Criminal Empires

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Over the last decade those engaged in the study of, or the battle against criminals and criminal organisations have become increasingly preoccupied with the problem of how the income from such activity is hidden and laundered. This new concern reflects a dramatic expansion of the scope and wealth of criminal empires over the course of the 1970s and 1980s[1].

The sums of money under their control are sometimes seen as sufficient to threaten the financial foundations of small countries, undermine the fiscal integrity of large countries, and introduce an important new element of instability in the operation of the entire international monetary system.

While the drug traffic is the most notorious constituent of the flow of dirty money seeking to hide and then reappear, suitably cleansed, there are many more. Huge sums are generated by everything from arms trafficking to maritime fraud, from insider trading to smuggling. Furthermore, one of the most important contemporary criminal activities in terms of size and social impact is the looting of developing countries by those in a position to plunder the public purse and strip the foreign exchange reserves. It is a rare drug baron whose wealth can't match that of several recently deposed or retired heads of state.

In fact, of the various components of the international pool of dirty money, the sums generated by what might be seen as more benign forms of criminal activity—be they asset stripping, commodities fraud, counterfeiting and a whole host of other so-called white collar crimes—are likely far greater in aggregate volume that those deriving from drugs. Official estimates of the annual global flow of drug money sometimes top the US $500 billion level. It is certainly true that many countries' finances have deteriorated to the point where their solvency depends in good measure on the inflow of money from the export of drugs—Jamaica, Lebanon, Bolivia, Peru and Colombia, for example. Furthermore within countries, particular regions such as Sicily and Florida, have, at various points in their recent history, been similarly dependent on drug money for a substantial part of their prosperity. Revelations of massive drug-money laundering operations continue to shake the reputations of major banks—witness recent scandals around the Bank of Credit and Commerce International in Luxembourg, the big Swiss banks in the "Lebanese Connection" case, or the Banco de Occidente following Operation Polar Cap[2].

Nonetheless, common sense suggests that global dirty money flows derived from other sources—capital flight and fiscal fraud, diamond and gold smuggling, trafficking in stolen goods and securities and so forth—are likely much greater in aggregate volume than those produced by the drug trade. But that is not grounds for complacency. Precisely, the reverse. All of that dirty money circulates through the same clandestine channels, hide out in the same havens, and employs the same methods to avoid detection. That poses a special problem for tracing—and retrieving—criminal financial flows. Once drug money is mixed with the rest, for a host of technical and political reasons, separating the two is often impossible.

The laundering process

The process by which criminal money is hidden and laundered is generally addressed at an enterprise or a purely technical level. At that level money laundering is a three-step process with variations limited only by the money launderers' imaginations. First, criminal money is secretly accumulated; second it is moved to refuge in a financial institution (either hidden in the accounts of an onshore business or deposited with an offshore bank); third, it is returned to the person of criminal organisation initiating the process with the geographic and/or occupational origins of the money disguised[3].

The actual techniques used are themselves merely minor variations on devices used routinely by legitimate business. In the hands of criminals, transfer pricing grades into phony invoicing, inter-affiliate real estate transactions become reverse flip properly deals, back-to-back loans turn into the loan-back scam, hedge or insurance trading in stocks or options becomes matched or cross trading, and lateral transfers develop into the so-called Chinese underground banking scheme.

Nor, when these techniques are actually applied to criminal money, have they changed much in spirit or objective since the 1920s when American bootleggers, flush with cash and fearing the attentions of the tax authorities, first pioneered them.

What is different now is not so much a matter of technique per se or of objective. Rather, it is the scale on which the laundering takes place.

Over the last two decades, the drug trade has changed from serving a set of essentially unrelated regional markets to catering to a burgeoning and increasingly integrated world-wide market[4]. Similarly, in place of the old pattern of the occasional money laundering institution, there has emerged what is virtually an integrated underground multi-functional global financial system. It serves to assist flight capitalists in evading exchange controls, to abet insider traders in evading the scent of the securities commissions, to help fiscal fraudsters in evading taxes, and to aid drug traffickers in evading the scrutiny of law enforcement officers.

As a result of these developments, money laundering, and the very criminal activities that generate the money needing to be laundered, should be understood not just as enterprise level phenomena to be dealt with as a technical problem of law enforcement, but as global macro-economic phenomena that ultimately have only a political solution.

There are many developments in the world economy, and the international financial system, that have not only greatly facilitated the practice of moving and laundering dirty money, but converted a problem that used to manifest itself on the enterprise level into a genuinely systemic one.

The underground economy

The most striking change in the overall profile of economic activity over the past decade has been the remarkable growth of the percentage of economic activity of all sorts now done "off-the-books"[5]. In many countries the underground, unreported sectors are now sufficiently large to make nonsense out of official economic statistics and therefore out of the economic policy prescriptions based upon them. Most of the transactions done in the underground economies consist not of explicitly criminal activity but of otherwise legitimate business activity that has chosen to go off-the-books to evade taxes and dodge regulations. Nonetheless, the growth of the underground economy prepares the way for the generalisation of explicitly criminal activity both by extending the frontiers of acceptable economic behaviour and by creating a whole host of new opportunities for money launderers.

Fuelling the world economy

In Western countries the growth of the underground sector reflects a complex network of social and political factors. On one level it indicates the breakdown of social consensus and the de-legitimisation of the state in the eyes of its citizens. The causes of that de-legitimisation stem from everything from perceptions that the fiscal system is blatantly unfair, to the renewed vigor with which the greed of individual accumulation has been pushed in the last decade. All the recent rhetoric by politicians about the need to get the state off the backs of the entrepreneurial classes, together with aggressive pursuit of deregulation, has created a climate of entrepreneurial "permissiveness" that inevitably blurs, in some people's minds, the borderline between legitimate and illegitimate economic activity.

