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The fight against money laundering

An economic analysis of a cost-benefit paradoxon

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Abstract

Purpose – To provide an economic view on the costs and benefits of anti-money laundering (AML) efforts.

Design/methodology/approach – Based on a international, comparative study conducted in Switzerland, Singapore and Germany, the authors outline the impact of AML measures on banks and the financial services industry. The paper discusses possible reasons for the failure of AML to fight the predicated crimes. It also discusses the collateral damage caused by AML.

Findings – Compared with the monetary and non-monetary costs of money laundering prevention for the society and the economy, the benefits are small. Instead of broadening and deepening the current AML framework, a thorough review of the current approach should take place.

Research limitation/implications – Costs and benefits of AML measures are hardly quantifiable. The authors resort to a qualitative approach, stylising possible outcomes and side effects of money laundering prevention.

Practical implications – Useful set of arguments for discussing the benefits and shortcomings of the current and upcoming AML measures.

Originality/value – Money laundering measures and their impact are examined using basic laws of economy and financial intermediation.

Keywords Money laundering, Economic value analysis, Cost benefit analysis

Paper type Conceptual paper

Prologue

The Swiss Banking Institute of the University of Zurich has, in co-operation with universities in Germany and Singapore, conducted an international survey on the anti-money laundering (AML) measures among banks in Switzerland, Germany and Singapore[1]. The conclusions of the survey are puzzling:

- Banks consider the compliance with AML rules as essential and important.
- The AML rules' implementation is highly burdensome and causes significant costs and efforts throughout the banks.
- There seems to be a broad consensus amongst practitioners and scientists that the impact of money laundering prevention on the predicate offences is small.

It is the objective of this paper to analyze the puzzle of these three findings and formulate some theses for the future development of AML measures.

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Introduction

Banks and other participants in the economy have become used to ever increasing regulation, but constantly complain about the burden they face in fulfilling the requirements. According to the "Banana Skin Report" in 2005[2], "the remorseless rise in regulation has become the greatest risk facing the banking sector". Regulators have taken up these concerns and consider the balance between costs and benefits of existing and upcoming regulatory requirements today[3]. This is, however, not true for all regulatory aspects. One notable exception is the area of money laundering and terrorism financing. Various provisions have been enacted which engage the financial services industry in the fight against the use of the financial sector by criminals. In contrast to other regulatory areas such as capital adequacy or risk management, benefits and costs of AML ventures are not considered. The AML pipeline is full of upcoming provisions, especially as the relevance of organised crime, drug trafficking and other illegitimate ventures did not decrease in spite of the massive measures taken during the last two decades.

When discussing with banks and other financial services providers about AML, they mainly emphasize on the implementation costs, which place a significant burden on the industry, especially on smaller market participants. A recent study[4] showed, that money laundering prevention measures account for 45 per cent of the total regulatory burden and 2 per cent of the total costs in Swiss private banking. The cost of regulation exhibits strong economies of scale. The burden for small banks[5] is more than twice as high than for bigger banks. Small banks are therefore heavily penalised against larger institutions. This applies for the implementation of banking regulation in general, and for money laundering prevention in particular. However, private banks also regard money laundering prevention as the most important regulatory area[6].

According to the official view, the money laundering prevention measures work along the following principle[7]: first, by depriving the criminals of their illicit assets, the expected revenue of a predicate criminal venture declines. Second, by imposing the necessity of laundering the assets, the transaction costs increase. Finally, the money laundering prevention efforts increase the probability of being detected and convicted[8].

Whilst this deterrence mechanism sounds logically reasonable, its effectiveness and efficiency for fighting predicate crime is doubtful. Direct costs and collateral damages are high, the benefits for reducing predicate crimes small. This paper focuses on the "collateral damage". We show that money laundering prevention measures leads to undesired side effects both for the economy and for the society as a whole. They may even counteract one of the most important objectives of the endeavor, to fight organized crime.

The next section introduces basic economic principles and outlines their applicability in the area of money laundering and money laundering prevention. Applying these economic laws, the following section describes the impact AML provisions have on the legitimate and illegitimate sphere of the economy. The strategy of banks and states in implementing current and developing upcoming AML provision is then discussed. The final section gives basic rules the authors deem important for assessing and improving the AML efforts.

