



Drug Trafficking and Money Laundering

by Scott Ehlers, Drug Policy Foundation

The trade in illicit drugs is estimated to be worth \$400 billion a year, and it accounts for 8% of all international trade, according to the United Nations. In order to invest the profits of their illicit activities and avoid having their assets seized by the government, drug traffickers must transform the monetary proceeds from their criminal activity into revenue from apparently legal sources. This is known as money laundering.

In a May 1998 speech, President Clinton declared, "Up to \$500 billion in criminal proceeds every single year—more than the GNP of most nations—is laundered, disguised as legitimate revenue, and much of it moves across our borders." As much as \$100 billion a year in

drug trafficking cash moves through the U.S. financial system, according to the Financial Crimes Enforcement Network (FinCEN).

Though there are many ways to launder drug money, the process generally involves three basic stages. The first stage, "placement," entails disposal of the drug proceeds into domestic banks and foreign financial institutions. The second stage, "layering," moves funds between multiple financial institutions to hide their source and ownership and to disguise the audit trail. This can involve wire transfers or shell companies

in offshore havens. In the third stage, "integration," a legitimate explanation for the funds is created. This can be done, for instance, via front companies, false invoicing, purchase of financial instruments (stocks, bonds, and certificates of deposit), or investment in real estate, tourism, and other legitimate businesses.

Innumerable schemes have been devised to hide the large sums of currency that are generated by illicit drug sales. One method, "structuring," involves breaking up large amounts of cash into transactions that amount to less than \$10,000 to avoid currency-reporting requirements.

At present, the Colombian Black Market Peso Exchange method "is the single most efficient and extensive money laundering 'system' in the Western Hemisphere," according to FinCen. The system involves Colombian traffickers who sell their dollar profits at a discount to agents in the U.S. who work for

peso brokers in Colombia. Once the dollars are delivered to the U.S.-based agent, the Colombian broker deposits the agreed-upon funds in pesos in the traffickers' account. The broker assumes the risk of introducing the laundered funds into the U.S. banking system and later sells the inventory of dollars to Colombian importers who bring in various legal goods, such as cigarettes or computers.

Other laundering schemes involve casinos, gems and precious metals, wire transfer companies, and smuggling currency out of the United States. Money launderers also use various offshore banking havens such as Panama, the Cayman Islands, the Bahamas, Aruba, Liechtenstein, and the Isle of Man.

Between 1970 and 1995, a series of U.S. laws, regulations, and directives have sought to scrutinize movements of large cash transactions and suspicious financial activities. The Bank Secrecy Act (1970) obligates financial institutions to report cash transactions in excess of \$10,000 using the Currency Transaction Report (CTR) and requires individuals to report the transportation of currency in excess of \$5,000 (now \$10,000) into or out of the United States.

The 1986 Money Laundering Control Act declared money laundering to be a crime in its own right and made "structuring"—transactions to avoid filing a CTR—a criminal offense. In 1995, Clinton signed Presidential Decision Directive 42, which freezes U.S. assets of Colombian drug trafficking organizations and bars U.S. companies from doing business with the traffickers' front companies.

Various agencies (including the FBI, Customs, Drug Enforcement Administration, Internal Revenue Service, Federal Reserve Board, and Treasury) are responsible for enforcing money-laundering laws. FinCEN, a U.S. Treasury division, uses artificial intelligence technology to analyze all CTRs and Suspicious Activity Reports filed by banks, thrifts, credit unions, and commercial and law enforcement databases.

Financial Intelligence Units (FIUs), similar to FinCEN, have been formed in many countries to obtain and process financial disclosure information and support anti-money-laundering efforts. Internationally, various national, regional, and global agreements and institutions (such as the Inter-American Drug Abuse Control Council of the Organization of American States) seek to combat money laundering. The 1988 UN Drug Convention also contains significant anti-money-laundering and asset-forfeiture provisions.