After all, criminals rarely object to the concept of free enterprise. They simply take the concept to its logical conclusion[6].

The spread of underground transactions aids criminal money laundering in a practical way as well. Logic and convenience should dictate that cash transactions in a modern economy decline in relation to those conducted by credit card. It is often assumed by law enforcement personnel that the dramatic rise in the volume and percentage of sales of cars and houses done in cash in certain areas is prima face proof of the spread of drug trafficking. In fact, it could just as easily result from the off-the-books sale of macrame wall hangings. The more off-the-books transactions of all sorts occur, the more cash will be in use; and the more cash is in use, the less attention a drug trafficker will draw to himself by high profile cash purchases.

Furthermore, traffickers seeking to actually launder their cash before using their criminal incomes also benefit from the proliferation of otherwise legal, off-the-books activity. The greater public acceptance of the underground economy, the more sophisticated and widespread the institutional facilities for dodging regulations and taxes, the greater will be the availability of facilities for laundering drug money.

Technically the processes are identical. Drug money will be part and parcel of a burgeoning pool of black and grey-market money and able to take full advantage of all the services available for that pool, both at home and abroad.

In developing countries the main factor that has stoked the growth of the underground sectors of their economies, including the trafficking in drugs, has been economic crisis—the interrelated combination of deep recession and an unbearable burden of international debt. As a result, in many countries the underground sectors probably equal or even exceed the legal economy in aggregate turnover.

In the context of the general growth of underground economic activity in developing countries, drug trafficking ceases to exist as a segregated and socially marginalised economic activity, and instead becomes just one element in an interrelated matrix of black markets in which gold might be exchanged for arms, arms for drugs, drugs for cash, cash for American cigarettes or Japanese electronics and those goods in turn for precious stones. Once drug trafficking is subsumed into a complex network of black market deals, the layers of financial and economic, not to mention political and military cover, enjoyed by the trafficker are inevitably compounded.

Nor is there much prospect of reversing the growth of black market activity in developing countries until a process of broadly based economic development can be reactivated.

The service economy

Another of the structural changes in the world economy facilitating the hiding and laundering of criminal money is the growing percentage of measured GNP in developed, and in the more advanced developing countries, that is accounted for by the "services" sector[7]. It is a general trend in economic history that countries start with their economies geared overwhelmingly to primary production; shift towards secondary manufacturing activity; then in their "mature state", concentrate on the tertiary, or services sector. This shift from production of tangible goods to the production of intangible services opens up new possibilities for the laundering of criminal money.

The best cover for the domestic laundering of criminal money is a business engaged in legitimate retail trade, especially one that generates large amounts of cash on a regular basis. The higher the service content of the products sold, the greater the potential to use the legitimate retail business to hide the proceeds of crime. Successful use of a retail business for disguising the flow of illicit money requires that is must be difficult for anyone probing the accounts to define a clear relationship between the cost of physical inputs and the total value of the output. The difference between them is largely the "service" part of the business. The higher the "service" component of the product being sold, the easier it is to falsify the accounts.

Of course money washed through retail businesses attracts the attention of the tax collector. But, contrary to the stereotype that the criminal economy always involves tax evasion, smart criminals pay at least part of their taxes. Money cannot be regarded as washed completely clean until the state has effectively inspected and certified the cleansing job by accepting the money launderers' tax return.

However, for those criminals who wish to shelter as much income as possible from the state and are not satisfied with the myriad of schemes the state provides the wealthy for legally evading taxes, retail businesses provide ample opportunities reduce the tax bite even further by inflating costs. The techniques are the obvious ones—paying wages and salaries to ghost employees, paying fees to "consultants" and the falsifying of invoices for supplies.

Nor is that the only potentially dangerous implication of the rise of the service sector. It may also mean that a widely held view of the operational difference between criminal and legal business may be in the process of becoming obsolete.

There is a common confusion between two different concepts of hiding money. Sometimes the objective is to hide the very existence of a criminal money flow—for which purpose there are few alternatives to working in cash. But sometimes the objective is to hide the nature, rather than the existence, of a criminal money flow. An on-going alibi becomes more important that anonymity. In this case there is nothing that logically precludes the use of checks or credit cards in conducting retail deals in contraband goods or services. There is no doubt that cash still dominates retail drug deals. But it may well be that the use of checks is now more than an occasional oddity; and given the frequency with which prostitutes now accept credit cards, it would be foolish to assume that drug traffickers are far behind[8].

On balance, given the fact that accounts in retail service businesses are easy to falsify, one could enunciate a straightforward rule—the higher the percentage of GNP accounted for by the services sector, then, from the point of view of the economy as a whole, the easier will be the job of laundering criminal money.

Debt crisis and drug boom

Another fundamental structural change in the world economy that has directly affected both the supply of black market money and the facilities available for laundering it is the international debt crisis[9].

During the 1970s developing countries had easy access to the international banks, with the result that their debt loads escalated rapidly. After 1981 the supply of new loans dried up. At a time of acute economic crisis, the worst since the 1930s, developing debtor countries found their financial positions crushed under a twin burden. They had to pay service charges on existing debt at a time when interest rates reached unprecedented levels and the prices of their legal export commodities were severely depressed. They also had to support a huge wave of capital flight as their elite, increasingly jittery over the social instability that the economic crisis was engendering, set up en masse unregistered retirement savings plans in the usual offshore havens.