Economic aspects of the anti-money laundering measures

In this paper, we present a stylised view on AML prevention and its positive and negative effects by applying basic laws of economics. We assume that the same economic laws apply both to the legitimate and the criminal spheres of the society.

Basic principles of economics

In classical economic theory two basic forces determine the behavior of an individual. First, every individual acts rationally and aims to maximise his personal utility. This principle is taken into account for most decisions an individual takes. For criminal ventures which are committed to acquire personal wealth in particular, the decisions are governed by this principle. Second, the personal utility of an economic venture is mainly determined by its expected costs and revenues, which in turn are governed by the fundamental laws of demand and supply.

In this classical world of Adam Smith, it is not the individual person or company who looks after the wellbeing of the nation:

> He [the individual] generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. [. . .] he intends only his own security; [. . .] he intends only his own gain, and he is in this, as in other cases, led by an invisible hand to promote an end which was no part of his intention[9].

The state should protect its citizens from "violence" and "injustice"[10]. Adam Smith proposed the "obvious and simple system of natural liberty"[10], where:

> . . . every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men.

But these principles only work, if the legal framework, e.g. AML rules, does not lead to distortion of competition. Given the differences in economic law and implementation worldwide, and also the different impact of AML rules and other regulation on the participants of the economy, this assumption is questionable. State regulation often actively sets competitive incentives and therefore promotes certain institutional structures. This is dangerous, as could it retard, "instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour"[10].

Supply and demand. In an open and competitive market the invisible hand determines the volume and the price of goods and services through the law of demand and supply. Any good or service is available and traded on the market if there is enough demand, if producers are willing to supply the product or service in principle, and producer as well as customer can agree on a price.

For the supplier, the predominant objective is to create value out of his activities. In that case, the price has to cover the production costs (raw materials, salaries, etc.), transaction costs, and a premium for the risk and the profit of the producer.

Besides production costs, transaction costs play a decisive role for a market economy. They represent the price for using the market mechanism and thus for the exchange of goods and services between producers and consumers. The lower the transaction costs are, the better the invisible hand can work to raise the wealth of nations. Examples for transaction costs are transportation costs for a good produced,

but also fees for using the financial system to arrange the payment for the good or service obtained. Money laundering costs are also transaction costs.

Criminals as rational beings. The modern economic theory of crime is based on the essay "Crime and Punishment" published by Gary Becker[11]. The main purpose of the article was "to answer [. . .] [the] questions [. . .], how many resources and how much punishment should be used to enforce different kinds of legislation"[12]. Becker assumes that a person commits an offense if the expected utility to him exceeds the utility he could get by using his time and other resources at other activities:

> This approach implies that there is a function relating the number of offences by any person to the probability of detection and conviction, to his punishment if convicted, and to other variables, such as the income available to him in legal and other illegal activities [. . .][13].

Fighting the cause by fighting the result. When applying Becker's model to the AML world, a peculiarity has to be considered: the prevention and punishment measures are not taken against the predicate offence or offender, but against a consequential act of a money launderer, who is not necessarily the same person as the predicate offender[14]. Consequently, a possible conviction of the money launderer does not automatically imply a conviction of the predicate offender.

Ceteris paribus, tighter AML provisions lead to higher production and transaction costs of the predicate crime. They should therefore influence predicate offender. He may loose the assets to be laundered due to confiscation. In addition, detecting money laundering raises the possibility of detection and conviction for the predicate offender. Empirical evidence suggests that this relationship is only weak if verifiable at all[15]. As described below, the predicate offender has other alternatives to choose than laundering all the criminal proceeds. He can thereby significantly reduce the money laundering costs and risks of his venture.

Economy of money laundering prevention

For most parts of the economy, AML rules act as a cost component and influence the profitability of illegitimate and legitimate ventures. Hence, they set incentives against engaging in legitimate and illegitimate activities. Contrary to most other state determined exogenous variables, AML rules are not static, but subject to constant change and development. This section deals with the rules steering the regulation process, i.e. the economy of money laundering prevention. The "market" participants, i.e. states, international organisations, banks and other members economy, are supposed to be rational decision makers.

More of everything. The world of money laundering prevention, AML regulation and rules can be depicted along three dimensions.

(1) *Criminal vs clean*. There is a "clean world" (defined by the absence of predicate offences) and a "criminal world". Money laundering is moving money from the criminal into the clean world or – what is essentially the same – hiding the criminal origin.