Key Points

- Drug traffickers seek to transform the monetary proceeds from their criminal activity into revenue with an apparently legal source. This is known as money laundering.
- Drug profits moving through the U.S. financial system are estimated to be as high as \$100 billion a year.
- Many countries have criminalized money laundering and instituted banking regulations to deter money laundering and make it easier to detect and seize the assets of criminal activity.

In May 1998, President Clinton announced “a comprehensive international crime control strategy for America” in which he pledged to “seek new authority to fight money laundering and freeze the U.S. assets of people arrested abroad.”

Despite numerous laws, treaties, multilateral agreements, and public pronouncements, large-scale trafficking and money laundering continues because the demand is high, profits are enormous, and detection is difficult. Cocaine is produced for export at \$950 to \$1,235 a kilogram and sold at the wholesale level in the United States for \$10,500 to \$36,000 a kilogram. A kilogram of heroin costs about \$3,000 to produce, but it sells wholesale in the U.S. for \$95,000 to \$210,000. The average Colombian trafficking organization earns approximately \$300 million annually, according to a 1994 State Department report.

Most illicit drugs are grown and processed in poor countries where economic opportunities are scarce, law enforcement is weak, and officials can be bribed or eliminated. Increasingly, as well, money laundering is also taking place in developing countries. “Measures in major financial markets to detect and prosecute laundering are driving it toward less developed markets linked to the global financial system,” writes World Bank financial analyst David Scott.

The globalization of trade, finance, and communications has made it easier to transport illicit drugs and launder the proceeds. The sheer volume of financial transactions, many via wire transfers or electronic messages between banks, is staggering. Within the U.S., more than 465,000 wire transfers—valued at more than \$2 trillion—are handled daily. Another 220,000 transfer messages are carried in and out of the United States by an international messaging system known as SWIFT (Society for Worldwide Interbank Financial Telecommunication).

In 1995, the Office of Technology Assessment (OTA) estimated that within the U.S. approximately 0.05% of transfers (or roughly 250 transactions a day) involve money laundering.

Although a wire transfer initially contains information about the sender or “originator” of the transfer, as the transfer passes through several banks before reaching the beneficiary’s account, the identification of the originator is often dropped. Under regulations instituted in 1996, U.S. banks are required to identify the originator and the beneficiary of wire transfers, and such information must travel with the message throughout the transfer. But foreign banks are not required to supply this information.

Several services offered by international banks have been used by launderers. “Private banking,” a little known and largely unregulated service, has been offered by Citicorp, Chase, and other U.S. financial institutions. It provides what Congresswoman Maxine Waters (D-CA) describes as a “don’t ask, don’t tell” policy toward their wealthiest, and sometimes dirtiest, clients.”

This service can involve offshore accounts, moving large sums of money from one country to another, devising

intricate networks of accounts, and helping to purchase homes, businesses, and investments with laundered funds. The service can also include setting up “concentration accounts,” where funds from various individuals are commingled and their origins not identified. Citibank’s private banking service, for instance, laundered tens of millions of dollars in drug money for Raul Salinas, the jailed brother of former Mexican President Carlos Salinas.

Although the U.S. is one of the world’s leading money laundering centers, very few money laundering cases are actually filed—an indication that this crime is difficult to detect and/or that inadequate resources are being devoted to enforcement. In 1995, only 62 criminal money-laundering cases were filed with U.S. attorneys, of the 138 defendants, 52 were convicted.

In May 1998, however, the Justice and Treasury departments announced the successful culmination of “Operation Casablanca,” hailed as “the largest, most comprehensive drug money laundering case in the history of U.S. law enforcement.” The three-year sting operation (involving some 200 undercover agents) led to the arrest of 26 Mexican bank officials, the seizure of an estimated \$150 million, and the freezing of over 100 bank accounts in the United States and Europe.

The U.S. accused three of Mexico’s largest banks and the Canadian auditing firm Price Waterhouse of knowingly aiding Juárez (Mexico) and Cali (Colombia) drug cartels in laundering hundreds of millions of dollars of their U.S. drug sales. Mexican officials said they were jointly (with the U.S.) investigating another 260 cases of alleged money laundering.

