transactions were sub-contracted out to ABN AMRO’s third-country branches, which then obscured any reference to Bank Meli (US Federal Reserve et al. 2005, p. 5).

ABN AMRO’s Chicago and New York branches were simultaneously dealing with a Libyan state chartered bank registered in the United Arab Emirates, the Arab Bank for Investment and Foreign Trade (ARBIFT). US authorities observed that

‘Prior to August 1, 2004, the Chicago Branch of ABN AMRO cleared US dollars checks for ARBIFT. The cleared checks were submitted by one of ABN AMRO’s overseas branches, which had arranged for ARBIFT to not endorse or stamp the checks’ (US Federal Reserve et al. 2005, p. 6).

These dealings with Iran and Libya were found to violate US regulations, specifically transactions that have cloaking features that can be used to avoid or evade the specific compliance requirement when engaged in commercial or financial ventures with these two countries. In addition to the US$ 40 million fine (out of the total of US$ 80 million) levied against ABN AMRO for these specific infringements of the Iranian Transactions Regulations and the Libyan Sanctions Regulations, the OFAC ordered the bank to undertake independent audits. These were deemed necessary to review operations and transactions in ABN AMRO’s Dubai (UAE) and Chennai (India) branches to determine the extent of US commercial relations with Iran and India. Presumably, charge information could then be used to launch investigations into specific instances of money laundering.

What is important here, is that such commercial arrangements between US individuals and firms and Iran would only constitute a money laundering offence
under US law, not under the laws of India, UAE, or under the laws of The Netherlands, the location of ABN AMRO’s headquarters. It demonstrates the considerable degree of variation, and disagreements between countries and companies, as to what actually constitutes money laundering and its predicate offences. Furthermore, it is crucial to emphasise that ABN AMRO was not found guilty of money laundering per se, but rather of engaging in ‘unsafe and unsound practices’ that increased the potential risk for criminal abuse (US Federal Reserve et al. 2005, p. 6).

Money laundering involves three key stages: placement, where ‘dirty’ money is lodged with an entity (for example a business or a bank) for ‘cleaning’, which occurs during the second phase of layering where funds are channeled through the financial system (with varying degrees of complexity). At the end of the layering phase, funds move to the final stage of integration. This is the last cycle of the laundering process where funds are completely cleaned and are then integrated into the economy at points of investment and/or consumption (see chapter five on techniques of money laundering for more details). Because of the speed in which the means of money can be transformed and cleansed anew through placement, layering and integration, it is a major challenge to detect and lay charges for money laundering, even though an analysis of transactions make it possible that laundering had occurred.

1.3. CARIBBEAN COMPANIES, SECURITIES FRAUD AND FAKE BONDS: THE COLLAPSE OF REFCO AND AUSTRIA’S BAWAG BANK

There is thus no uniform, consistent approach to, or definition of money laundering. The 2005 collapse of the US securities trader and the involvement of Austria’s third largest bank (Bank für Arbeit und Wirtschaft) reads like a series of money laundering transactions. Refco’s former CEO, Philip Bennet, has been accused in the US courts of fraudulently concealing US$430 million in losses and missing funds (Shapiro 2006). Prior to the discovery of these financial irregularities, Bennett had borrowed US$21 million from the trade-union owned BAWAG bank. Its involvement in the US derivatives and securities firms went deeper than this. BAWAG had participated in New York based Public Investment in Private Equity (PIPE) trading schemes whereby companies short of liquidity raise equity by selling stock at discount prices often through hedge funds. BAWAG used hedge funds based in Liechtenstein to facilitate its participation in the highly speculative PIPE market. In the meantime Refco had incorporated six companies on the Caribbean island of Anguilla, which were jointly owned by a company called Liquid Opportunity and
BAWAG. They in turn held US$525 million in fake bonds in an entity incorporated in Bermuda (Shapiro 2006).