(2) *Sectors of the economy*. Seen from the standpoint of the Financial Action Task Force (FATF), there exist four different sectors of the economy:

- Financial institutions are subject to special rules and AML supervision as well as to criminal law.

- Designated non-financial businesses and professions are subject to the same special rules and supervision, and are also subject to criminal law.
- Non-designated businesses and professions are subject only to criminal law. No special rules and no AML supervision apply.
- Private individuals, natural persons outside sector (a) and (b) are only subject to criminal law.

(3) *Country-specific differences*. There are different countries with different domestic laws, rules and institutions. They can be broadly categorized into:

- Black-listed countries[16];
- Complying countries, which can be rated further by the extent of compliance with the FATF recommendations[17].

Over recent years, the strategy of FATF has been "more of everything": to move the fences in a way that the clean world shrinks and the criminal world grows (extending the definition of "predicate offence"); to enlarge the "financial" and "designated" sectors which are subject to special AML rules and supervision, and thus to reduce the non-supervised part of the economy; to sharpen the rules to which the supervised sectors are subjected; to sharpen the requirements for the countries in the AML rating process.

Incentives for and against regulation. If state intervention into the market, such as AML rules, affects all market participants in the same way, the relative competitive position of a single participant is not influenced. In that case, regulation fosters or hampers the wellbeing of the economy without changing the relative wellbeing of the single members.

If intervention affects different market participants in different ways, certain competitors may face an advantage or disadvantage, the relative distribution of wealth between the members of the economy is affected. In the end, the structure of a particular market and industry is changed. The same is valid if regulatory provisions differ between countries or industries. Such differences lead to "regulatory arbitrage" by rational actors, so that activities are performed in the country or by the industry which faces least regulatory constraints and costs.

Only in the latter case, market participants have an economic incentive to try to influence the state interventions in order to improve their position. In the area of money laundering prevention, the following situation applies:

- Banks and other financial service providers are against stronger regulation for themselves or promote heavier regulation for others, as long as there are competitors which have a better position. They are indifferent if a level-playing-field exists. They intend "only their own security"; [...] they intend "only their own gain," [9] they do not promote the interest of the economy as a whole. In certain cases, banks may even lobby for stronger regulation, if this could lead to a competitive advantage.
- Clients of banks have no or low influence on state intervention, even if their own economic position (compliance costs are in the end paid by the client) and their rights (e.g. privacy and other basic rights) are concerned. The client has no better choice[18], is not thoroughly informed[19] or simply not interested[20].

What is criminal – what is not?

A pivotal issue in money laundering prevention is the decision, whether an activity, a person or funds are legitimate or not. This is difficult to judge. The criterion of legitimacy divides the whole economic sphere into two parts, the legitimate and illegitimate (or "criminal"). It seems to be feasible to locate a particular good, service or an economic entity within one of the two spheres. In reality, this is not possible. The classification is even more difficult if several jurisdictions are involved, each with most of the time slightly, sometimes even vastly different views on the legitimacy. The same applies to the offences qualifying as predicate crime for money laundering[21]. Therefore, the legitimacy of a good or service cannot be judged upon the subject itself. One has always to know the background.

The classification as (il)legitimate gets even more complicated, if not impossible at all, when we introduce money to the model. By definition, money is a medium of exchange and a store of value. It is, by definition, abstract, i.e. the value or function of money, e.g. a bank note, is independent of the current, prospect or former owner and also independent of the transaction due to which the current owner is in possession of the money. By looking at a bank note or a gold coin, it is impossible to judge if it has been acquired by legitimate means or not. The same applies to account entries in a bank. In most countries bank notes and coins are the only legal tender, and they are anonymous and abstract by definition.

The distinction between criminal and legitimate world is only feasible if an activity, a deal, a person or a legal entity can clearly be associated with one of the two spheres. What looks like a simple decision, is a complicated venture, which is traditionally performed by state institutions such as prosecutors and courts. In the context of the fight against money laundering, the judgment about the legitimacy is increasingly transferred to private sector institutions such as banks. These, however, are not well equipped and qualified for this task. If they have to take on police and judicial functions, their primary function as financial intermediaries suffers. In addition, different conditions apply to banks and the state, and the two behave differently.

Impact of anti-money laundering measures on the economy

Money laundering prevention influences both the illegitimate and the legitimate world.