But the detection of money laundering is impeded by various national laws that protect financial, communication, and data privacy. In the United States, the Right to Financial Privacy Act of 1978 provides many of the procedural protections for financial records guaranteed more broadly by the Fourth Amendment. The Electronic Communications Privacy Act of 1986 essentially prohibits the monitoring of wire transfers while in transit or in storage without a court order, warrant, or administrative subpoena.

In a significant number of countries, bank secrecy laws hinder obtaining comprehensive information about financial transactions by prohibiting banking officials from releasing customer information to persons outside the financial institution, or simply by prohibiting access by foreign law enforcement agencies on the grounds of national sovereignty. Additionally, under data protection laws such as the European Union’s Data Protection Directive, information may be prohibited from leaving a signatory country if it is being sent to a country with less stringent data protection laws.

Key Problems

- A wide variety of social factors ensure that drug trafficking and money laundering will continue to thrive for the foreseeable future.
 - Money laundering is difficult to detect because of the high volume of banking transactions and because laundered transactions largely resemble legitimate commerce.
 - The U.S. Constitution, domestic privacy laws, and similar legal restraints in foreign countries impede the detection of money laundering.
-

Although various international standards have been written to guide governments in adopting anti-money-laundering policies, not all jurisdictions have implemented regulations. Those countries that have not implemented these standards should be encouraged to

do so to reduce money laundering activity.

Key Recommendations

- Strengthen domestic and international anti-money-laundering cooperation and regulations.
- Increase funding for treatment, prevention, and economic development programs in both the U.S. and source countries to reduce drug production, sales, consumption, and trafficking.
- Revise the UN Conventions on Illicit Drugs to permit governments to experiment in the regulated distribution of currently illicit drugs.

In the U.S., regulations and procedures for banks and other financial institutions need to be tightened and controlled. There also needs to be more vigorous prosecution of banks and banking officials who knowingly assist in and profit from money-laundering operations. Objecting to the mammoth financial merger of Citibank/Citicorp and Travelers Group, Rep. Maxine Waters, introduced amendments to the 1998 Financial Services Act that would:

- require the Federal Reserve Board (when reviewing bank merger applications) to evaluate a company's anti-money-laundering efforts and refuse to allow a merger if one of the companies is under investigation, is being prosecuted, or has been found civilly or criminally liable for a money laundering offense;
- require any bank engaging in private banking activities to file yearly reports describing the procedures used in these operations and how the bank was complying with federal anti-money-laundering laws; and,
- prohibit concentration accounts, which have been known to be utilized by money launderers.

The laundering of drug proceeds can be reduced through the implementation and strengthening of anti-money-laundering standards, but these regulations can only have a limited effect on curtailing money laundering. In 1995, the Office of Technology Assessment analyzed the feasibility of implementing a massive data surveillance system that could serve as an "automated informant" for suspicious activity. The OTA found the system would not work because the number of money laundering transactions is believed to be relatively small, limited information is contained in wire transfers, and it is difficult to characterize a "typical" money laundering transaction, rendering identification and profiling

very problematic. Such a system would also pose a serious threat to privacy and constitutional protections.

Rather than simply focusing on implementing more laws to fight money laundering and drug trafficking, greater emphasis should be placed on addressing the fundamental causes of the problem—namely, the demand for drugs and a lack of economic opportunities in both developing countries and U.S. urban centers. In the U.S., more emphasis should be placed on treatment, prevention, and urban development in an effort to reduce drug demand and sales. This would, in effect, reduce the proceeds to drug traffickers.

Although drug trafficking and money laundering will be reduced if demand for illicit drugs is reduced in consumer countries and if alternative forms of development are implemented in source and transit countries, drug consumption will continue to exist. The artificially high profits of supplying drug consumers serve to impede alternative forms of development.