In October 2005 Refco’s board learned that Bennett had fraudulently hid loans from Refco to his own companies, from which he in turn borrowed again from BAWAG in an attempt to repay Refco. This was not enough to stop his suspension as CEO. The share-price plummeted. However, the collateral for BAWAG’s loan to Bennett comprised of shares in the company itself. Within a few days of the scandal breaking, these were worthless leaving the bank with massive losses (Rajwade 2005). This caused a run on the bank back in Austria with depositors at one stage withdrawing as much as €100 million per day. In addition, Refco’s creditors launched legal action against BAWAG claiming US$1.3 billion, ‘alleging that the bank actively helped Bennett to deceive the company’ (Shapiro 2006). One commentator observed that “[In] parallel with Enron, WorldCom and umpteen other companies, it is the top executives, whose compensations run into tens of millions of dollars, who seem to be perpetrating the biggest frauds’ (Rajwade 2005, p. 2). However, do these transactions constitute money laundering? On one level these fraud-triggered corporate collapses exhibit classic money laundering characteristics: A crime is committed (fraud) which has a financial gain, these gains are then placed in a myriad of offshore and onshore corporate structures, they are then layered to make them appear legitimate financing and they are then reintegrated as clean property or investments such as stocks and bonds.

However, the charge of ‘money laundering’ has been curiously absent from the Refco case. Bennett himself has been charged with securities fraud, not money laundering, though in the US securities fraud is a predicate crime that can attach a charge of money laundering. By contrast in Austria there is no crime for ‘self-laundering’, that is only third parties can be charged with money laundering, not offenders who have committed an offence. There remain on the one hand substantial variations between states as to what actually constitutes money laundering and on the other hand there has been an escalating legal trend to conflate an ever-increasing number of all manner of ‘crimes’ and activity (both financial and non-financial) under the rubric of ‘money laundering’.

This has direct consequences for attempts to measure the amounts and economic effects of money laundering. Where money laundering is defined at as broadest level to include tax evasion and fraud, it can result in a discursive and financial ‘blow-out’ in the very term ‘money laundering’ and economic estimates of the amounts of domestic and transnationally laundered funds. However, where money laundering is defined narrowly to include only the proceeds of a limited number of crimes such as drug dealing and fencing without the need for complex financial engineering, or where the layering and integration phases are not fully addressed then estimates can correspondingly be quite low. In this book, varying estimates of the volume and economic effects of
money laundering are situated within these two often-competing trends (conceptualizing money laundering narrowly or expansively).

1.4. DEVELOPING DEFINITIONS AND MEASURING MONEY LAUNDERING: CONTROVERSIES AND POLITICAL CONTEXTS

Money laundering has become a growth industry involving a large number of countries and law enforcement agencies together with non-governmental, multilateral, intergovernmental and supranational organizations. The Bank of International Settlements (BIS), the Organization of Economic Cooperation and Development (OECD), the G8, G20, EU members’ finance and justice ministers, several departments in the United Nations, the World Bank, the International Monetary Fund (IMF), and the Financial Stability Forum (FSF) are all involved in regulatory efforts designed to assess and reduce money laundering. This has led to a plethora of bilateral and multilateral rules and agreements that have made effective regulation a challenge for all Financial Intelligence Units (FIUs) that are mandated with enforcing and regulating AML provisions. It has also contributed to jurisdictional arbitrage whereby money launderers can take advantage of multiple rules and conflicting agreements.

Despite these challenges, there is growing international consensus on money laundering and the most effective ways of countering it, though these have been driven by key state actors (particularly the US). For example the G7 established the Financial Action Task Force (FATF) in 1989 to examine and investigate efforts to combat money laundering. Since that time it has become the main multilateral AML organization and its capacities to set international standards have been increasingly strengthened. For example, the FATF has issued its 40 recommendations on money laundering as a benchmark upon which countries can measure how effective their AML policies are. At the same time there remains a lack of clarity as how to best approach money laundering, due to competing national definitions and enforcement procedures. One commentator has observed that:

Their analyses, reports and recommendations reveal a disturbing tendency to quote each other’s work; since they enjoy substantially the same membership, this practice amounts to self-corroboration. Moreover, at times they offer overlapping sets of rules and best practices to deal with money laundering. It is ironic that the international community would fail to produce a single, unified set of rules to take on a criminal activity that thrives precisely on exploiting differences in laws and regulations. (Morris-Cotterill 2001, p. 22).
There is thus widespread debate and even uncertainty as to what constitutes money laundering.

Chapter two in this volume provides an overview of different definitions of money laundering. These all have distinctive meanings, but they have been appropriated without concern for these distinctions in law and in AML legal enforcement with important methodological implications when measuring the amounts and effects of money laundering.