Influence on the criminal world

Like any businessman, criminals are interested in keeping costs down and earnings up. In view of rising costs for money laundering, the first and simple solution could be backing out of predicate criminal activities which create a need for money laundering. The current anti-money laundering framework seems to be built on this concept. Reality shows that it does not work, though. Since, the beginning of the fight against money laundering about 20 years ago, the targeted predicate crimes (drug trafficking and organized crime) have grown and prospered. Empirical evidence shows that the shadow economy gained importance during the last decades[22]. Even in developed countries, the shadow economy has the size of 10-30 per cent of the countries' GDP[23].

The decision to undertake a predicate crime is determined by demand and expected gains. In the case of drug trafficking, the demand is still there, even though drug trafficking is illegal. This means that customers exist which are willing to pay for the good, no matter whether it is illegal or not. Consequently, there also are suppliers on

the market. While these have to bear the costs for doing illegitimate, covert activities, they are able to cover these burdens by raising the price of the good. Certain aspects enable them to set their prices nearly without constraints.

In legitimate markets, there (mostly) is competition, which is carried out over product quality and price. Competition requires transparent markets, where suppliers and demanders can acquaint themselves with the market condition. Monopolies and other market structures hampering competition and market transparency are actively fought against by the state. In the illegitimate world, the invisible hand of competition does not work well. This world is dominated by other forces. Relying on the addictiveness of the clients, suppliers are able to set the price at their discretion. Competitors are forcefully put out of business and cartel-like arrangements are usual, certainly in the world of organized crime.

This enables the suppliers to effectively control the revenue variable of the profitability calculation. Even if money laundering contributes significantly to the overall costs, suppliers are able to get significant excess profits, which in turn makes the business financially very attractive.

Reaction of the criminal world

The AML measures have made moving money from the criminal world into the clean world more costly. However, criminals are not forced to launder all the criminal proceeds on a gross basis. They can choose amongst several alternatives:

- Criminals can keep the money in anonymous form: the most important medium where the distinction between criminal and clean is impossible are bank notes (and coins). In most countries cash is the only legal tender, and it is perfectly legal to store and move any amounts of cash. Although cash may have several disadvantages compared with bank deposits, the difference may not be too severe, especially in the case of currencies that are also accepted outside the respective country. In addition, there are alternative and perfectly legitimate systems for anonymous payments, such as the century old and efficient Hawala[24] system.
- Criminals could avoid money laundering altogether by keeping the dirty money in the criminal world. The bigger the criminal world relative to the clean world is, the easier and more valuable this alternative becomes. In the extreme case where the whole world is criminal, money laundering becomes unnecessary and even impossible.
- Criminals may use one of the oldest and most efficient payment mechanisms: bilateral or multilateral netting, with or without counterparty substitution. The clearing system[25] is the most important institution for diminishing the demand for money in the broader sense. The system was already described and recommended by Adam Smith for the case that "gold and silver should at any time fall short in a country"[26]. "Buying and selling upon credit, and the different dealers compensating their credits with one another once a month or once a year, will supply it [money] with less inconvenience"[26]. To make use of this mechanism, criminals will "buy and sell upon credit" within the criminal world and balance the remaining net amount by transferring it to the clean

world. They can thus reduce the amount and the total cost of money laundering substantially.

- Criminals may use the international financial system, thus exploiting legal, regulatory and other differences between different countries.
- Criminals may use "non-designated institutions" (in the FATF terminology) and private individuals for transferring criminal money into the clean world. Examples are the legendary pizzeria for smaller amounts, international trade[27], real estate or corporate finance for big transactions. From the criminal's point of view it could be advantageous to not only use the clean institutions for laundering criminal money, but to merge the predicate criminal activity into the non-criminal activity of a non-designated institution. The routes through the non-designated sectors are less liquid and thus more expensive and need substantial resources.

All alternatives require professional resources and long-term investments. Such a environment is typically provided by organized crime. It is conceivable that AML measures promote large, sophisticated organized crime structures rather than fight them.

Influence on the legitimate world

By definition, crime prevention deals with criminal actions which have not been committed[28]. So, from a criminal law point of view, persons and legal entities are not criminal yet, if at all. This raises the bar for acceptable costs and collateral damages.