Money literally poured out of the developing debtor countries, through the tax and bank secrecy centres, to sanctuary, especially in the US. The same American banks, whose commercial banking departments had been so eager to lend their depositors" money to the developing countries in the 1970s, now put their private banking departments to work collecting it back again in the form of flight capital. In many debtor countries, the total amount of capital flight exceeded their aggregate foreign debt. While US banks made about 30 percent of the original loans, the US culled about 65 percent of the return flow of flight capital.

Not only was the resulting credit crunch a central factor in accelerating the general rise of black market activity in many developing countries, but it also put some of their governments in an awkward position. Given the curtailment of new bank loans and the burden of capital flight, the only way they could continue to pay interest on their existing debt and to buy essential imports (without which further industrial decline or even starvation were possible) was to attract back itinerant money. Inevitably that included a return flow of narco-dollars. Suitably washed through neighbouring bank secrecy and tax havens, narco-dollars were on the surface indistinguishable from flight money returning home. As economic conditions worsened, governments facing mounting social unrest were not inclined to peek too far below the surface.

That raises an obvious question with respect to all of the pressure being placed on developing countries to curb the activities of their narco-trafficantes, namely whether or not they should insist on a quid-pro-quo. Some have argued that the additional burden imposed by co-operation in the war on drugs that primarily benefits the Western consuming countries, especially the United States, is grounds for asking for additional financial aid and/or debt relief. For developing countries, the most useful form would be to implement programs to eradicate drug trafficking and to search and seize drug traffickers' assets held inside their countries of origin, and to demand that, in exchange, the US agree to combat the laundering of flight capital through American banks. After all, capital flight from developing countries does them far more economic and social damage than the sale of developing country-produced drugs does in the

United States. The social and political violence associated with the American-sponsored war on drugs in Latin America has only served to exacerbate the problem of capital flight.

Incidentally, that problem of distinguishing flight capital from drug dealers' treasure, or for that matter from tax evaders' hoards or from the financial flows of insider trading, works two ways. As the private banking departments of major US financial institutions expand their world-wide business in competition with Swiss and similar institutions that have historically dominated the refugee money trade, who can really be sure about the origins of the wealth they are administering? Who can verify how much is the result of capital flight or a tax revolt by the elite of developing countries—money the US welcomes—as distinct from the cash hoards of drug dealers whom the US claims to be committed to rooting out and seizing? That raises the fourth structural change in the world economy that facilitates the laundering of criminal money—the blurring of the behavioural distinction that used to be observable between legitimate and illegitimate money[10].

Casino capitalism

The last two decades have witnessed a dramatic shift in the nature of asset preferences among investors. Increasingly, as exchange controls and restrictions on international investment are being formally dismantled or informally undermined, as national and international financial supermarkets emerge, as the technology of electronic information flows knits together national money and capital markets, there has emerged a great ball of speculative liquidity which races around the world at the touch of a computer key, searching for tiny interest rate spreads, anticipating exchange rate changes, or fleeing real, imaginary or contrived political instability.

Today, foreign exchange markets turn over daily some $175 billion, of which only about 5 percent is directly linked to the financing of international trade. The rest is purely speculative in nature with the result that matched or cross-trading in currency and precious metal options has become potentially the most efficient, and one of the hardest to police, of all the techniques of modern money laundering[11].

That speculative fever, so evident in currency markets, has also infected the world's stock markets.

Making the fruit forbidden

There was a time, not so long ago, when fiduciary institutions, pension plans and even wealthy individuals used to select securities on the basis of long term prospects for capital gains which in turn were based ultimately on the economic success of the underlying business. Of course there was always a speculative element at play; but it was assumed that the trends of market values would, over the long run, reflect economic fundamentals.

Now the investment function of equity markets has been overwhelmed by rapid-fire, computerised speculative trading programs. That has had two consequences for the laundering of criminal money. One is that criminals have found it easy to insert themselves in the speculative matrix. Brokerage houses have become important depositories of criminal money, and cross-trading along with boiler room sales, has given criminal financial managers an opportunity to simultaneously launder money and swindle innocent investors[12].

The second consequence is the ironic one. The more sophisticated have financial markets become in terms of their capacity to circulate wealth and turn over assets, the less dependable they have become as instruments for financing long term capital accumulation. That opens up more opportunities for criminal cash to seek respectability—in the form of long term investment as venture capital in otherwise legitimate enterprises starved for funds by the diversion of organised capital markets into purely speculative activity.

In both cases, this shift in the nature of equity markets has meant the blurring of the frontier between the criminal and the legal economy. In developing countries this frontier has always been poorly defined. The Colombian stock exchange routinely trades bearer CDs that were issued by the central bank, no questions asked, in exchange for black market dollars. It is not farfetched to suggest that much of the success of the Bombay Stock Exchange is based on its role as a huge laundromat for for smugglers. In Hong Kong and Panama the very distinction between criminal and legal money is an alien concept.

In the industrialised countries the recent blurring of this frontier has meant that criminal money is better able to hide among the financial flows of the legal economy. There are those who would suggest that the Vancouver Stock Exchange, for example, is nothing more than an overgrown boiler room fueled by Hong Kong flight capital and drug money, while the American market for penny stocks has recently been spotlighted as another institution to attract the unwanted attention of mob-linked scam artists.