Illegal activities can also include both civil and criminal offences. An offence that is illegal is not necessarily criminal. For example, while it is illegal to gamble in an unlicensed casino in The Netherlands it is not a criminal offence to do so. In the Australian jurisdictions of South Australia and the Australian Capital Territory it is illegal to possess cannabis but it is not a criminal offence to do so (provided possession does not exceed two grams of marijuana per person). Another striking feature is that some definitions assert that money laundering involves the attempt to hide the source of illegal or criminal income, whereas others stress the act of ‘making it appear legal’. The former could include the archetypical and clichéd case of ‘hiding money under a pillow’, whereas the latter necessitates some degree of willful action to bring the money back into the legal economy. An active attempt to hide the source of criminal income also corresponds with analyses of money laundering that involve placement, layering and integration.

Despite the fact that legislation varies between countries, it is important to find a common definition of money laundering. For measuring money laundering one needs a clear definition that includes all predicate crimes. Originally, money laundering referred only to the laundering of drug money. In the last 20 years however, it has been extended to include theft, fraud and an increasing number of other offences. Today, the FATF definition includes terrorist financing. From a legal perspective this means that there has been a tremendous paradigm shift (see chapter two).

The FATF has made great efforts to define money laundering clearly. However, these efforts have been aimed at achieving an international standard that nevertheless conceals the existence of national variations in legal definitions. It seems important to have an international and interdisciplinary debate on what money laundering is, what it includes and what it excludes.

1.5. MONEY LAUNDERING: CONCEPTUAL PROBLEMS

There are several controversial points involved in conceptualizing money laundering. First, the definition of money laundering developed gradually (and was initially confined to the United States) but as it did so it began to encompass an ever-escalating number of crimes. This has affected the ability to measure the
extent of money laundering in economics. Chapter 2 of the book gives an overview on definitions of money laundering in law. It opts for a broad definition that includes not only proceeds from drugs and fraud but also from tax evasion and illegal work. Chapter 3 shows how definitions of the illegal economy, the shadow economy, underground banking and money laundering are related to each other. This still leaves the question of what would be the most appropriate definition of money laundering unanswered. The choice of definition might also depend on the question posed.

Part of the controversy stems from inter-disciplinary approaches to money laundering. Criminologists opt for methods such as case studies, carefully following each dollar bill, while economists tend to use existing published data to model, forecast and predict. Some criminologists do not consider modeling an appropriate method. They simply do not believe models and find them ‘luchtspiegelingen’ as the Dutch say – spun out of thin air. Chapter 3 gives an overview of possible ways to measure money laundering in different disciplines and attempts to provide theoretical foundations for the economic model used in this book.

1.6. ESTIMATING THE AMOUNTS OF MONEY LAUNDERING

Another difference among disciplines is the fact that economists usually do not question the underlying data base from international organizations. In Chapter 4, these inter-disciplinary debates turn out to be of particular interest for the question whether or not global money laundering is large or small. This means that the underlying global data of international organizations are therefore also questioned.

While the diversity of definitions complicates efforts to estimate the amounts of laundered money circulating both nationally and internationally, moves to develop enhanced models that give more accurate assessments of the amount, flows and effects of money laundering may contribute resolving some of the more controversial aspects of debate in scholarship and policy. As Reuter and Greenfield (2001, p. 171) observe:

‘knowing the value of drug exports from Mexico to the US is US$1–3 billion rather than US$10–20 billion may be very important for purposes of allocating resources for money laundering investigations or even passing money laundering regulations in Mexico’.

Therefore making estimates has important policy implications.
Introduction

It is necessary to open up, critically interrogate and analyse various estimates of money laundering, which arbitrarily circulate like magic figures around the world (chapter 4). These estimates are important. International organizations, national governments, the media, NGOs and law enforcement agencies refer to them constantly. The International Monetary Fund (IMF) for example, has estimated money laundering at 2–5 percent of world Gross Domestic Product (GDP), but few others have made an attempt to quantify global money laundering. Finding the underlying model of such estimations is an important step to improve estimates of money laundering. For this we reconstruct and transparently show in chapter four a model of how to measure money laundering that closely corresponds to current estimates. This includes critiques of the assumptions made, testing the model and suggestions on ways to improve it in the future. This should allow more accurate and internationally comparable estimates of money laundering to be made.