In contrast to prosecution, which affects only alleged criminals, everyone is subject to crime prevention and AML measures. Current money laundering law exactly requires that, as every financial transaction could involve illicit funds.

Besides these direct cost of AML measures, there are also indirect costs in the form of collateral damage:

(1) Damage for the society:

- A loss of civil liberties[29], especially privacy. The AML provisions are a threat to the privacy of the individual;
- It is the goal of the official AML policy "to counter the use of the financial system by criminals". Society seems to accept that criminals use other parts of its systems jointly with non-criminals: examples are the transportation system, the education system, the legal system, or the health care system.

(2) Economic damage:

- The AML mechanism increases the direct costs of legitimate market transactions in the same way as illegitimate ones. By increasing the transaction costs of the economy, the AML measures hinder the working of the invisible hand and reduce the wealth of the nations. The whole economy faces increased transaction costs for using the financial system and the payment mechanism in particular. The effect is not limited to transactions of the "financial sector" but it impacts also the "designated non-financial businesses and professions" in the same way. It also increases the production costs of most services provided by the "financial sector" and the "designated non-financial businesses and professions";

- Economic sectors, actors and countries with a low sophistication of AML systems and probably a low reputation[30] face heavy discrimination, severely impacting chances of participating in the benefits of international trade and co-operation;
- The risk exists of making the "complying institutions" and "complying countries" an exclusive club. This leads to regulation driven promotion of monopolistic or oligopolistic structures and results in high economic costs.

Interaction between criminal and legitimate sphere

Applying the AML framework described above, the attributes "criminal" and "legitimate" are not only given by law and courts, but actually by the private sector as well. Because the latter applies a risk-based approach, it may judge a person or an action as "doubtful" which is not "criminal" but "not legitimate enough" or "not profitable enough". Emphasis has to be put on the fact that "doubtful" for a bank does not need to mean "criminal" in any way. The actual "criminality" of clients and their funds is hardly recognizable. Hence, banks and other financial services providers rely on criteria such as nationality, religious affiliation, industry and domicile of a client to create a risk profile. Depending on the risk affinity the bank has and its regulator allows, prospect clients may be refused because they exhibit high-risk criteria, without any hints on the actual doubtfulness of a client.

By treating actually legitimate clients and transactions as "doubtful" they are moved from the legitimate world to the grey one, with many consequences:

- Many services and provisions of the legitimate world are not available any more to all economic subjects or only available at prohibitively high costs.
- The illegitimate world will be happy to offer these services, but to their conditions.
- This will firstly lead to an extension of the criminal world, and secondly to the secluding criminalisation of persons originally acting in the legitimate world.
- The extension of the criminal world provides new liquidity and members to it, thus enabling the criminal world to acquire more services and products without leaving the criminal sphere.

The results of such a shift can be severe. The more services and products can be supplied out of the criminal world, the higher is the relative value of non-laundered money. This reduces the need for money laundering, strengthens the illegitimate economy and removes funds and resources from the legitimate sphere of the economy, which is subsequently weakened. Here, the fence is not shifted by the regulators and supervisors. Instead it moves by itself into the wrong direction.

This is especially the case when the list of predicate offences is extended. When the predicate offence was drug dealing only, the chance to meet this criteria was very small. Today, given the extensive list of predicate offences, it is likely that there is at least a chance that a prospect client is engaged in such activities. Therefore, the investigation effort rises as does the risk and cost for all client relationships.

Anti-money laundering and effectiveness: a paradoxon?

After over 20 years of money laundering prevention, the results are disappointing: organised crime and drug trafficking still prosper. Banks face a high burden because of their active involvement in money laundering prevention. The various prevention schemes have weakened the basic rights of the bank clients, who have to pay for the prevention measures. Of course, there has been some success. Compared to the direct and indirect costs as well as to the estimated volume of organised crime, the victories are minor and the costs are high.

However, AML regulation is going to be extended instead of being thought over. Why does a review not take place? Who is in charge?

Role of banks and the financial services industry

Banks and the financial services industry are applying the laws and regulations they are required to. Complying with the requirements is mandatory, as the market players risk their license or at least the comity of regulators and supervisors. Even complaining about the rules too loudly could be conceived as doubtful conduct.

In addition, they sometimes react with even stricter and more detailed rules defined by themselves or industry associations. They do so mainly to foster their reputation, prevent further regulation by state and international entities and to minimise risk.

