Making Promises Good:
The Anti-Money Laundering Regime as a Multi-Purpose Tool for Governance

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Abstract

The creation of this international anti-money laundering regulatory regime is, contrary to its neglect by the literature, important in two ways. First, it provides us with a second example - alongside the Basle Accord – with which we can examine how political barriers to regulatory cooperation and coordination might be overcome; without overstating the success of the anti-money laundering regime the paper argues that a lot of the political circumstances that enabled cooperation and coordination to develop in this case can be applied in facing other economic crime forms. The FATF case may help us to identify important political conditions that can foster collective regulatory initiatives in the international financial area and especially in South Eastern Europe. Additionally the anti-money laundering regime may be useful more directly in pursuing some other regulatory and security goals of particular interest for the Balkan region. Specifically, the kinds of international cooperation and coordination that have been introduced to combat money laundering may help to strengthen international regulatory initiatives aimed at curbing corruption, tax evasion and capital flight and fighting the threat deriving from international organised crime and global terrorism.

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1. The imperative of cooperation

There is a wide spread belief among academics that cooperation and coordination are difficult in the financial regulatory sector, and that for two main reasons: First, they argue that international regulatory initiatives may serve global economic welfare, but are often scuttled as states see them in a more political light as serving one country's national interests over others. Second, even if each state shares the same goal, cooperation and coordination may still fail because of collective action problems. For example, all states may see new international regulatory standards as desirable, but some may be tempted not to follow them as a way of attracting more financial capital and business to their less-regulated financial markets. Their attitude undermines the effectiveness of regime as a whole. Indeed, more generally, many argue that the heightened mobility of financial capital has unleashed powerful competitive deregulation pressures that inhibit not just collective re-regulatory initiatives at international level but even unilateral ones in each country's own markets. Any re-regulatory initiative is likely to be opposed – particularly by the domestic financial sector – on the grounds that it will render the national financial system uncompetitive. As important as these kind of arguments may seem –especially highlighting the political difficulties of international regulatory cooperation and coordination in the financial sector, they by no means can challenge the importance of a paradigm where international regulatory cooperation and coordination have developed substantially: the international or rather global fight against money laundering. Over the last two decades, states around the world have begun to construct an elaborate "*global prohibition regime*" that seeks to curtail money laundering (Nadelmann, 1990).

Despite this approach of internationalization of the issue of money laundering it is often

regarded - and even worse handled - as a separate, "stand alone" entity. This is evidenced also by the fact that some member countries have developed financial sector reform strategies and anti-corruption strategies that have failed to address the FATF recommendations according to which "*... country policy makers should be aware that ... money laundering is the flip side of corruption and other criminal activity. Corruption is one of the predicate offences for money laundering. Cutting off the means to use the proceeds of crime is a major deterrent ... It is therefore of paramount importance that AML/CFT [Countering the Finance of Terrorism] programs are integrated not only within national development plans but also within financial sector reform and anti- corruption programs (ESAAMLG 2005-2008).*" A crucial concern motivating the recent interest in a corruption-money laundering nexus is the implementation failures experienced in combating each financial crime separately. As the enactment today by 198 countries and jurisdictions of FATF AML-laws and regulatory frameworks has had a limited impact on the combating money laundering, the widespread acceptance of global anticorruption standards has failed to reduce the level of international corruption, referring primarily to the medium and large-scale corruption often featuring high public officials and senior political figures and involving largest amounts of money thus able to pose a threat to economic development, political stability and the functioning of representative democracy.

Corruption and money laundering are linked. Similar to other serious crimes, corruption offences, such as bribery and theft of public funds, are generally committed for the purpose of obtaining private gain. Money laundering is the process of concealing illicit gains that were generated from criminal activity. By successfully laundering the proceeds of a corruption offence, the illicit gains may be enjoyed without fear of being confiscated (FATF, 2012). According to the UN there are important links between money laundering and corruption urging for coordination and the appropriate measures (Levi/Reuter, 2011). Additionally, the joint UN Office for Drugs and Crime (UNDC) and World Bank *Stolen Assets Recovery* (StAR) Initiative and the World Bank Anti-Money Laundering (AML) measures can substantially contribute to the fight against corruption noting that "*Corruption and Money Laundering are a related and self-reinforcing phenomenon*" (UN, 2007). Evidently the launch of the StAR initiative in September 2007 was the first expression of the importance awarded to the issue.

