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MONEY-LAUNDERING BILL SHOULD TARGET CRIMINALS, NOT LOW TAXES

DANIEL J. MITCHELL, PH.D.

The despicable attacks on September 11 in New York and Washington have underscored the importance of international cooperation in the fight against crime and terrorism. Regrettably, however, some politicians are using this effort as an excuse to attack low-tax countries. Claiming that financial privacy laws in "tax havens" hinder worldwide law enforcement, they want to restrict America's economic relationships with these low-tax jurisdictions. Money-laundering bills moving through the House and Senate, for instance, would allow the Secretary of the Treasury to label any jurisdiction a "primary money laundering concern" merely because it has a low-tax economy.

This is the wrong approach. The United States should seek to punish nations that harbor terrorists and their money, not nations with low taxes and financial privacy. Contrary to popular perception, bank secrecy laws do not prevent governments from obtaining information when investigating crime. This is true in America and in "tax haven" jurisdictions. Low-tax nations will collect and provide information that can be used to investigate and prosecute illegal activity in cases involving universally recognized crimes such as terrorism, murder, and drug running.

Money Laundering. The proposed legislation assumes that tax havens attract a disproportionate amount of dirty money. There is no evidence for this. Criminals rarely venture "offshore" because of the added risk. Shifting money across borders—and then back again when the funds are needed—dramatically increases the probability of detection. The United Nations has acknowledged that criminals avoid so-called tax havens since they are a "red flag" for law enforcement.

Most criminal money is obtained in the United States and Europe—and that is where it is laundered. The Organisation for Economic Co-operation and Development's Financial Action Task Force acknowledges that criminal "funds are usually processed relatively close to the underlying activity; often…in the country where the funds originate." According to an article in *Government Executive*, "The International Monetary Fund estimates that about $600 billion is laundered each year globally. Estimates of U.S. money-laundering

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traffic hover at $300 billion, including about $60 billion in drug money alone."

Punish America's Enemies. Law enforcement and intelligence agencies should track down terrorists and their funds, regardless of whether this leads them to high-tax nations or low-tax nations. Investigators have put together a mountain of evidence on the September 11 attacks, and these data should satisfy any legitimate "probable cause" tests that other nations require before waiving financial privacy laws.

The effort to stop international crime should be based on three principles:

1. **Identifying likely criminals.** Each day, there are 700,000 electronic money transfers involving about $2 trillion. The vast majority represent legitimate commerce. It is impractical to expect law enforcement to take these raw data and somehow identify the transfers that are criminal in nature. The first step, therefore, is to identify suspected terrorists and criminals so that the legal community can target transactions likely to be tied to illegal activities.
2. **Tracking beneficial ownership information.** Once likely suspects are identified, their assets also must be identified. Privacy laws can be suspended or waived during investigation and prosecution of universally recognized crimes like terrorism and murder.
3. **Using law enforcement resources wisely.** Some governments go to great lengths to tax income earned outside their borders. This is bad policy. Conscripting law enforcement officials and turning them into adjunct tax collectors diverts resources that should be used to identify and catch terrorists and other criminals.

The Right Approach. The United States should build better legal relationships with all civilized nations and punish those who harbor criminals and their funds. Specifically, the United States should:

- **Make clear that a lack of cooperation from other jurisdictions will not be tolerated.** Financial institutions in jurisdictions that refuse to cooperate by providing evidence, especially regarding the recent attacks, should be sanctioned. If this behavior continues, they should be denied access to the U.S. economy. Hiding terrorist money and shielding evidence is no different from sheltering terrorists.
- **Expand America's network of mutual legal assistance treaties.** MLATs set out rules that permit effective cooperation while respecting national sovereignty and due process. In general, they obligate signatory nations to assist in the investigation and prosecution of actions that are criminal offenses in both nations. This approach also would reveal nations that are unwilling to help the United States, either because they refuse to negotiate an MLAT or because they fail to comply with one that is in force, and thus are deserving of sanctions.
- **Drop the "tax harmonization" agenda put forth by international organizations.** The Administration should permanently derail international initiatives to hinder tax competition. The European Union and the OECD are seeking to prop up Europe's welfare states with polices such as "information exchange" that would allow them to tax income earned in low-tax jurisdictions. This is bad tax policy and reduces assistance from low-tax jurisdictions. Needless to say, extraterritorial tax enforcement should not be part of any MLAT. It would deter countries from signing these agreements and undermine cooperation.

