



Drug Trafficking & Money Laundering

by Bruce Zagaris and Scott Ehlers

The trade in illicit drugs is estimated to be worth \$400 billion a year, or 8% of all international trade. 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.

Though there are many ways to launder drug money, the process generally involves three basic stages. The first stage, placement, entails depositing the drug proceeds into domestic and foreign financial institutions. The second stage, layering, involves creating layers between the persons placing the proceeds and the persons involved in the intermediary stages, to hide their source and ownership and to disguise the audit trail. This can involve complex manipulations and the use of wire transfers, shell companies, bearer shares, and nominees in offshore financial centers (OFCs). In the third stage, integration, the proceeds have been washed, and a legitimate explanation for

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

Launderers have devised an infinite number of schemes to hide the large sums that are generated by illicit drug sales. One method, structuring, involves breaking up large amounts of cash into transactions that each amount to less

than \$10,000 to avoid currency reporting requirements. Other laundering schemes involve casinos, gems and precious metals, wire transfer companies, and smuggling currency out of the United States. The enormous profitability of drug trafficking enables criminals to take advantage of the balloon effect of transnational contraband trade. As soon as law enforcement officials identify and act to block one laundering method, criminals switch methods, industries, geographic routes, intermediaries, technologies, and so forth. These wealthy and powerful drug syndicates employ professionals and use the latest technology, intelligence, and methods, including buying influence in smaller countries, so that they are always a step or two ahead of law enforcement.

Since 1970, a series of U.S. laws, and directives have sought to scrutinize suspicious financial activities and criminalize

deceptive cash transactions. The 1986 Money Laundering Control Act declared money laundering to be a crime in its own right and made structuring to avoid currency reporting a criminal offense. In 1995, President Clinton announced an initiative and 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. However, a number of other countries have questioned this approach, and no other country has yet agreed to adopt this U.S. initiative.

In 1999, the U.S. enacted the Foreign Narcotics Kingpin Designation Act, which extends the directive to cover kingpins of all nationalities and requires U.S. banks and financial institutions to apply a complex web of economic sanctions against kingpins and their associates. In practice, U.S. financial institutions are required to install and monitor software to detect names of individuals and entities on the kingpin list.

Various agencies (including the FBI, Customs, Drug Enforcement Administration, IRS, Federal Reserve, and Treasury) are responsible for enforcing money laundering laws. FinCEN, a U.S. Treasury division, uses artificial intelligence technology to analyze all Currency Transaction Reports (CTRs), which persons must file with the U.S. government when they receive cash payments over \$10,000, and Suspicious Activity Reports filed by banks, thrifts, credit unions, and commercial and law enforcement databases.

Various national, regional, and global agreements and institutions (such as the Inter-American Drug Abuse Control Commission of the Organization of American States) seek to combat money laundering. 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. The 1988 UN Drug Convention requires signatories to criminalize drug-related money laundering and to enact asset forfeiture laws.

In 1989, the G-7 countries formed the Financial Action Task Force (FATF), which has issued 40 recommendations or standards to control money laundering. In 2000, the U.S. prompted the FATF to issue a report that identified 15 "non-cooperative countries and territories" (NCCTs) and stated that if they do not sufficiently comply within one year, they would be subject to countermeasures. In fact, almost immediately, the U.S. and other FATF members required financial institutions to increase scrutiny of transactions from NCCTs, thereby inhibiting or in some cases practically precluding most transactions from some of these jurisdictions.

Key Points

- Drug traffickers need to convert the proceeds from their criminal activity into revenue with an apparently legal source.
- Drug profits moving through the U.S. financial system are estimated to be as high as \$100 billion a year.
- Virtually all countries have criminalized money laundering and developed regulations to deter money laundering and facilitate the detection of criminal activity.

Problems with Current U.S. Policy

Law enforcement, national security, and military agencies have lobbied vociferously and successfully for antinarcotics enforcement appropriations to offset reduced, post-cold war budgets. 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.” Yet despite numerous laws, treaties, multilateral agreements, and public pronouncements, large-scale trafficking and money laundering continues, because the demand for drugs is high, profits are enormous, and detection is difficult. The average Colombian trafficking organization earns approximately \$300 million annually, according to a 1994 State Department report.

The globalization of trade, finance, and communications has made it easier to transport illicit drugs, persons, and commodities of all kinds and to launder the proceeds. Many criminals invest simultaneously in ships and planes in order to facilitate their trade in humans, drugs, art, automobiles, endangered species, and money. 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). The large number of transactions precludes effective policing without sacrificing normal commerce.

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 issued 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.

Launderers utilize diverse services offered by international banks, financial institutions, and a host of intermediaries and professions. Private banks, correspondent banks, off-shore banks, internet banking and gaming, international business companies, international trusts, wire transfers, concentration accounts, automated teller machines, pass-through accounts, mortgages, and brokerage accounts provide a rich source of tools by which criminals and their agents can launder money.