The modeling for the estimates used in this approach adopts the methodologies used by John Walker (1995; 1999[a]; 1999[b]), an Australian economist and consultant to the country’s Financial Intelligence Unit (FIU), Austrac (Australian Transaction Reports and Analysis Centre). This was the first analyst to make a serious attempt at quantifying money laundering and the initial output from his model suggests that US$2.85 trillion is laundered globally. We measured a modified Walker model with more accurate data for the Netherlands. The figure that up to US$50 billion of funds is laundered in the Netherlands (that Walker originally calculated for the Netherlands in 1995) seems to be too high.

These new estimations exposed the strengths and weaknesses of the Walker Model. One of the main strengths in this model is that it is a pioneer study that estimates money laundering on a large scale for all countries for the first time.

Having worked for Austrac, Walker also incorporated his grounded knowledge on money laundering into the modeling. Walker also had access to information, data sets and expert interviews in the field (indeed surveys of Australian police forces and criminologists were vital in the first stage of his calculations) and consequently had developed an appreciation and a ‘feeling’ for the extent of money laundering.

Criminological accounts of money laundering use intuition and intersubjectivity in their methodologies, even if they are not aware of it. For example the analysis of case studies requires reflexivity and intuition about information provided in crime files.

This is not to say that the model we use is without problems. It assumes that all countries attract criminal money for the same reasons. It conflates very different countries with very different economic structures. All of these encompassing models share these problems (see for example estimates for the
shadow economy by Schneider 2002). The way the Walker Model is used for the estimations made here, acknowledges these problems.

This volume incorporates national case studies of money laundering in two medium-sized industrial countries: the Netherlands and Australia. The incidences and character of money laundering in these two countries is considered emblematic for other members of the Organization for Economic Cooperation and Development (OECD). Discussions and analysis of money laundering in the Netherlands and Australia, is contextualised internationally and in relation to a number of important third countries, particularly the United States and the United Kingdom. These two country studies have allowed us to improve Walker’s original money laundering model by introducing the most up-to-date data for the Netherlands and Australia, and by calibrating international measures.

Walker tends to overestimate money generated for laundering in the Netherlands, by about 40 percent, but money laundering in both the Netherlands and Australia is still sizeable. Our results indicate that there is €8 to €14 billion from crime generated in the Netherlands of which 37 to 44 percent will remain in The Netherlands to be laundered. This means that money laundering from crime in The Netherlands amounts to €3 to €6 billion per year, with the most likely estimate to be €3.8 billion. The remaining generated money for laundering will be placed somewhere else. In addition, criminal money from abroad will also flow into the Netherlands. There is also an additional €14 to €21 billion that flows into the Netherlands from the top 20 origin countries of generated money for laundering. This means that the amount of money laundering with which the Dutch have to deal accounts for about €18 to €25 billion, hence about four percent of the Dutch money demand, or about 5 percent of Dutch GDP. Findings for Australia suggest that money generated for laundering amounts to US$1–3 billion. Additional money flowing into Australia amounts to US$12–18 billion. Money laundering is about 5 percent of Australian GDP. In both countries, money laundering is sizeable.

1.7. TECHNIQUES OF LAUNDERING

Part of the controversy about the volume and importance of money laundering is also due to the fact that different disciplines concentrate on different phases of money laundering. As discussed earlier, the first phase of money laundering occurs at placement where the proceeds of crime are deposited at a bank, smuggled over a border or infused with the turnover of a legitimate business. This phase can be called the placement or pre-wash phase. The second phase is the layering phase (the main wash) where money is circulated many times, either nationally or all over the globe to hide its illegal source. In this phase compli-
cated financial constructions such as complicated hedging and derivative constructions can occur. The third phase is the reintegration phase, where the money is parked permanently, like in the bond market or in the real estate sector.

Do money-laundering estimates, such as those generated by Walker’s model capture all possible techniques of money laundering? Does it include complex financial engineering and the risk factors that the US Federal Reserve identified in ABN AMRO’s ‘unsafe and unsound’ banking practices that I started this chapter with? This is where legal diversity (and accompanying uncertainty), estimates of national and global volumes of laundered funds and techniques of money laundering intersect. Chapter five analyses these techniques of money laundering.

