

# Money Laundering and Flight Capital: The Impact on Private Banking

Permanent Subcommittee on Investigations of the Committee on Governmental Affairs,  
United States Senate

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Good afternoon Madam Chairman and Senators. Thank you for the opportunity to appear before the Permanent Subcommittee on Investigations to talk with you about one of this nation's larger but least visible problems.

What I would like to do today is frame the issues of money laundering and flight capital in the context of our domestic and foreign interests, discuss two principle components of flight capital - corruption and trade mispricing, provide examples of how U.S. policies and practices facilitate the stream of illegal funds into our economy and suggest restraints on private banking necessary to begin resolving these issues.

## **Parallel Flows**

The theft of funds and disappearance of resources out of Russia has brought to world attention more vividly than at any earlier moment in history the problems of money laundering and capital flight. Yet, what has been taking place in and out of Russia closely resembles what has been occurring in connection with Latin America throughout the 20th Century, in and out of Africa since the years of independence in the late 1950s and early 1960s, in the Middle East long riven with wealth disparities and ideological shifts and in Asia in recent decades, particularly in the last two years of the Asian financial crisis. Of equal concern must be the severe impact of these global problems on U.S. domestic and international interests.

Laundered criminal money and illegal flight capital passes out of other countries and into the United States by the hundreds of billions of dollars. As destructive as these tides are, however, they are aided by both U.S. public policies and private practices. The problem is not limited to a single or a few institutions. It is one that the United States faces as a nation.

In order to distinguish money laundering from parallel financial flows that do not constitute money laundering, it is useful to add the word "criminal," to assure that what is being referred to is the movement of funds that violate U.S. anti-money-laundering legislation. This legislation specifies some 170 crimes and malpractices which establish a predicate offense for criminal money laundering.

The term "flight capital" generally does not encompass criminal proceeds but instead refers to commercial and private funds being moved from one country to another. A distinction must be made between its legal and illegal manifestations. The legal component of flight capital is generally after-tax money that is properly documented as it passes across borders, and it remains on the books of the entity from which it is transferred. Such free market operations are accepted as largely beneficial to investment, trade and development, leaving aside the question of the utility of short term capital controls.

The illegal component of flight capital is quite different. Almost always tax evading and therefore illegal out of the countries from which it comes, it is improperly documented or related to a preceding or following improperly documented transaction, and it disappears from any record in the country of its origin. The destructiveness of this cascade for both originating and receiving countries is now gaining long overdue attention.

The motivations for these two forms of flight capital differ. The legal component is normally fleeing to safety and can be expected to return to the country of origin when investment conditions are attractive.

The illegal component is fleeing to secrecy, to be accumulated in a hidden manner and, as private bankers can attest, rarely returns to the country of origin.

### **Components of Illegal Flight Capital**

Illegal flight capital has many elements, of which the more important include the following:

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- Corruption by foreign government officials, arising from misappropriation or embezzlement of public resources and bribes and kickbacks on government contracts paid into or accepted as deposits into foreign bank accounts, is an especially secretive aspect of these financial flows.
- Falsification of prices on import and export transactions in order to generate a percentage or even a multiple of the value of the trade that is then paid into a foreign bank account is the most widely used means of producing illicit transfers.
- Real estate transactions and securities trades, often between related parties and improperly priced and paid for in order to shift money between countries, offer creative avenues for generating illegal flight capital.
- Wire fraud, particularly emanating from ostensibly respectable but criminally compliant banks, has become a major aspect of the problem, inundating western financial institutions with the proceeds of ill-gotten gains.

The first two of these major components of illegal flight capital corruption and trade mispricing - have been carefully studied, specifically because both are dependent on international cooperation to facilitate their movement. Out of other countries into western coffers has poured at least \$1 trillion in the decade of the 1990s by these two means alone, virtually every dollar assisted by western financial and commercial interests.

The passage of corrupt money from developing and transitional economies into the United States and Europe is estimated at a minimum of \$20 billion per year and perhaps as high as \$40 billion per year. Mispriced international trade generates a flood of money from developing and transitional economies into the United States and Europe of at least \$80 billion per year. The total of these two components of illegal flight capital is therefore at least \$100 billion per year coursing into western economies. It is estimated that no less than half is immediately or eventually transferred to the United States - \$50 billion a year, a half trillion dollars in this decade.

A more exhaustive examination of illegal flight capital, including an estimate of a) the exploding wire fraud component, and b) money that spills from developing and transitional economies directly into offshore tax havens often without immediate assistance by western business people and bankers, although eventually lodged in U.S. and European accounts, would produce substantially higher figures, likely multiplying the total to several hundred billion dollars annually.

### **Benefits and Costs**

Focusing on the \$100 billion per year of illegal flight capital facilitated by the United States and Europe arising from corruption and trade mispricing, the benefits and costs of this inflow merit clear analysis. The benefit is that it brings that sum of money - \$100 billion a year - into western economies, at least \$50 billion to the United States. The costs can be seen in the impact of these torrents on both domestic and foreign interests.