The illicit drug trade funds powerful criminal organizations, resulting in widespread corruption, violence, and an undermining of the rule of law. This, in turn, impedes the prosecution of these organizations, weakens the judicial system, and prevents the effective implementation of anti-money-laundering controls in the banking system. Weak legal structures and social instability also thwart legal commercial development.

Ultimately, the UN Conventions on Illicit Drugs (1961, 1971, 1988) must be revised to allow for signatory parties to experiment in regulating the distribution and sale of certain illicit drugs if the problems created by prohibition are to be addressed. Unfortunately, recent actions by the UN make it clear that such experiments will not be considered. A new UN counter-drug plan proposed to the 1998 General Assembly Special Session on Illicit Drugs is useful in promoting crop substitution programs, but it sets the wholly unrealistic goal of eradicating the world's entire production of heroin, cocaine, and marijuana by the year 2008.

There are a variety of regulation schemes that could be implemented to control access to drugs while removing the profits from criminal enterprises. Ideally, the aim should be to minimize the harm that drugs cause to users and society at large, to shrink the size of the black market, and to obviate the need to launder illicit funds.

Scott Ehlers (ehlers@dpf.org) is the Associate Editor of The Drug Policy Letter, the quarterly journal of the Drug Policy Foundation.

Foreign Policy in Focus is a joint project of the Interhemispheric Resource Center (IRC) and the Institute for Policy Studies (IPS). The project depends on sales and subscription income, individual donors, and grants from The John D. and Catherine T. MacArthur Foundation, General Service Foundation, and various church organizations. *In Focus* internships are available.

Editors
Martha Honey (IPS)
Tom Barry (IRC)

Production
Grant Moser

Communications Director
Erik Leaver (IRC)

Orders and subscription information:

Mail: PO Box 4506
Albuquerque, New Mexico 87196-4506
Phone: (505) 842-8288
Fax: (505) 246-1601
Email: resourcectr@igc.apc.org

Editorial inquiries and information:

IRC Editor	IPS Editor
Phone: (505) 388-0208	Phone: (202) 234-9382/3 ext. 232
Fax: (505) 388-0619	Fax: (202) 387-7915
Email: resourcectr@igc.apc.org	Email: ipsps@igc.apc.org

Website: <http://www.foreignpolicy-infocus.org>

Sources for More Information

Organizations

American Bankers Association
1120 Connecticut Ave. NW
Washington, DC 20036
Voice: (202) 663-5000
Fax: (202) 828-4535
Website: <http://www.aba.com>

American Bar Association
Criminal Justice Section
740 15th St. NW
Washington, DC 20005-1022
Voice: (202) 662-1500
Fax: (202) 662-1501
Email: crimjustice@adonet.org
Website: <http://www.adonet.org/crimjust/home.html>

Cato Institute
1000 Massachusetts Ave. NW
Washington, DC 20001
Voice: (202) 842-0200
Fax: (202) 842-3490
Email: cato@cato.org
Website: <http://www.cato.org>

Drug Policy Foundation
4455 Connecticut Ave. NW, Suite B-500
Washington, DC 20008-2328
Voice: (202) 537-5005
Fax: (202) 537-3007
Email: dpf@dpf.org
Website: <http://www.dpf.org>

Washington Office on Latin America
400 C St. NE
Washington, DC 20002
Voice: (202) 544-8045
Fax: (202) 546-5288
Email: wola@igc.apc.org
Website: <http://www.wola.org>

Publications

Ahmed El Amin, "Money Laundering: The Solution Lies in Education," *Bermuda Sun*, October 11, 1996, available at: <http://www.bermudasun.org/issues/Oct11-96/moneylaunder.html>.

Department of State, Bureau of International Narcotics and Law Enforcement Affairs, *International Narcotics Control Strategy Report* (Washington, DC: Dept. of State, March 1998).

General Accounting Office, *Drug Control: Status of U.S. International Counternarcotics Activities* (Washington, DC: GPO, March 12, 1998).