The short-term goal for Washington should be the identification and punishment of the terrorists and all those who gave them aid. The long-term goal should be implementing policies that make it much more difficult for terrorists and other criminals to operate across national borders. Laws focused on criminal activity—combined with good police work and intelligence gathering—are the right approach. Sweeping new regulations on the financial services sector and unwarranted attacks on low-tax nations are not.

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The despicable attacks on September 11 in New York and Washington have underscored the importance of international cooperation in the fight against crime and terrorism. Because criminals and terrorists, such as those in Osama bin Laden's al-Qaeda network, often operate in more than one country, it is crucial that law enforcement authorities around the world assist each other by sharing information and evidence, including financial information. The challenge lies in achieving this cooperation without compromising either national sovereignty or the privacy rights of law-abiding citizens.

Regrettably, instead of seeking to promote international teamwork, some politicians are using the recent attacks as justification to go after low-tax jurisdictions (or "tax havens"). They argue that the successful financial services sectors of these free-market economies can be used for money laundering. The House Financial Services Committee and Senate Banking Committee have drafted similar bills ostensibly designed to fight global money laundering,[1] but both of these bills contain language that will hinder cooperation, restrict international tax competition, and undermine the sovereignty of low-tax jurisdictions.

There is a much better approach. To improve the international effort to bring the terrorists and their sponsors to justice, the United States should build better legal relationships with all civilized nations, regardless of their tax systems. Such cooperation often is facilitated by signing bilateral agreements such as mutual legal assistance treaties (MLATs). These pacts set out rules that permit effective cooperation while respecting national sovereignty and due process. Not all MLATs are the same, but they generally obligate the signatory nations to assist in the investigation and prosecution of actions that are criminal offenses in both nations.

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Many low-tax jurisdictions have MLATs with America and other nations. Others would like to sign MLATs, but this process is hampered because many high-tax nations—aided by the "harmful tax

1. The Senate version is S. 1511, the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, and the House version is H.R. 3004, the Financial Anti-Terrorism Act of 2001.

competition" initiative sponsored by the Organisation for Economic Co-operation and Development (OECD)—want to tax income earned in low-tax nations. Low-tax nations correctly refuse to be bullied into "information exchange" proposals that would force them to put the tax laws of other nations above their own, and this dispute has hindered cooperation in other areas.

Supporters of the House and Senate money-laundering bills have stepped into this debate by siding with the interests of high-tax nations. This approach will be counterproductive. Rather than enact legislation that could undermine effective international teamwork to counter the spread of terrorism and crime, Washington should target those who violate the commonly shared laws of civilized nations. Specifically, the United States should:

- **Make clear that a lack of cooperation from other jurisdictions will not be treated lightly.** Financial institutions in jurisdictions that refuse to cooperate by providing evidence, especially regarding the recent attacks, should be sanctioned. If this behavior continues, they should be denied access to the U.S. economy. Hiding terrorist money and shielding evidence is no different from sheltering terrorists.
- **Expand America's network of mutual legal assistance treaties.** Combined with improved domestic law enforcement and global intelligence gathering capabilities, additional MLATs would make life more difficult for criminals who operate on a global basis. This approach also would reveal nations that are unwilling to help the United States, either because they refuse to negotiate an MLAT or because they fail to comply with one that is in force, and thus are deserving of sanctions.
- **Drop the OECD and European Union (EU) tax harmonization agenda.** The United States should put an immediate stop to initiatives that target low-tax jurisdictions. "Information exchange" and other forms of tax harmonization are bad tax policy and would interfere with the effort to expand the network of MLATs and establish procedures that ensure rapid response for important cases.

TAX HAVENS ARE NOT THE PROBLEM

Some politicians assert that financial privacy laws in "tax havens" hinder worldwide law enforcement, and they want to restrict America's economic relationships with these low-tax jurisdictions. The bills moving through the House and Senate, for instance, would allow the Secretary of the Treasury to label any jurisdiction a "primary money laundering concern" merely because it has a successful low-tax economy.

This policy is absurd. Maintaining low taxes is not a criminal activity. There also is no evidence that the terrorists behind the September 11 attacks relied on "tax havens" to launder their money. In fact, it appears that they may have utilized banking systems in the United States, England, Germany, and various Middle Eastern states. Moreover, tax havens are more likely than other nations to have MLATs with the United States that are already in force.