#### *A) Domestic*

One hundred billion dollars a year in illegal flight capital coming into the United States and Europe provides cover for a far larger amount of criminal money laundering, estimated at \$500 billion to \$1 trillion per year, again half to the United States. Illegal flight capital and criminal money laundering are two rails on the same tracks through the international financial system. The

Treasury Department has estimated that 99.9 percent of the criminal money that is presented for deposit in the United States gets into secure accounts. Antimoney-laundering efforts are a failure. The United States has been progressively pursuing various aspects of this program for more than 25 years and

cannot point to a reasonable measure of success. The easiest thing for criminals to do is to make their criminal money look like it is merely corrupt or tax evading money, and Men they do it passes easily into our economies.

*The domestic cost of illegal flight capital is that it removes anti-money laundering as an effective instrument in the fight against drugs, crime and terrorism, thereby weakening our ability to prevail in facing some of the most perilous threats to our society.*

## B) Foreign

Illegal flight capital facilitated by the United States and Europe has an equally severe impact on foreign interests, as can be illustrated with specific examples:

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- Russia, of major strategic importance, has been impoverished by the greatest illicit diversion of resources that has ever occurred out of any country in a short period of time - \$150 to \$200 billion in a decade by very conservative estimates, with figures as high as \$500 billion being offered. This has been accomplished through a combination of criminal money laundering and noncriminal but illegal flight capital, and almost every dollar of this unprecedented deluge has been aided and expedited by western commercial and banking institutions.
- Nigeria is one of the principal suppliers of oil to the United States, the most populous country in Africa and pivotally important to the stability of that continent. Yet, the biggest single thief in the world in the 1990s was almost certainly the late military dictator Sani Abacha, with \$12 to \$16 billion passing out of Nigeria in corrupt and tax-evading money during his murderous five year regime, most of this to the personal accounts of Abacha and his immediate family members.
- Pakistan is a nuclear state in a volatile subcontinent, Mere corruption and tax evasion are so rampant and the economy so depressed that these conditions contributed to a coup d'etat, upsetting the nation's tenuous hold on democracy.
- From Mexico the surge of drugs into U.S. cities and economically depressed aliens across borders presents what many consider to be one of our principal foreign policy challenges. Yet, we legally give "Mite glove treatment" to high status criminals moving drug and bribery proceeds out of our southern neighbor.
- China could be the next country destabilized by corrupt and tax-evading flight capital. Semi-official estimates provided in Beijing suggest that already \$10 billion a year, probably more, in illegal funds is passing out of the country. The possibility exists that, as China integrates more into the world economy, this could grow to \$20, \$30 or \$50 billion a year, potentially repeating the Russian scenario.

In these and many other states, facilitation of the movement of corrupt and tax-evading money drains hard currency reserves, heightens inflation, reduces government revenues, worsens income gaps, cancels investment, hurts competition, limits free trade and solidifies the permanence of poverty. And it does this at a time when growth in the rest of the world is of rising importance to the economic prosperity of the United States.

*The foreign cost of illegal flight capital is that it erodes U.S. strategic objectives in transitional economies and undermines progress and stability in developing countries comprising two-thirds of the world's population.*

## Examples of Facilitation

The word "facilitate" has been used at several points above in reference to U.S. and European activities that encourage and enable the channeling of illegal flight capital out of transitional and developing economies into western assets. A selection of examples of ambiguities and contradictions in policies and practices, focusing primarily on the United States, will serve to illustrate the point:

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- The United States has enacted cash deposit reporting requirements and antimoney-laundering legislation, beginning some 25 years ago and expanding since. In contrast, Treasury Department

officials have stated on multiple occasions that it is U.S. policy to attract flight capital out of other countries, with little or no heed paid to whether or not it is tax evading.