Applying a risk-based approach. The risk aspect is arguable. Regulators, especially in Europe, begin to apply a risk-based approach to their money laundering regulation. The reason is that innovation on the criminal side makes it difficult for regulators and prosecutors to keep pace and to formulate detailed money laundering criteria *ex-ante*. In addition, the banks are allowed to adapt their money laundering effort along their risk assessment of a particular client. A retail customer with few and standardised transactions such as the salary reception and rent payment requires less caution than a cash-intensive business or a private banking client with assets distributed internationally.

The risk-based approach, however, places a high responsibility on the banks, as they have to develop their own assessment framework, take sound decisions and defend their work when problems arise. In that case, they may have to prove the ability of their assessment framework to courts and regulators and cannot just show a filled form with predefined check boxes, which was supplied by the regulator.

Avoiding the risk of wrong decisions. Banks are not always willing to take this responsibility. Big banks with an extensive client base and significant assets under management may be able to apply a very low risk affinity and to refuse clients which raise the slightest suspicion[31]. Smaller banks, in a competitive position not so favorable, may be inclined to accept such clients, at least if checks about the background of the clients do not reveal problematic aspects. These checks, however, are expensive and decrease the profitability of such a client relationship. Another strategy of the bank may be to let the supervisor take the decision. They can achieve that by filing suspicious activity reports (SAR), which will result in a supervisor's decision about the alleged legitimacy or illegitimacy of a client or transaction. If such a decision is available, the bank minimises its risk to perform any wrongdoing *ex-post*.

Differences in the type of business and attitude of banks and countries regarding SAR reports can be seen by looking at the statistics of Financial Intelligence Units (FIUs). In Switzerland, 863 SARs were sent to the Swiss FIU in 2003. About 80 per cent

of these cases were forwarded to the prosecutors after a first investigation. In the same year, 100,000 reports were sent to the FIU in the UK. In 2005, 195,000 reports were filed[32]. The resource requirement to deal with this vast volume of reports on the banks' and the state's side is enormous. The relationship between reports and crime is questionable. There is a weak correlation in the area of drugs[33], but no significant dependency to other areas of crime[34]. Furthermore, with each report, the privacy of the client is compromised.

Compliance as quality criterion. Furthermore, bank specific compliance efforts performed in addition to the required ones can be used to establish a quality criterion (e.g. a certification) which in turn could result in a competitive advantage like preferential treatment by the regulators or positive effects on reputation[35]. This could result in a "closed shop" where some competitors form and promote a "regulatory island". Market participants not able to join this shop because of low sophistication, size, upfront effort to meet the arbitrary criteria for joining or due to other factors, are in turn penalised, although their services and products may be equally good or better and there may be no tenable evidence that meeting the joining criteria leads to more effective money laundering prevention. A "three-tiered" world arises:

(1) the "good" institutions;

(2) the "questionable" institutions and countries, which are not able or willing to comply with the rules, but do not necessarily facilitate money laundering; and

(3) the "bad" institutions with a bad track record.

For a bank, the objective is to fulfil the regulatory requirements, to belong to the "good" world and to take care that all its competitors face the same requirements and therefore the same costs. In that case, they face no competitive disadvantage, because the rules are the same for all of them[36]. They also have access to the global financial market, because they comply with the international rules. Indeed, banks and financial centres are very much preoccupied with the maintenance of "level-playing fields". In addition, they are able to pass the cost of compliance efforts to the client. In the end, the client pays for the bank's efforts to maintain its reputation.

Other goals of AML are not relevant for a bank's decision. Banks do not take part in discussions on the feasibility of AML, as this could hamper their reputation and success. Banks therefore have only a weak incentive to engage in fundamental AML discussions, as long as they are in the "good" tier of the world. If they do not, they may put all efforts in joining the first level, rather than questioning the AML strategy.

Role of countries as regulators and policy setters

The creation, implementation and enforcement of rules in the area of criminal and civil law as well as banking regulation and supervision is in the competence of sovereign states, which therefore also should be the ones to address the issues of upcoming and existing rules. The advancing globalisation of the economy in general and the financial services business in particular lead to a different picture. In order to foster international cooperation and prevent regulatory arbitrage, frameworks are coordinated on an international level. Single member states of the FATF, although constituting and taking part in the organisations, do not seem to have a significant influence on the rules and "mandatory recommendations". The classification outlined in the previous section applies for states as well, as does the decision and incentive matrix. Therefore, even

most states will neither be able nor willing to question or influence the AML strategy in a substantial way.