That mixing of hot money flows into a great ball of speculative liquidity is not fully comprehensible without reference to a fifth development in the infrastructure of international finance—the rapid spread of banking and corporate secrecy havens around the world. Financial havens established in one political jurisdiction to evade another jurisdiction's laws have a long pedigree, particularly in Europe[13]. But in the 1970s and 1980s, paralleling the emergence of a genuine underground banking system operating on a world scale, the number of political jurisdictions providing sanctuary to money seeking secrecy and refuge from the fiscal, monetary or juridical authorities of its place of origin proliferated almost faster than accountants specialising in tax evasion could keep track of them[14]. There were several reasons.

Euromarket and underworld

One was the boom in international bank lending through the Euromarket in the 1970s and early 1980s. International banks attempted to get a competitive edge on each other by booking loans through offshore havens. Use of an offshore booking branch meant three crucial freedoms—freedom from restrictions on how, where and to whom they could lend, freedom from regulators who might want to subject the bank's capital position to embarrassingly close scrutiny, and freedom from the onerous burden of paying taxes on the income earned from their lending activities.

Where branches of big international banks set up shop, smaller banks followed, offering their clients three crucial freedoms—freedom to do with their money what they wanted, freedom to avoid having law enforcement agencies poke into the results, and freedom from the onerous burden of paying taxes on the consequent personal and business income.

These developments were encouraged by the haven countries. A number of small, impoverished island economies—first in the Caribbean, then in the South Pacific and more recently in the Indian Ocean—tried to compensate for lack of indigenous natural resources by generating income and employment in the financial services sector. It was the collapse of employment in shipping that launched in the Cayman Islands into the financial services business; and it was after the debacle of its steel industry that Luxembourg decided to replace to jobs by pushing the growth of the banking şector.

The result is that explicitly criminal activity can be conducted through financial machinery that is protected by two sets of interests. One is a powerful lobby of legitimate financial institutions and corporations from the major countries to whom the Euromarket offshore booking facilities and the potential of incorporating subsidiaries in tax havens are essential to maintaining a competitive edge. The second is the ruling political elite of the haven countries who literally cannot afford to have their countries' status as banking and corporate secrecy havens challenged.

Curiously, in all the storm and fury over criminal money flows, this dependence of the haven countries on their financial services sectors is glossed over. While occasionally some token offer is made to drug-producing countries of financial aid for crop diversification (the value of which is almost immediately negated by such activities as the recent American sabotaging of the international coffee agreement), no serious offer of an alternative source of employment has ever been made to a financial haven country. The result is that they are all still in business, and likely to remain so for the forseeable future.

Needless to say, once drug money begins circumnavigating the world of tax and bank secrecy havens, once it is mixed in with the enormous sums coursing through the modern international money market, it is virtually impossible to identify. This is particularly the case because, while the governments of some haven countries are willing, at least in theory, to co-operate in the search for drug money, they will do nothing to undermine their countries' attractiveness to other forms of money of dubious origin. Once abroad, it is simple to use bank and especially corporate secrecy laws of one, or preferably, a multitude of financial havens, to disguise the nature of the money and return it, via phony invoicing, through sham real estate or stock transactions or by the use of the loan-back scam, to the criminal entrepreneur.

Not all bank and corporate secrecy havens are of equal value to those intent on hiding and laundering criminal money. Their value will depend on how well integrated they are into the global financial system. It will depend on how truly secure their banking and corporate secrecy laws are. It will also depend on how much cover their normal economic activities provide.

This was the key consideration in making Panama the premier laundromat of the hemisphere. Panama is much more than a large banking and financial centre[15]. Its economy rests on several major service industries. Furthermore, it lacks a national currency of its own—the US dollar circulates instead. Many other countries in the region have bank secrecy laws as tight as those of Panama, and many others are just as heavily involved in the instant-corporation manufacturing business, but none can boast the cover of a huge legitimate inflow of US dollars—from tourism, trade and military spending. The fact that Panama has perfectly legitimate reasons for generating large surpluses of US currency forms, for the wholesalers of drugs, a macro-economic equivalent of the cover a retail service outlet would give a street dealer intent on laundering his proceeds. It also helped to make Panama something of a clearing house for other bank secrecy havens in the Caribbean—insta-banks set up other havens that could hold their assets in the form of deposits in Panamanian banks, and any suitcases of cash that came their way could be shipped off to Panama instead of attracting unwanted attention by being remitted directly back to the United States.

Cashing in on the global economy

Use of tax and bank secrecy havens is only necessary if the criminal entrepreneur is faced with the need to engage in full-service laundering—placing cash in the financial system, disguising its origins and then withdrawing it again for business or pleasure. In fact, there are several developments in the world economy that provide opportunities to completely avoid contact with the formal banking system.

One of these allows the trafficker loaded with cash from retail sales to take advantage of the burgeoning world black market and its insatiable appetite for American currency. It assures that, by the time the American currency is finally deposited in a bank, it is so far removed from the drug trafficker by virtue of having circulated through so many interrelated black markets, that the money trail is simply impossible to follow even if each and every bill contained an electronic beeper and a row of flashing red lights.

Recently there has been concern expressed over the ultimate destination of about half of the $100 bills printed every year in the United States. There have been reports that by now nearly $50 billion worth can be found washing around in the huge international black market economy where those bills form one of the main instruments for conducting wholesale exchanges and one of the most popular instruments in which black market savings are held. Nor are the $100 bills alone. Two years ago the total stock of such US currency listed as "missing" and presumed alive, well and living abroad was already put at $125 billion. Assuming, as seems reasonable, that the velocity with which that stock of bills circulates in the underground economy is not dramatically slower (in fact it is likely even faster) that the rate at which cash circulates in the overground economy, the aggregate flow of contraband trade that can be turned over with $125 billion in cash is truly staggering[16].