- The United States requires a customs declaration to be filed in connection with imports and exports into and out of the United States, and it is an offense to file a false declaration. Yet, in practical terms the customs declaration is signed by a freight forwarder, not by the buyer or seller, and so long as it accords with the commercial invoice accompanying the transaction it is rarely challenged by the U.S. Customs Services. Because of this laxity, trade mispricing in the form of commissions, rebates and kickbacks is often routine practice in winning and maintaining export and import orders in soft currency markets, present in hundreds of thousands of transactions handled by U.S. commercial and banking interests.
- A perception of tax evasion is expected to generate a Suspicious Activities Report (SAR) in U.S. banks. Yet, when an exact percentage of proceeds from an international trade transaction is taken out of the domestic party's account and deposited into the foreign party's account within the walls of the same bank, even transaction after transaction, no SAR is filed, although from long experience the bankers and business people involved know full well that tax evasion is a result of these kickbacks.
- The United States has enacted an Advance Pricing Agreement that makes it difficult for foreign multinational corporations with local subsidiaries to misprice trade in order to take tax-evading money out of the United States, placing the onus for demanded clarifications squarely on the suspected evader. Yet, U.S. regulations are, across the board, far more accommodating to mispricing that brings corporate tax-evading money from other countries into the United States.
- The total amount of foreign aid from the United States, other Organization of Economic Cooperation and Development (OECD) countries and the World Bank combined is about \$50 billion per year. Yet, this \$50 billion inflow to developing and transitional economies is completely offset by the \$100 billion which illegally flows back out of other pockets in those same countries with U.S. and European assistance.
- No contradiction is more glaring than in connection with the issue of corruption, on which these hearings are principally focused. The Foreign Corrupt Practices Act makes it illegal for Americans to bribe foreign government officials. Yet, it is not illegal for private bankers and financial advisors to call on foreign government officials, including those perceived to be corrupt, and offer to assist them in moving, consolidating and managing ill-gotten gains in foreign bank accounts. What U.S. law conveys, in effect, to American business people, financial advisors and bankers is, do not bribe foreign officials; however, if wealthy foreign officials are encountered, including those suspected to be corrupt, then the United States wants their money.
- Officials from Treasury, Justice and State departments, the Federal Bureau of Investigation, the Drug Enforcement Administration and the United States Agency for International Development frequently meet with foreign leaders and officials to discuss and offer assistance in addressing issues of drugs, crime, corruption and terrorism. Yet, these earnest efforts are severely undercut when private bankers initiate or respond to the desires of corrupt foreign officials or those acting on their behalf to move funds to and hold assets in U.S. bank accounts. The perception is very widespread in developing and transitional economies that the West - the United States and Europe in the main - is not serious about reducing the very profitable part of its business maintained from the accumulation and management of the proceeds of corruption.

### **Private Banking,**

The United States has, according to all credible estimates, become the largest repository of ill-gotten gains in the world. U.S. private bankers honed their products and services in the 1970s and '80s, targeting particularly Latin American, African and Asian capital that was gushing into Europe. What had earlier been a somewhat passive function has now become an active pursuit, with expanding private banking departments taking advantage of porosities in the regulations of this and other nations, frequently operating at the outer edges of legal and policy constraints. In these efforts, more secrecy is often accorded to corrupt foreign interests than is available to U.S. citizens. Long before the expression "don't ask; don't tell" entered into the American lexicon, it had become established procedure in U.S. financial institutions.

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- The United States should take the lead in removing the offer of safe haven to corrupt money from around the world. An effective approach to this task would, while maintaining existing compliance requirements, add three strengthened regulations to U.S. banking practice:
- Establish that public corruption by foreign government officials or handling the proceeds of corruption by their immediate family members or anyone acting on their behalf constitutes a crime or predicate offense under U.S. antimoney-laundering legislation.
- As regards deposit, savings or custodial accounts of foreign government officials, their immediate family members or anyone acting on their behalf, require U.S. banks to maintain on file two current reports signed by bank officers attesting to inquiries and examinations confirming that deposits and inward transfers to these accounts (possibly above a threshold amount such as \$10,000) have been carefully scrutinized, including through third party inquiries, to reasonably assure that such inflows comprise money that has been legally earned and legally transferred.
- Require the account holder - foreign government official, immediate family member or anyone acting on their behalf to sign a periodic declaration to be held by the bank stating that deposits and inward transfers being made constitute money that has been legally earned and legally transferred.

These regulations will have little or no effect on U.S. banking activities of foreign government officials who have legitimate non-government financial resources and/or government compensation levels sufficient to their U.S. account activity. However, the regulations, in particular the final one requiring account holders' declarations, will have the effect in very large measure of discouraging lodgment in the United States of the proceeds of corruption. After establishing such regulations in the U.S. banking system, efforts should then be made, as was done in the case of the Foreign Corrupt Practices Act, to encourage adoption of similar legislation by other governments.

### **A Three-Part Problem**

The combination of criminal money laundering and illegal flight capital constitutes the biggest loophole in the free market system. Drug kingpins and global thugs thrive because money laundering is easy, and money laundering is easy because illegal flight capital is cultivated and maintained. No western nation is more harmed in this process than the United States. The fallacy in our policy is that we attempt to control the criminal element while at the same time pursuing and facilitating the corrupt and tax-evading elements. This is not possible. We will never effectively curtail the one while at the same time soliciting the other.

Success in fighting dirty money will be achieved only when the United States addresses all three parts of the problem - criminal, corrupt and commercial. Of these, the corrupt component arising in foreign countries is perhaps the most damaging in its impact on U.S. domestic and foreign interests, hugely multiplying the criminal and commercial tax evasion components. Purposefully drawn policies and regulations can greatly diminish foreign corrupt money in U.S. financial institutions, markets and assets, and the effort will prove beneficial to a broad range of our most vital interests.