2. The Global Anti-Money Laundering Regime

The regulatory regime in issue is primary understood as a response to the financial crime of "*money laundering*" *-the process of falsely legitimizing a criminal's income and assets-* and is intended by the launderers to disguise the money derived from their criminal activities that they intent to save, invest and use for the commitment of further criminal activities. It mainly facilitates criminal groups' expansion, corroding financial institutions and financial support of terrorist organizations. In this aspect we need to examine crime as a business process requiring funding, technical skills, distribution mechanisms, and money laundering facilities; the larger the criminal business, the more likely all these elements will be required. Though not all of the criminals can be labeled "*organized criminals*" there obviously are functioning such groups and networks (Levi, 1998) thus avoiding the sometimes over-homogenized imagery of organized crime, focusing on the international and regional implications of money laundering.

It is widely recognized that economic globalization has encouraged the growth of a wide variety of illicit international economic transactions. Hardly surprising is the fact that money laundering activities –that is the activities, which hide the origins and ownership of money earned through criminal means- should be prominent aspect of this phenomenon. Criminals have taken particular advantage of the dramatic globalization of the financial sector activities, enhanced by technological developments and financial liberalization and in particular of the proliferation of offshore secrecy havens as places to hide the earnings of their illegal origins.

Money laundering is a diverse and complex process. It involves three independent steps that may coincide: *placement*, as bulk cash proceeds are physically placed; *layering*, as the proceeds of criminal activity are separated from their origins by layers of complex financial transactions; and *integration*, when an apparently legitimate explanation and cover are provided for illicit proceeds which by this stage have been transformed into legitimate assets. Crime and in particular drug

smuggling generates an enormous amount of income that attracts organized criminals and affords them great power. The response of the internationally community to the dramatic growth of money laundering activity, which is estimated to as much as US$ 1,6 trillion per year (Lewis, 2016), began to form in the late 1980s as a set of initiatives in a variety of intergovernmental organizations including the United Nations (the 1988 "Vienna Convention" Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances), the Bank of International Settlements (the 1988 recommendations to the banks), International Organization of Securities Commissions (IOSCO), the European Union (four money laundering directives), the Council of Europe (the 1990 "Strasbourg Convention" on Money Laundering), the Organization of American States, the Commonwealth, Interpol, as well as many bilateral legal assistance treaties. Unquestionably the Financial Action Task Force (FATF), a free-standing body of 37 members initially set by the G-7 in 1989, has the leading role in addressing money laundering issues. FATF issued from 1990 to 2004 its 40+9 Recommendations revising them in 2012, which provide a basic framework relevant to all parties involved in the effort to prevent money laundering, from national governments through to financial institutions, marking an attempt to *privatize* a large part of Anti-Money Laundering enforcement.

2.1 Key Futures of the Regime

By its nature the international anti-money laundering regime seeks to bolster the ability of each government to crack down on money laundering activity within its borders instead of imposing controls on capital flow at the borders. This is being achieved in two ways. First it actively *promotes international harmonization of domestic law and practices* designed to combat money laundering and second it *encourages extensive international information sharing and legal cooperation* between governments. Anti-laundering laws accomplish their goals in part by creating an audit trail throughout the world as banks, financial institutions, and non-financial institutions are required to "know their customer," which means that they must obtain written identification from the customer and verify and record such information. A related aspect of the "know your customer" principle is the currency transaction report, which obliges covered persons to transmit customer information to the competent authorities. Another principle is the duty of covered persons to identify and report "suspicious transactions." Covered persons commit a crime themselves by failing to perform them. Even so, the private sector has complained of the burden of distinguishing legitimate from suspicious international dealings. Another anti-laundering principle requires governments to trace, freeze, seize, confiscate, and ultimately forfeit illicit assets from crime (compare Katsios, 1998) within a *National Anti-Money Laundering Strategy*. Contrary to the views advocating the need of an unconditional competitive deregulation of the international financial system, the implementation of the Money Laundering Regime poses, after the Basle Accord (compare Kapstein, 1998), a formidable example of how an international re-regulating activity has overcome skepticism and competitive concerns setting common standards, which were accepted by governments and financial institutions, by giving adequate "*reputational incentives*". Indeed financial Institutions and governments are keen to adopt new regulations in order to maintain (or acquire) reputation within the financial markets (Helleiner, 2000). As the Anti-Money laundering Regime has been characterized of extending its geographical coverage beyond the FATF member-countries FATF has successfully "encouraged" many non-member states to adopt the forty-nine recommendations, endorsing them to "problematic" regions such as Eastern Europe, the Russian Federation, South-Eastern Asia and various mini-states in the Indian and Pacific Ocean. Interestingly enough FATF has further to its monitoring also a controlling function for the non-cooperative non-member countries regarding and assessing through Mutual Evaluations (peer reviews) on their compliance with its recommendations, threatening them otherwise with "*counter measures*" in the sense of a "*black-list*" and enforcing a financial "*quarantine*".