General Accounting Office, *Money Laundering: A Framework for Understanding U.S. Efforts* (Washington, DC: GPO, May 1996).

General Accounting Office, *Money Laundering: FinCEN's Law Enforcement Support, Regulatory, and International Roles* (Washington, DC: GPO, April 1, 1998).

Ethan A. Nadelmann, "Unlaundering Dirty Money Abroad: U.S. Foreign Policy and Financial Secrecy Jurisdictions," *Inter-American Law Review*, vol. 18, no. 1, 1986.

Office of Technology Assessment, *Information Technologies for the Control of Money Laundering* (Washington, DC: GPO, September 1995).

Douglas W. Payne, "Drugs into Money into Power," *Freedom Review: Drugs and Dollars: A Global Challenge*, vol. 27, no. 4, July-August 1996.

C. Peter Rydell and Susan S. Everingham, *Controlling Cocaine: Supply Versus Demand Programs* (Santa Monica, CA: RAND, 1994).

Paul B. Stares, *Global Habit: The Drug Problem in a Borderless World* (Washington, DC: Brookings Institution, 1996).

World Wide Web

Drug Enforcement Administration
<http://www.doj.gov/dea>

Financial Action Task Force
<http://www.oecd.org/fatf>

Financial Crimes Enforcement Network
<http://www.treas.gov/fincen>

Money Laundering Alert
<http://www.moneylaundering.com>

Subscription Information

You can subscribe to *In Focus* at one of three levels, receive *In Focus* in one of five ways, and choose which categories of *In Focus* you want to receive. Mark the level of subscription you want, how you want *In Focus* delivered, and the topic categories you want. No extra charge for email delivery to mail and fax subscribers. (Individual copies of *In Focus* are \$2.50, postpaid; bulk orders of *In Focus* are \$12.00 for 10 copies of the same issue, postpaid; orders for delivery outside the US are double the listed prices. Subscriptions do not include back issues. Contact the IRC for a list of available back issues.) Make checks payable to the Interhemispheric Resource Center. We also accept VISA and MasterCard.

U.S. Subscription Level

- \$15 10 briefs
 \$30 20 briefs
 \$60 50 briefs

Foreign Subscription Level

- \$30 10 briefs
 \$60 20 briefs
 \$120 50 briefs

Delivery

- Regular mail Regular mail & email
 Fax only Fax and email
 Email only

Topic Categories

- | | | |
|---|---|---|
| <input type="checkbox"/> All (receive all briefs) | <input type="checkbox"/> Economic Aid | <input type="checkbox"/> Mexico |
| <input type="checkbox"/> Foreign Policy Overview | <input type="checkbox"/> Global Governance/United Nations | <input type="checkbox"/> South America |
| <input type="checkbox"/> Trade and Investment | <input type="checkbox"/> International Financial Institutions (IFIs) and Debt | <input type="checkbox"/> Africa |
| <input type="checkbox"/> Government Agencies | <input type="checkbox"/> Food and Farm | <input type="checkbox"/> Middle East |
| <input type="checkbox"/> Military and Peace | <input type="checkbox"/> Border and Immigration | <input type="checkbox"/> Asia/Pacific |
| <input type="checkbox"/> Human Rights and Democracy | <input type="checkbox"/> Central America | <input type="checkbox"/> Western Europe |
| <input type="checkbox"/> Environment | <input type="checkbox"/> Caribbean | <input type="checkbox"/> Central and Eastern Europe |
| <input type="checkbox"/> Labor | | <input type="checkbox"/> Former Soviet Union |

Name		Institution	
Street Address			
City		State	Zip Code
VISA/MasterCard Number		Expiration Date	
Signature	Daytime Phone	Fax Number	Email Address

Send subscription to:
Interhemispheric Resource Center ♦ Box 4506 ♦ Albuquerque, NM 87196-4506
Voice: (505) 388-0208 ♦ Fax: (505) 388-0619 ♦ Email: resourcectr@igc.apc.org