The Cayman Islands, Switzerland, and the Bahamas are just a few of the major financial centers that have such treaties with the United States.[2] These jurisdictions provide information and other forms of assistance to the United States when presented with evidence of a crime in America that also would be a crime if committed within their borders. The MLAT does not obligate them to help the United States enforce the Internal Revenue Code, of course, but it does mean that there is no barrier—including bank secrecy laws—to cooperation in the investigation and prosecution of heinous acts, such as the murderous attacks of September 11.

What Is a Tax Haven?

There is no official definition of a "tax haven" (sometimes called an "offshore financial center" or OFC), but this term generally is used to describe low-tax economies that attract considerable foreign investment. The United Nations, for instance, defines an offshore institution as "any bank anywhere in the world that accepts deposits and/or

2. See *http://travel.state.gov/mlat.html.*

manages assets denominated in foreign currency on behalf of persons legally domiciled elsewhere."[3] The Financial Stability Forum, by contrast, defines OFCs as "jurisdictions that attract a high level of non-resident activity."[4]

Tax havens exist all over the world. According to the United Nations Offshore Forum, between 60 and 90 nations and territories participate in the offshore market.[5] The U.S. Department of State lists 52 regimes, including the United States.[6] The OECD, sponsor of a heavily criticized "harmful tax competition" initiative, has identified 41 jurisdictions.[7] The largest OFC, by some measures, is London;[8] others classify America as the world's biggest tax haven.[9]

Some of the stereotypes about tax havens are accurate. Such countries usually have low tax burdens. The Cayman Islands, Bermuda, and the Bahamas, for example, do not have any income taxes. Other jurisdictions, such as Jersey, Liechtenstein, and Hong Kong, have low-rate, flat tax systems. Equally important, these nations and territories usually have "source based" or "territorial" tax systems, meaning that the jurisdictions do not tax income earned outside their borders and do not help other nations tax income that is earned inside their borders.

Indeed, the primary reason that tax havens have financial privacy laws is to protect their economic competitiveness. Bank secrecy laws make it difficult for high-tax nations to tax income earned in low-tax jurisdictions, since foreign tax collectors are not among those authorized to have private financial data.

The Limits of Bank Secrecy

Although more than 90 jurisdictions around the globe "offer themselves as providers of bank secrecy,"[10] almost every nation has financial privacy laws. This list includes the United States. It is a criminal offense in America for a financial institution to release private information to unauthorized parties.

Contrary to popular perception, bank secrecy laws are not absolute. These privacy protections do not prevent the government from obtaining information when investigating and prosecuting crime. Depending on the country, bank secrecy laws also do not apply if a government wants to tax financial assets or the earnings of these assets.

Other countries also have laws that protect people from the unauthorized release of personal financial data. And, like those on the books in the United States, these laws do not guarantee unlimited privacy. If there is sufficient reason to suspect criminal activity, governments are able to access financial records. That information can be used to investigate and prosecute illegal activity, especially in cases of universally recognized crimes such as terrorism, murder, and drug running.

INTERNATIONAL COOPERATION IN FIGHTING CRIME

The terrorist attacks on September 11 focused official attention on the need for international cooperation in tracking down the terrorists, their financial networks, and those who support them. Al-Qaeda reportedly operates in more than 50 countries, so closing down its operations in one

3. United Nations, "Financial Havens, Banking Secrecy, and Money Laundering," 1998, at *https://www.imolin.org/finhaeng.htm*.
4. Financial Stability Forum, "Report of the Working Group on Offshore Centres," April 5, 2000. The Financial Stability Forum, based in Switzerland, is a forum for regulators examining international financial issues. See *http://www.fsforum.org*.
5. Michael Sesit, "U.N. Targets Offshore Centers; Plan Aims for Minimum Standards," *The Wall Street Journal*, January 25, 2000.
6. U.S. Department of State, "1999 International Narcotics Control Strategy Report," Bureau for International Narcotics and Law Enforcement Affairs, March 2000, at *http://www.state.gov/www/global/narcotics_law/1999_narc_report/ml_intro99.html*.
7. See OECD Web site, at *http://www.oecd.org/pdf/M000014000/M00014130.pdf*.
8. Financial Stability Forum, "Report of the Working Group on Offshore Centres."
9. Marshall Langer, "Who Are the Real Tax Havens," *Tax Notes International*, December 18, 2000, available at Center for Freedom and Prosperity, *http://www.freedomandprosperity.org/Articles/tni12-18-00.pdf*.
10. United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

nation will have little effect. All nations should work together to end this scourge by helping law enforcement agencies track down terrorists and others who violate the common laws of civilized nations.