Challenges in the international space

Today, when crossing borders with a financial transaction (e.g. a simple payment), no single state authority seems to be relevant anymore. This has been most impressively proved in June 2006, when it became official that the US Government has tapped into the S.W.I.F.T. database[37]. Many central banks, governments and industry members have been informed. Also, the program should be seen as illegal in most of the G10 countries. However, none of the countries affected, except for the USA and Belgium, saw itself as a responsible point of contact for the issue at all.

As long as there is no point of contact, there is no means to effectively complain about a state's or international organisation's action. This is devastating, as the typical client has no means to oppose the intrusion in his own basic rights [38].

Conclusion

The authors have performed a stylized analysis of the laws governing the cost and benefit of anti-money laundering policies. Without recommending specific actions or strategies, they think that the following theses should be considered:

- Measures taken to prevent money laundering in the financial system, may it be by state entities or the private sector, have to be judged upon their effectiveness to achieve the stated goal.
- Benefits should be defined in terms of predicate crime. To counter the use of the financial system by criminals is not a viable objective.
- There is a limit for the acceptable direct costs and collateral damage. Cost-benefit analyses should be performed and alternatives have to be considered.
- As a general rule, a measure should be deployed only, if the benefits achieved exceed the costs. It is not feasible to place a high burden on the society and economy without corresponding results.

As a common opinion, the current money laundering prevention framework fails to reach its own original goal, which is to reduce predicate offences. It is wrong to conclude that the current framework is not strong enough. The reason is, that the attractiveness of criminal ventures is determined by many factors, and the cost of money laundering is just one of them and can be compensated by others. AML regulation has achieved a life of its own, where the objective to prevent predicate crime has been replaced by other desires. This may not only hamper the achievement of the original goal, but may also impose damage in the legitimate spheres of economy and society.

Notes

1. Wuensch and Geiger (2006).
2. CSFI (2005, p. 35).
3. FSA (2000, pp. 5-9); for the regulatory strategy in Switzerland see Eidgenoessisches Finanzdepartement (2005, p. 5).
4. Hubli and Geiger (2004, p. 34 et sqq.).

5. Banks with less than 100 employees are regarded as small banks.
6. Hubli and Geiger (2004, p. 32).
7. Cuellar (2003, p. 315).
8. Cuellar (2003, p. 393).
9. Smith (1846, Book iv, Chapter ii).
10. Smith (1846, Book iv, Chapter ix).
11. Becker (1968).
12. Becker (1968, p. 169).
13. Becker (1968, p. 177).
14. In fact, a judgement of the German Bundesgerichtshof (2000) denies the possibility to convict a predicate offender for money laundering the proceeds of the predicate offence. This view is applied only in very few jurisdictions.
15. Baker (2005, pp. 173-74), Cuellar (2003, p. 440) and Bolle (2004, p. 63).
16. FATF (2006a, p. 12).
17. A list of evaluation reports is available at FATF (2006b). See also Cuellar (2003, p. 437).
18. All providers have to apply the same rules and processes.
19. Geiger and Wuensch (2006, p. 16).
20. Wuensch and Geiger (2006, p. 3).
21. Baker (2005, p. 187).
22. Schneider and Enste (2000, p. 81).
23. Schneider and Enste (2000, p. 104).
24. Venturi (2006, p. 5 et sqq.).
25. Geiger (2001, p. 25).
26. Smith (1846, Book iv, Chapter i).
27. FATF (2006c, pp. 3-8).
28. Hassemer (1993, p. 669).
29. Hassemer (2002).
30. Developing countries, countries in transition, countries of non-European/non-American background mostly have a weak reputation in regard to money laundering prevention and other related areas like corruption, etc.
31. The Sarbanes-Oxley legislation is assumed to cause similar effects. See Butler and Ribstein (2006, p. 58 et sqq.)
32. Lander (2006, p. 14).
33. Cuellar (2003, p. 427).
34. Cuellar (2003, p. 428).
35. Wuensch and Geiger (2006, p. 4).
36. Wuensch and Geiger (2006, p. 2).
37. Lichtblau and Risen (2006).
38. Geiger and Wuensch (2006).

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