OFCs—through which large sums of money are shifted from one country to another—involve intricate networks of accounts used to purchase homes, businesses, and investments with laundered funds. The Cayman Islands, for instance, is now the world’s sixth largest financial center, according to investigative reporter Ken Silverstein. Concentration accounts permit funds from various individuals to be commingled without divulging their origins. Private banks, little known subdivisions of every major U.S. financial institution, offer regulatory

deference to wealthy clients. For instance, Citibank established private banking services for Raul Salinas, brother of former Mexican President Carlos Salinas, without following its own internal rules on due diligence for starting such accounts. Raul Salinas then laundered tens of millions of dollars in drug money.

Although the U.S. is one of the leading money laundering centers, very few U.S. money laundering cases are actually prosecuted—an indication that this crime is difficult to detect and 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 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 case resulted in fierce diplomatic protests by Mexico, because the U.S. violated its sovereignty by conducting undercover operations in Mexican territory without Mexico’s knowledge, approval, or participation, as required by various international and bilateral agreements. In April 2001, however, the Mexican government of Vicente Fox shifted course and signaled its willingness to allow U.S. intelligence and law enforcement officials unprecedented access to share intelligence.

The detection of money laundering is impeded by various national and international laws that protect individual rights to 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 buffer the release of comprehensive data about financial transactions by prohibiting banking officials from divulging customer information to persons outside the financial institution or by blocking access by foreign law enforcement agencies on the grounds of national sovereignty. Additionally, under data protection laws such as the European Union’s (EU) 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. The EU privacy rights require that records of suspicious transactions and intelligence information be destroyed after a period of years, unless prosecutors have taken enforcement action; the U.S. policy is to keep such information indefinitely.

Key Problems

- Despite numerous laws and treaties, large-scale drug trafficking and money laundering continues to thrive.
 - The U.S. may have reached the point where new anti-money laundering impositions will adversely undercut civil liberties and normal commerce in the U.S. and abroad.
 - Very few U.S. money laundering cases are actually prosecuted.
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Toward a New Foreign Policy

Although various international standards have been written to guide governments in adopting anti-money laundering policies, not all jurisdictions have implemented regulations. "Soft law" standards, in the form of recommendations, should be transformed into hard law through international conventions with effective enforcement provisions.

Regulations and procedures for banks and other financial institutions need to be evenhanded and in close conformity with those of other countries. Washington should reconsider the advisability of unilateral extraterritorial sanctions and operations, unless the U.S. has exhausted all means of cooperative approaches to kingpin and related sanctions. The Bush administration should, for instance, respond to the Vicente Fox government's new openness in sharing intelligence not by unilaterally operating inside Mexico but by building collaborative procedures for detecting and prosecuting international money laundering, corruption, and drug trafficking. And the White

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. The allocation of enforcement resources to combat international drug money laundering and drug trafficking is disproportionate to the harm from the trade and restricts the ability of law enforcement bodies to focus on violent forms of crime, such as terrorism, weapons trafficking, and trafficking in human beings.

Rather than simply increasing the enforcement regime against money laundering and drug trafficking, greater emphasis should be placed on actions and resources that address the fundamental causes of the problem—namely, the demand for drugs and the lack of economic opportunities in both developing countries and U.S. urban centers. In the U.S., more emphasis should be placed on addiction treatment and urban development in an effort to curb drug demand and sales. This would, in turn, reduce the proceeds to drug traffickers. Although drug trafficking and money laundering will be reduced if the 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 from supplying drug consumers serve to impede alternative forms of 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. Unfortunately, recent actions by the UN make it clear that such experiments will not be considered. A UN counterdrug 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.

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Key Recommendations

- Strengthen anti-money laundering cooperation and regulations, reduce unilateral extraterritorial enforcement actions, and safeguard the rule of law and fundamental rights under both the Constitution and international human rights statutes.
- Increase funding for addiction treatment and economic development programs in both the U.S. and source countries to reduce drug production, sales, consumption, and trafficking.
- Revise U.S. and international policies and laws to permit governments to experiment in the regulated distribution of currently illicit drugs.

House should follow the recommendations of the congressionally created Judicial Review Commission on Foreign Asset Control, whose January 2001 report, based on the Foreign Narcotics Kingpin Designation Act (Kingpin Act), recommended that the Office of Foreign Asset Control (OFAC) adopt greater openness and responsiveness and submit to more formal administrative review of its final actions.

Washington should realize the limitations of harsh enforcement policies, such as anti-money laundering measures and economic sanctions, on illicit drug trafficking. These regulations can only have a minor effect on curtailing money laundering. In 1995, the OTA found that anti-money laundering regulations do not work, because the number of money laundering transactions is believed to be relatively small, insufficient information is contained in wire transfers, and it is difficult to characterize a typical money laundering transaction, rendering identification and profiling very problematic. In addition, a tougher system would, as noted by the Judicial Review Commission, also pose a serious threat to privacy and constitutional protections.

The illicit drug trade funds powerful criminal organizations, resulting in widespread corruption, violence, and

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Organizations

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Council of Europe
<http://www.coe.int/>

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

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

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

Inter-American Drug Abuse Control Commission, Organization of American States
<http://www.cicad.oas.org/>

Money Laundering Alert
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United Nations Office for Drug Control and Crime Prevention
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