This is good news for those seeking an interest-free device for shifting the burden of financing the US budget deficit onto the rest of the world, but it does have important adverse consequences for tracing criminal money.

Take a hypothetical suitcase of US $100 bills accruing to a Colombian trafficker. It could be used for a variety of purposes. To keep business going, some of the cash could be sent to Peru or Bolivia to buy coca paste.

In the coca growing areas of Peru, representatives of Peruvian banks arrive to convert dollars to local currency, and to transport the dollars to Lima where dollars can be sold at a premium above their purchase price in the countryside. The bank collects an arbitrage profit, and the dollars are swallowed into a black market that involves millions of people and trades everything from baby food to electronic goods.

Some of those dollars similarly sent to Bolivia to buy coca paste might find their way to Brazil and Chile to purchase ordinary consumer goods which are smuggled back into Bolivia. The dollars in turn might be converted into Brazilian gold and precious stones (which are smuggled abroad and sold for huge marks-up). They might be swallowed up in local black markets or they might be resold to persons seeking foreign currency in amounts greater than allowed by exchange control law. Those persons, in turn, would use the dollars to import goods from abroad, to set up a retirement account in Switzerland or to pay a visit to Disneyland.

Some of the dollars accruing to Colombia traffickers could be sent to Venezuela. Approximately $100 million in contraband trade flows across the

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Colombia-Venezuela border every month. Venezuela long used its petro-dollars to subsidise the import of consumer goods, especially durables such as automobiles, and to keep down the prices of essential products—meat and gasoline. It did it with so much success that the authorities are now looking for fully $8 billion illegally diverted from the foreign exchange fund into the hands of businesses and individuals which did not qualify for the subsidies. This massive embezzlement indirectly facilitated the laundering of Colombian drug money. Dollars could join contraband gold in flowing across the border into Venezuela to be exchanged for cheap, government subsidised consumer goods to be brought back to Colombia and resold for pesos at prices kept high by absence of subsidies and high tariffs.

Finally, some of the cash could be used in Colombia to purchase black market emeralds which are then smuggled out of the country. Colombia is by far the world's largest producer of emeralds and about 75 percent escape the official monopoly. Trading cash for emeralds permits both the divestiture of that cash and its conversion into an asset that, when resold abroad, may generate a profit of 400-1,000 percent (and far more if the exporter also controls the downstream cutting, polishing and retail sale). The proceeds of resale could then be invested in a piece of prime Costa del Sol real estate or used, through the front of a Netherlands Antilles shell company, to invest US government treasury bills to help finance the war on drugs.

A similar complexity characterises the opium-heroin traffic in South East Asia. In Burma the production of narcotics is dominated by a bizarre tactical alliance of Shah state separatists, old guard bosses of the Burmese Communist party and Kuomintang geriatrics. But drugs are only one of a host of contraband products that Burma produces. Some 70 percent of its jade, most of its teak wood and an increasingly large share of its tin join the flow of looted antiquities from Burmese temples in crossing the borders into Thailand. The insurgent ethnic militias, where they do not directly control the trade in various forms of contraband, encourage it and charge export taxes.

In Thailand, Hong Kong merchants buy Burmese teak and tin, jade and heroin, and stolen temple carvings indifferently, paying in general consumer goods, gold, arms and US dollars. Those dollars then join yet more jade and teakwood in crossing the border into the People's Republic of China where they are traded, once again, for general merchandise manufactured in China or imported into China from Hong Kong.

Of course, once the heroin gets exported from South East Asia markets into North America, the financing techniques must change. But it is still possible, at the international and wholesale level, to avoid contact with the formal banking system by employing the so-called Chinese underground banking system[17]. The ease with which this can be applied reflects another important structural change in the pattern of world commerce over the last few decades.

Side-stepping the formal banking system

Partly as a legacy of colonialism, partly as a result of civil strife and the search for economic opportunity not present in their places of origin, there has been a dramatic increase in the size and geographic spread of so-called trade diasporas—international networks of persons of common ethnic (and frequently extended family) background through which a great deal of international trade of a specialised nature is conducted. Just as in the US with regard to the crime groups of Sicilian and Neapolitan origin many decades ago, within the modern trade diasporas (Iranian, Israeli and Lebanese, Colombian, Cuban and Vietnamese, for example), ethnic mafias find it easy to hide, taking advantage of the opacity (in the eyes of the host country authorities) of the ethnic minority's language and customs, and the high level of mutual trust that may exist among the members. Almost any ethnic community that defends its cultural identity in its new home is likely to find itself exploited by criminal elements.

The advantages for the international criminal organisations of secreting themselves inside a trade diaspora are obvious—it permits adoption of lateral transfer techniques to paying for contraband goods. In the most often cited example, a shipment of heroin, for example, goes from the Far East to the West Coast of North America; as an order to pay a sum sufficient to cover the cost is secretly transmitted (in code or by word of mouth) to a legitimate business in Europe run by someone with ethnic ties to the traffickers. The bill is paid, and the businessman is compensated by a shipment from yet another part of the world of some perfectly innocent commodity necessary for his legitimate business.

Those studying the arts and sciences of money laundering react with amazement at the apparent fiendish cleverness of the so-called Chinese underground banking system, proof positive, it seems, of the inscrutability of the oriental mind.