Money can be laundered archetypically through the classic style in casinos, via money exchange agencies and through under-ground banking networks. Launderers can establish legitimate businesses on the one side, engage in illegal activities on the other, and pour the proceeds of their offending into their legitimate businesses laundering as turnover and profits. Smuggling cash together with wire transfers between countries can also be used to launder money, taking advantage of regulatory loopholes in banks and financial service providers such as trust companies.

Estimates of money laundering, either as a social or an economic problem, include our own face challenges when confronted by large scale laundering undertaken by companies or by criminals who create corporate structures to conceal the extent of money laundering under the guise of legitimate business activity. This also involves differences between countries in the regulation of corporate governance and wrongdoing. For example, what maybe routine corporate practice in one jurisdiction is an offence that could give rise to a charge of money laundering in another jurisdiction. This could include tax planning (which is permitted in one country, but considered criminal tax evasion in another), insider-trading (few countries now permit this, but there was a time when it was considered perfectly acceptable business practice) and dealings with third countries that are otherwise regulated (for example trading with Cuba and Iran are perfectly acceptable for European firms, but are restricted in the United States and can result in criminal charges for violations). This later case is precisely one of the reasons why ABN AMRO was fined in the United States.

Chapter three discusses ways in which money laundering could be estimated by empirical research into over and/or under invoicing exports and imports. This is potentially one way in which large firms engage in money laundering. Alternatively offenders may construct corporate vehicles that mimic the legitimate trading behavior of perfectly legitimate companies, and then turn to over/under priced invoicing together with transfer pricing as a means of laundering funds. This can be achieved using Special Purpose Entities (SPEs). SPEs are holding companies. They are shell companies. They have no minimum
capital requirement, so they can be worth $1 or alternatively hold assets worth
US$10 million in the British Virgin Islands, The Netherlands, Samoa, Delaware
or anywhere that local legislation permits their incorporation. SPEs are often off-
balance sheet, bankruptcy remote and private. They can easily be used for both
legitimate and illegitimate uses. They lend themselves to money laundering by
disguising loans as revenue to misstate earnings, concealment of losses,
embezzlement and other accounting improprieties. Financial scandals in which
SPEs were abused, include Banco Ambrosiano, the Bank of Commerce and
Credit International (BCCI), Enron and Parmalat, to name only a few. The risk
that SPEs pose for money laundering was another reason cited by US regulators
in their decision to fine ABN AMRO. The US’s own Government Accountability
Office (GAO) has acknowledged that US SPE shell companies presented a
potential risk for money laundering. The GAO (2006, p. i) observed that:

Federal law enforcement officials are concerned that criminals are increasingly using
US shell companies to conceal their identity and illicit activities. Though the
magnitude of the problem is difficult to measure, officials said US shell companies
are appearing in more investigations in the United States and other countries (United

Austria’s BAWAG bank also appears to have used SPEs for its American
investments (including in its dealings with Refco) incorporated in Anguilla,
Bermuda and Liechtenstein. It is the availability of SPEs in both ‘onshore’ and
‘offshore’ centers combined with their bank secrecy regimes or limited reporting
requirements that have made them targets for accusations that they are conduits
for money laundering. One of the findings of this book is however, that it is not
just small states that launder money, but large OECD countries that produce the
bulk of proceeds of crime to be laundered and whose financial systems are vital
in placement, layering and integration. Large industrialised economies maintain
a symbiotic relationship with small offshore tax havens, both need the other in
order to remain competitive, and this applies to both lawful and criminal money
at the same time.

1.8. EFFECTS OF MONEY LAUNDERING

Money laundering has significant short-term and long-term economic effects.
These effects are examined in chapters six and seven. A systematic literature
search has identified 25 effects of money laundering. Chapter six deals with the
short term effects. These include losses to victims and society due to money
laundering related crime, distortion of consumption, savings and investment and
effects on output and employment. Furthermore, monetary variables such as
interest rates, money demand and exchange rates can be affected. Also prices
can be deterred and whole sectors affected. The latter is especially evident in the real estate sector. A considerable amount of money ends up in real estate. This sector is less transparent than financial markets, legal persons can act instead of physical persons and the value gains are high involving the placement of large volumes of wealth.