3. Regional Implications

3.1 The Economic Nexus between Organized Crime and Terrorism

In the case of the fight against money laundering, the decisive action of the US played a mayor role. This action affecting global finance architecture has been legitimized by characterizing the war on drugs as a "*national security issue*"; since the terrorist attacks of September 11th the issue has been linked with the "*homeland security issue*" adopting a strategic option of "*finance warfare*". This lead international community to accept the significance of the money laundering issue for the debate about the internal *asymmetric threats* deriving from terrorism and organized crime. Indeed the vulnerability of the financial system to criminals and terrorists operating in international networks consists a clear and imminent threat to homeland security of almost every nation.

Although organized crime and terrorism do not necessarily have a symbiotic relationship, the conditions that promote one phenomenon very often promote the other. Because both criminal and terrorist activity thrive in unstable political conditions, associations between the two have appeared most often in "developing regions" like the SE Europe, rather than Western Europe or North America. The overlapping and cooperation of the activities of organized crime and terrorist groups has steadily increased in the years following the end of the Cold War, due a) to the *expansion of criminal activities* in the transition countries and b) to the *need of terrorists to find alternative sources of financial support* after the decrease of their "state sponsorship".

Association of the two types of groups has been occurring in three broad patterns: (a) The first pattern represents the primary form of contact between them and is *alliances for mutual benefit*, in which terrorists enter agreements with transnational criminals solely to gain funding, without engaging directly in commercial activities or compromising their ideologically based mission; (b) the second pattern is *direct involvement of terror groups in organized crime*, removing the "*middleman*" but maintaining the ideological premise of their strategy and (c) although mostly difficult to be distinguished from the second, the third pattern is the *replacement of ideology by profit* as the main motive for operations. Most of the terrorist groups operating in the region follow most closely the second pattern. They have been willing to engage directly in the scale of various commodities, including arms, narcotics, and people, as well as the laundering of their profits, to support ideological goals. Albeit, a natural progression seems to occur from the first category toward the third, due to the sheer complexity of most lines of transnational exchange of legal commodities. Contemporaneous transnational criminal organizations have proven the value of flexibility, mobility and pragmatism and contacts with such an atmosphere has caused ideological terrorists often to think as "*businessmen*". These third-level organizations tend to *sustain instability for the sole purpose of profit seeking*, something often observed during the last decades in the Western Balkans. Finally both interrelated networks -organized crime and terrorism- ultimately benefit from the large underground economy and the corrupted public sector in the countries of the Balkan peninsula.

3.2 Money Laundering as an Internal Security Issue in SE Europe

Southeastern Europe represents for Europe a significant geo-strategic and geopolitical region whose stability and security directly affects Europe's political and security infrastructure. Conflicts and instability are still prevalent in the Balkans and, as a consequence, security cooperation in Europe is struggling to cope with risks of a non-military nature. It is widely accepted that as a region, the Balkans at the dawn of the 21st century remains still weak and unable to deal efficiently with the new internal security threats. It is rather important for the efficiency of the Money Laundering Regime in Europe to have a generic picture of the Balkans and the hard security challenges prevalent there. Economics have become also in SE Europe one of the main security issues and money laundering provides the first real opportunity for the enforcement of cooperative "security" measures which will influence the future developments in the region. Even though *Internal Security Policy* is has not been always one of the primary concerns of the governments of the SE European countries, it is directly related to their National Defence Doctrines, to the extent that it aims to eliminate the risk of subversion of the National Defence from within or of its erosion by trends and changes of a social, economic, demographic and ecological nature, the impact and side-effects of which are manifested in the future. The improvement of the terms of National Security is achieved through the establishment of National Unity by means of measures aiming to

protect the social web and the demographic cohesion, as well as with the improvement of the state's financial status (Romm, 1993). The importance that economy, in particular, plays in the proper and effective defence policy of a nation is justified also historically. As *Lord Inskip* put it back in 1937: "*Seen in its true perspective, the maintenance of our economic stability would more accurately be described as an essential element in our defensive strength: one which can properly be regarded as a fourth arm in defence (...) without which purely military effort would be of no avail*". (The Minister For Co-Ordination of Defence, 1937).