The reality is that lateral transfers are routinely used in legitimate business. Certainly, even when done by overground institutions, they can grade into the grey or black areas of finance. The big American money centre banks used a lateral transfer technique—accepting pesos on deposit and making the equivalent in dollars at the black market rate available to the depositor in some other country—to do a thriving capital flight trade out of Mexico City until the Mexican authorities shut it down in 1986. Similarly, a Hong Kong bank could accept narco-dollars in cash and wire the money to a Santo Domingo casino. There the trafficker might withdraw it in chips, then recash the chips and have the money, disguised as gambling profits, wired back to his American account. But it is also true that tourism, a modern cash-heavy service industry, would have difficulty functioning if currency exchange houses were unable to accept a deposit in one currency and allow the depositor to withdraw it in another currency somewhere else.

Furthermore, the adaptation of the lateral transfer business to international commodity exchanges was first done, not by wily orientals operating from the back rooms of opium dens, but by legitimate international traders seeking to avoid the cost, inconvenience and potential danger of cash remittances. The coded instructions for third party payments used in the Chinese underground banking system are nothing but a criminal refinement of the operating principles of the bill of exchange that financed the overwhelming majority of the world trade from early modern times until well into the 19th century.

All that glitters

Yet another way to reduce, or even eliminate, contact with the international banking system is through the use of non-monetary instruments for effecting payments. There are all kinds potentially available—everything from rare postage stamps to airline tickets. The only criteria is that they be valuable in relation to bulk and easily liquified. Precious stones fit neatly into those categories—witness cocaine traffickers' traditional use of Colombian emeralds, as well as the increasing use of the Israeli diamond exchange facilities[18]. But first and foremost among non-monetary (or perhaps, in this case, semi-monetary) instruments for making international remittances is gold.

South Africa traditionally markets its gold in standard-sized bars through London. But from London part of that gold moves to Amsterdam and Zurich to be made into small bars and even wafers that are custom built for smuggling.

The gold then follows several routes. One is to Hong Kong, where it is absorbed into the general contraband (including narcotics smuggling) and capital flight business of the entire South East Asian region.

Another part goes to Istanbul where the Turkish *babas* trafficking in drugs and arms, on-ship part of the gold to Lebanon, and handle the return flow of black market dollars and Deutschemarks from the entire Middle East, washing them through a co-operative network of Swiss financial companies and banks[19].

Another part goes to Dubai, and from there is smuggled into India where it becomes an economic linchpin of one of the world's largest and most sophisticated black economies. In India there is a huge demand by well-to-do citizens (and some not so well-to-do), for secret treasure troves of smuggled gold. But gold is also the instrument through which heroin is purchased. And the heroin trail in turn leads further north.

Whiskey, banned under Islamic law in Pakistan, and gold are transported from India into Pakistan. Conversely, Pakistan smuggles heroin and weapons into India. Both are courtesy of the proxy war between the super powers in Afghanistan, a war which has allowed the North West Frontier Province of Pakistan to surpass Lebanon as the world's premier arms and drugs bazaar.

Arms, drugs and covert war

Of all the close associations between drug trafficking and other forms of black marketeering, none is as important as the tie to contraband arms trade. The combination of international embargoes, rapidly growing demand (until recently) in developing countries, and the proliferation of so-called covert wars through which countries conducted their conflicts by proxy, all favoured the emergence of a vast underground network trafficking in everything from small arms to nuclear weapons delivery systems. Arms trafficking bears so close a relationship to international drug trading that the two frequently constitute a virtual bartering network.

It is more than merely the fact that drugs form one of the favoured means of payment for arms deals. The exchange of drugs and arms is, on the simplest level, merely a financial technicality, albeit that it produces the interesting result that the money from wholesale drug deals can resurface as the profits from an officially sanctioned arms deal. On a political and macro-economic

Living by greed alone

level there is much more involved. There has emerged an actual symbiosis between the underworld of drug dealing and the underworld of arms trafficking. The two overlap through their sharing of personnel and methods, and both are in turn further integrated into the underworld of covert war[20].

The political interrelations between various sets of underground economic actors—be they drug traffickers or cut-outs acting quietly on behalf of governments in supplying the underground market with arms; be they guerrilla organisations committed to overthrowing a particular government or ideological system, or agencies of some existing governments engaging in covert economic warfare against others; be they smugglers and pirates operating on strictly private account or embargo busters pursuing the same kinds of activities on behalf of a sponsoring government—are extremely complex.

The result is that tracing the flows of money associated with a heroin trafficking organisation in Boston can blow the cover off a bank account set up by the IRA to fund weapons purchases. The heroin trail in the Indian subcontinent wanders past the operational centres of Afghan guerrillas, Pakistani military intelligence officers, Sindhi bandit gangs, Sikh separatists and Bombay gem smugglers in one direction, and through Iranian gun runners, Turkish gold smugglers, Bulgarian customs officers and Sicilian mobsters in the other[21].

Political obstacles to detection

Were not these structural developments in the world economy sufficient to complicate the search for drug money, there are a host of political problems on top. The most important of them is illustrated clearly by the confluence of drugs-and-arms trafficking and proxy warfare.

Major Western governments often use considerations of national security as a pretext for being at best highly selective in their efforts to stamp out drug trafficking. That same ambiguity characterises efforts to deal with the accompanying problem of how to curb the laundering of criminal activity proceeds.