Chapter seven deals with the long term effects of money laundering such as growth effects, effects on crime together with the impact on society and politics. Interestingly there can be positive growth effects from money laundering, which is why some countries (particularly those with bank secrecy or ring-fenced financial regimes) possibly overlook the risks of money laundering as a way of attracting capital and investment. For every one billion of additional laundered currency (recorded in a major world currency such as US dollars or euro) there will be a 0.1 percent increase in annual growth. If countries have established themselves as transit entrepôts and attract both criminal and lawful financial flows then they will most likely profit rather than suffer from the consequences of money laundering. The same most likely will hold true for employment, especially in the financial services sector. The ‘externalities’ are likely to be felt somewhere else.

However, if money laundering attracts more crime, the growth effect will turn negative. If money laundering leads to an increase in one million more crime cases, then growth will decrease by about 0.3 percentage points per annum. Money laundering therefore poses considerable economic risks.

As long as a country takes the benefits from crime, by accepting laundered funds but keeping the crime abroad at a safe distance, it free rides on crimes committed in other countries. This may not be a particularly moral position, but economically speaking, it carries no disadvantages and may well explain why so many countries have introduced bank features and ring-fenced regimes that facilitate the incorporation of SPEs. However, other studies (see for example Masiandaro’s work (with Filottto) for Italy (2001), demonstrate that criminal money will eventually attract more crime. Even if the acceptance, or tacit approval of money laundering seems like an attractive short term strategy in order to attract additional capital inflows, increased government revenues, a more buoyant business sector, employment and growth, it is a ticking time bomb in the long run.

Money laundering can also lead to corruption. In the first instance, it always needs some assistance from local third parties such as lawyers, notary publics and corrupt officials—the generous customs officer who discretely overlooks the suitcase full of cash, the friendly bank clerk who is not that diligent with proof of identity documentation or fails to report suspicious transactions. However inadvertent or tacit third party cooperation may be, there is a systemic risk that tolerating money laundering will facilitate increased levels of corruption.
To sum up: money laundering is a sizeable phenomenon in industrialized economies with undesirable effects. It is not only small islands, which launder, but rich and developed economies. Giants wash more, so to speak. It is, therefore, important to study what it is, how much it is and which effects it can have. This will be done in this book with a focus on two well developed middle-sized countries: Australia and the Netherlands. While focusing on Australia and the Netherlands, at the same time, the book is also sporadically using examples or drawing parallels with practices in other countries.

NOTES

1. This Introduction would not be what it is without the input of Greg Rawlings. In particular the case studies on banks used here I owe to him. I thank him for his generous input.
2. These ‘shell companies’ are specific holding vehicles with no physical presence and can be Special Purpose Entities (SPEs) or International Business Companies (IBCs).
3. In the US, the Bank Secrecy Act (31 USC 5311–5330 Bank Secrecy Act) governs key federal US AML legislation, policy and regulation. It has been incrementally strengthened since the US Congress first passed the BSA as the Currency and Foreign Transactions Reporting Act in 1970 (Biern 2004). Most notably the Money Laundering Control Act of 1986 and the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (part of the USA Patriot Act, Title III) have amended and extended the scope and jurisdiction of the BSA. The name Bank Secrecy Act implies that it provides US banks and financial institutions with bank secrecy when in fact its jurisdiction in the US does exactly the opposite. It requires banks and related financial institutions to maintain a paper trial of customers and transactions so that the full suite of US AML regulation and legislation, including where it is attached to predicate crimes, can be enforced. The BSA requires that banks and cognate financial service providers must provide for 1) ‘a system of internal controls’, 2) ‘independent testing for compliance’, 3) the appointment of personnel to ‘coordinate and monitor compliance’ and 4) to provide for their training (US Department of the Treasury Financial Crimes Enforcement Network 2005, p. 4).
4. Members of the G8 are: United Kingdom, France, Germany, Italy, Japan, United States, Canada and Russia.
5. The G20 refers to the group of countries: Argentina, Bolivia, Brazil, Chile, China, Cuba, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Philippines, South Africa, Tanzania, Thailand, Venezuela and Zimbabwe.