3.3 The Economic Dimension of Security

In this context, Greek mythology offers a suitable paradigm for the confrontation of the asymmetrical enemy strategy in the internal national front: when fighting with *Antaios*, Hercules disregarded that his opponent's mother was Earth; each time he would fell on the ground, he would recover his power. Finally, Hercules defeated his opponent by holding him in the air and cutting him off from the source of his power. It is through this prism that internal threats -such as organized crime, terrorism and corruption- must be cut off the source of their power.

The economic and social dimension of national internal security includes, by nature, the maximum possible degree of the "*uncertainty*" factor, the confrontation of which is only possible through a mechanism ensuring maximum possibility of initiative and adaptability of the defence mechanisms to this type of asymmetrical hostile strategies. The so-called "*asymmetrical*" *threats* aim to achieve either escalating or multiplying results in a country's internal front. In other words, asymmetry must be seen as a strategy and it must be understood that its constituent operations or attacks aim to implement this very strategy. It is for this purpose that asymmetry must be perceived not as a series of individual actions, but as a strategy that is purposefully implemented to achieve specific targets.

As a consequence, the response to this strategy must also be strategic and implemented particularly in the framework of a regional SE European Financial Intelligence Network (SEFINET). Overall, the concept of a SEFINET as an Anti-Money Laundering, Terrorism and Corruption platform has, primarily, a financial content and objective and, secondarily, a function as centralised instrument for the collection, analysis, evaluation and management of information and evidence on money laundering, terrorism, corruption and the organised economic crime, in relation with all associated Balkan countries.

4. Concluding Remarks

The fight against money laundering has assumed an urgent impetus at both national and international levels as a result of the scale that money laundering has begun to assume, especially with respect to the stability of the financial sector and the soundness of our democratic systems. The international community is trying to ensure through the Financial Intelligence Units (FIU's) compliance with international standards through a three-prong strategy that includes: a) assessment of all countries against the international standards, b) provision of capacity-building assistance for key-countries in need, c) insurance of appropriate consequences for countries, territories and institutions that fail to take reasonable steps to implement standards to prevent money laundering and terrorist financing.

By identifying and interdicting criminal and terrorist assets the *Anti-Money Laundering Regime* is can gradually link up responses to money laundering, terrorism financing and corruption, realizing at last a true potential. Taking into account that the presence of one type of financial crime reinforces the other, strengthening of Anti-Money Laundering (AML) and Counterring Terrorist Financing (CFT) systems can contribute in taming corruption and Anti-Corruption (AC) mechanisms can assist in combating Money Laundering. Although the modest results of the AML/CFT systems have also to do with corruption in administration, financial system and judiciary, the real challenge for the badly needed effectiveness and efficiency lies in the potential of the AML/CFT systems (e.g. Know Your Customer, Suspicious Transaction Reports, confiscation, intelligence gathering and sharing) to combat corruption by using financial intelligence. The effective implementation of the FATF Recommendations can help combat corruption by

safeguarding the integrity of the public sector, protecting designated private sector institutions from abuse, increasing transparency of the financial system and finally by facilitating the detection, investigation and prosecution of money laundering and corruption, and the recovery of stolen assets. Such a development presupposes the dismantling of bureaucratic hazards between the FIUs and the agencies combating corruption. Though AML/CFT and AC efforts are mutually reinforcing, they are not always brought together effectively especially regarding effective implementation of measures like beneficial ownership information as part of their AML/CFT customer due diligence processes. These facts have been acknowledged by the Financial Action Task Force (FATF) and the G20 Anti-Corruption Working Group (ACWG), which have been working together FATF.

Combating money laundering, terrorism financing and corruption requires first and foremost the crafting of appropriate laws and the creation of national, regional and global capacity and the coordination thereof. All the above presuppose the need for political commitment at all levels of the countries' of the region. The global Anti-Money Laundering Regime and the proposed SEFINET presents a realistic prospect for the SE European nations to succeed in creating a long-term functioning "regional alliance" on the grounds of soft-law against threats beyond national or religious identity. Greece and Romania, have the obligation to play a leading role in this effort by identifying and anticipating the real threats in the region.

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