For decades clever drug dealers, and the money launderers who aid and abet them, have been fully cognizant of the fact that the ultimate protection for their activities lies not so much in successfully using the corporate or bank secrecy laws of offshore havens, as in convincing governments, and in particular those governments' intelligence agencies, that their criminal activity in some way advances the national security of foreign policy objectives of the countries concerned. The examples are legion. Recall, for example: the American OSS, predecessor to the CIA, and its role in the resurrection of the Sicilian mafia during and after the Second World War or the similar role of the CIA in the

Corsican mob expansion in Marseilles in the late 1940s. Another example is the degree to which CIA-trained Cuban exiles, once freed from the pretense of waging war against Castro, leapt wholeheartedly into the business of trafficking in drugs and arms, using smuggling and money laundering techniques taught to them by their intelligence agency sponsors. Another is the on-going three-way connection between Taiwan's military intelligence, the country's biggest criminal organisation (the Bamboo Union) and the Kuomintang armies that traffic in opium and heroin in Burma and Thailand. Also, the Gaullist recruitment of underworld figures for rebuilding the French intelligence services in the 1960s, with the result that when the famous French Connection heroin ring was finally broken, by some accounts as many as half of those arrested had a tour of duty with one of the French intelligence services on their curriculum vitae.

No list would be complete without mentioning the long history of collaboration between the Japanese Yakuza and the country's military and political intelligence service, the recent scandals resulting from co-operation between Italian military intelligence and organised crime and the ties between the Bulgarian intelligence and Turkish *babas*. Also important is the multifaceted interplay between Colombian drug barons, Panamanian money launderers, and the CIA-sponsored Nicaraguan contras. Israeli civilian and military intelligence figures have a long history of turning a co-operatively blind eye to hashish and heroin deals made between Lebanese mercenaries and Israeli mobsters, while the tight relationship between American and Pakistani intelligence with the factions of the Afghan mujehadeen have become perhaps the single most powerful force in the world heroin trade.

That list is scarcely exhaustive. A companion list of dirty-money laundering banks and financial institutions can easily be compiled, each with well-known ties to one or more intelligence services[22]. The number of times that notorious drug-money laundromats have been protected by political authorities (or at least by their intelligence services) while those same political authorities are publicly declaring their concern over the deleterious effects of drug dealing an international disgrace.

Needless to say, any effort to evolve a policy to deal with the problem of criminal money flows that ignores this political dimension is doomed to futility from the start. Of course it may also be true that any effort to evolve a policy to deal with the problem of criminal money that starts with the premise that the political dimension must be squarely addressed is equally doomed to failure, though for quite different reasons.

It must be stressed that what is at work is not some sort of tightly controlled conspiracy. Rather there is a symbiosis of interests between two different underworlds—the underworld of crime, or covert economic action, and the underworld of intelligence, or covert political action—that leads the two to share methods, techniques and personnel, as well as short term objectives. It is not a strategic consensus so much as a tactical alliance at the operational

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level. Because of it, efforts to combat organised crime can sometimes be blocked at the highest political levels by real or contrived considerations of "national security". The result, in the United States and elsewhere, is a history of politically motivated selectivity when it comes to singling out particular producing countries and/or trafficking organisations for criticism and punishment. Critics inside the Congress of United States quite rightly decry the extent to which recent administrations suppressed the fight against drug trafficking in the interests of covert foreign policy objectives. This process reached its culmination in a recent Senate report detailing the connections between certain elements among, or associates of, the Nicaraguan contras with cocaine trade[23].

Appalling though this contra-cocaine connection may be, no one has yet proven the existence a top-down conspiracy to finance the anti-Sandinista crusade with drug money. Nor is there any proof that breaking the contra-cocaine connection would have any discernable impact on the overall supply.

Those same voices in Congress who objected to US government Central American policy, and therefore took the occasion to discredit it by reference to contra corruption in general and drug links in particular, were strangely silent with respect to US policy in South West Asia. In Congress there was virtually universal agreement with the US policy of pouring billions in taxpayers' money into arming and equipping the Afghan mujehadeen.

Yet not only was about 60 percent of the aid being misappropriated, but within the political leadership of the Afghan mujehadeen there emerged a powerful drugs-and-guns mafia. Unlike the contras and their cocaine connections, with the Afghans the traffic is tightly organised from close to the top. Unlike the marginal position occupied by certain contra-linked elements in the cocaine trade, the Afghan drug barons have become the single largest source of the world's heroin. One can perhaps be forgiven the opinion that what counted to the honourable senators is not so much the tainting of anti-drug efforts by their subordination to foreign policy objectives, but precisely to which foreign policy objectives those anti-drug efforts are subordinated.

Conclusions

The problem of tracing criminal money flows—of which the proceeds of drug trafficking represent only one, and likely not the most important stream—is daunting. The techniques employed are certainly sophisticated and the bulk of analysis and enforcement activity has been oriented towards understanding.

But much more important than the techniques per se, are the complications raised by structural changes in world economy—the generalisation of underground activity, the rise of the services sector, the on-going crippling effects of the global debt crisis on developing country economies, the shift of the world financial system away from investment and towards pure speculation, and the emergence of a veritable network of interconnected world black markets through which the proceeds of illegal activity can be hidden and moved.

Nor can the political dimension of the money laundering process be ignored. There are all too many countries now, either producers of contraband goods or providers of financial facilities to hide the returns, that literally cannot afford to probe too closely into the nature and origins of the income flowing their way—without a major committment from the developed countries to replace income lost from illegitimate activities with debt relief, project assistance and trade concessions. While countries increasingly concerned about the sale of narcotics to their own populations have grudgingly come around at least to the principle of advancing economic aid to the producing countries, none have seriously considered similar programs to replace the income countries would lose from shutting down the financial apparatus that facilitates the laundering of criminal money.

Nor is it reasonable for the industrialised countries to expect much co-operation from the developing world until those industrialised countries are prepared to take some drastic steps to get their own houses in order—in a more fundamental way than merely stepping up efforts to track down and prosecute individuals.

Drug money, generated by the consumption preferences of the population of industrial countries is evil; but, in the eyes of those same industrial countries, flight capital, generated by the savings preferences of the population of the developing countries is not. Not only do both forms of hot money flow through the international financial system using the same techniques and often the same financial institutions, but it would be difficult to find an instance where drug money posed as great a threat to the social fabric of an industrial country as the flight of capital does to that of a developing country.

In both cases what must be done is to address the problem not just as a matter of crime prevention, but as symptoms of profound and disturbing changes in the structure of world economy and the interrelations among its member countries.

References

1 - It also reflects bandwagoning by politicians and press on a potentially "hot" issue that could be used to buy votes and sell news magazines. Public attention in the US, and in many other countries, was attracted to the issue by the 1983 publication of "The Cash Connection" by the US President's Commission on Organised Crime. It was a silly and sensational document, containing nothing new.

2 - These scandals kept the issue of money laundering firmly in the public eye. See, for example, *Business Week*, April 17, 1989, and *Time*, December 12, 1989.

3 - For a summary description of the technicalities of the process see R. Thomas Naylor "Drug Money, Hot Money and Debt", *The European Journal of International Affairs*, Vol II, No 3, Winter 1989.

4 - For an overview, see Pino Arlacchi, "The Worldwide Drugs System", *The European Journal of International Affairs*, Vol II, No 3, Winter 1989.

5 - There is vast and growing literature on the underground economy in which little is of value in understanding the criminal market mechanism. The great majority of that literature is concerned with the issue of "measuring" the aggregate size of underground activity, rather than probing structural or historical cause or empirical content. For a general survey see Vito Tanzi, ed, *The Underground Economy in the US and Around the World*, Washington: 1982. Also see, Edgar Feige, ed, *The Underground Economy: Tax Evasion and Information Distortion*, New York: 1989.

6 - This flies in the face of the notion of the organised criminal conspiracy—as in the stereotyped view of the American mafia or in the characterisation of Cali, Medellin or Guadalajara "cartels" in modern drug trafficking. For a statement of the contrary view, see Peter Reuter, *Disorganised Crime*, New York: 1983. Much of this debate is based on a confusion of criminal organisation as a social or political phenomenon with a conspiracy to control the actual market for contraband goods and services—where the rule of free enterprise seems to prevail.

7 - See especially C L Karchmer, *Illegal Money Laundering: A Strategy and Resource Guide For Law Enforcement Agencies*, National Institute of Justice, Washington: 1988.

8 - One of the best investigations into the interaction of the criminal and legal economy is by A G Anderson, *The Business of Organised Crime*, Stanford: 1979.

9 - For a detailed survey see R. Thomas Naylor, *Hot Money and the Politics of Debt*, Unwin, London: 1987.

10 - One irony of the capital flight phenomenon is that drug traffickers may be able to use efforts by developing countries to attract back flight capital, specifically through debt-equity swaps, as yet another tool for laundering their money. See *The Economist*, August 20, 1988.

11 - An excellent account of this technique was given by master money laundering and flight capitalist Michele Sindona to journalist Nick Tosches. See Tosches, *Power On Earth*, New York: 1986.

12 - For an excellent survey of these possibilities see Diane Francis, *Contrepreneurs*, Toronto: 1988.

13 - The first systematic investigation of the criminal use of overseas financial havens written in English was by Thurston Clarke and John Tigue, *Dirty Money*, New York: 1975.

14 - For a comprehensive look at the modern problem from an American viewpoint see Richard Blum, *Offshore Haven Banks, Trusts and Companies*, New York: 1984.

15 - For an overview of the financial regulations that account for Panama's success, see M T Hernandez, "Financial System of Panama" in Robert Effros, ed, *Emerging Financial Centres: Legal and Institutional Framework*, Washington: 1982.

16 - See, for example, *Time*, April 26, 1982, and *Globe and Mail*, Toronto, August 22, 1988.

17 - For accounts of this phenomenon, see James Mills, *The Underground Empire*, New York: 1986; C Lamour and M Lamberti, *The Second Opium War*, London:1974; and G L Posner, *Warlords of Crime*, New York: 1988.

18 - On the Israeli diamond exchange as a vehicle for cocaine money laundering, see *Middle East International*, April 14, 1989 and *Jerusalem Post*, March 13, 1989. Israel is one of the world's least known tax and bank secrecy havens. For a description of the accommodating and discrete attitude Israeli bankers have towards cash from abroad, see the Israeli newspaper, *Koteret Rashi*t, August 25, 1984.

19 - This was the kind of exchange that formed the basis for the notorious "Lebanese Connection" affair that precipitated a major scandal in Switzerland and forced the recent resignation of the Justice Minister. For an Account see Jean Ziegler, *La Suisse Lave Plus Blanc*, Paris: 1989.

20 - A thorough investigation of this interconnection is by Jonathan Kwitny in his work on the Nugan-Hand Bank. See his *The Crimes of Patriots*, New York: 1987.

21 - For a description, see *Forbes*, April 17, 1989.

22 - A number of examples are given in a book by the late Penny Lernoux, *In Banks We Trust*, New York: 1984.

23 - US Senate, Committee on Foreign Relations, Subcommittee on Terrorism, Narcotics and International Operations, *Drugs, Law Enforcement and Foreign Policy*, Washington: 1988.