Governments have a shared interest in stopping serious criminal behavior.[11] This common goal leads to a variety of cooperative endeavors, including joint operations when criminals operate in more than one country. But even when a crime is committed in just one nation, other nations can still offer assistance. Extradition treaties, for instance, allow a nation to track down and apprehend a fugitive or criminal who has fled to another country.[12] In other cases, a nation may need evidence—such as financial records—that is in another country.

In this type of example, a foreign country will assist in the investigation and prosecution of criminal activity, but usually with the following two conditions:

- **Nations are not obliged to put other country's laws above their own.** The long-standing principle of international law known as "dual criminality" asserts that governments will help each other investigate and prosecute offenses that are crimes under the laws of both countries. This practice is why there is effective global cooperation when dealing with terrorism, murder, drug running, and other offenses that violate the common laws of all civilized nations.

  Countries do not necessarily provide assistance, however, if an alleged offense does not violate their laws. The United States, for example, presumably would not help China investigate and prosecute Chinese pro-democracy protesters, because supporting freedom is not a crime in America. This situation explains why so-called tax havens usually do not help enforce the tax laws of high-tax countries when the high-tax country is trying to tax income that is earned in the low-tax country.

- **Nations generally must respect the due process safeguards and constitutional protections of other countries.** Assuming that the dual criminality principle applies, governments may help to obtain evidence and other information for foreign governments, but they typically will require that the investigation follow due process and respect constitutional rights. A country seeking America's assistance, for instance, would have to show probable cause to get a search warrant. An alleged offender also would have the right to contest judicial decisions and the right of appeal.

  These safeguards protect civil liberties and ensure that a foreign government is not engaged in a fishing expedition or persecuting someone for a hidden reason. Other nations, of course, have similar protections that govern information requests from the United States government.

Signing More MLATs

To facilitate international cooperation, the United States will need to expand its network of mutual legal assistance treaties. Such bilateral agreements create procedures for information sharing and other forms of assistance in the investigation and prosecution of crime. When combined with good police work and effective intelligence gathering, MLATs and other cooperative bilateral accords can be effective tools in the fight against crime.

The United States has MLATs—either in force or awaiting ratification—with only about 50 nations. The negotiation, ratification, and implementation of additional MLATs should be part of Washington's new anti-crime agenda. This cooperative approach would create an international alliance, with members committed to aiding in the investigation and prosecution of universally recognized

11. Crimes generally have to reach a certain threshold of severity before governments expend the time and resources necessary to secure international assistance. No country, presumably, is going to seek extradition or utilize an MLAT for a shoplifting offense.

12. Countries with extradition treaties retain the right to be uncooperative. France, for instance, will not send murderers back to the United States if they might be subject to the death penalty.

crimes like terrorism, murder, fraud, and drug running. Existing MLATs have proven to be successful and would be even more beneficial if new procedures are developed to ensure prompt and effective action in dealing with serious offenses like terrorism.

Tracking Criminal Funds

Internationally active criminal networks like al-Qaeda often leave a money trail as funds are transferred from one location to another.[13] Other types of organized crime, particularly drug smuggling, also involve the transfer of funds across national borders. Obtaining information about this activity so that it can be used to punish the criminals and deter future crimes requires three things:

1. Identification of likely criminals. World financial markets are immense. Each day, there are 700,000 electronic money transfers involving about $2 trillion.[14] The vast majority of these transactions, perhaps more than 99 percent, represent legitimate commerce. As a result, it is impractical to expect law enforcement to take these raw data and somehow identify the transfers that are criminal in nature.

   The first step in the process, therefore, is to identify the suspected terrorists and criminals so that the legal community can target transactions that are likely to be tied to illegal activities. Needless to say, international cooperation between police forces and intelligence agencies can play a critical role in making these determinations.

2. Providing beneficial ownership information. Once law enforcement has identified likely suspects, the next step is to identify their assets. Financial institutions around the world are supposed to know the "beneficial" owners of financial assets.[15] Privacy laws almost always protect this information, but these laws can be suspended or waived when a government is investigating and prosecuting universally recognized crimes like terrorism and murder.

   Governments, therefore, should cooperate in the identification of these accounts of suspected criminals and ascertain both the source and the use of these funds. Guidelines for this cooperation, including the level of evidence required for assistance and appropriate due process protections, could be part of an MLAT.

3. Using law enforcement resources wisely. To follow the money trail to the criminals and their supporters and then use that information to prosecute them, governments must use their law enforcement resources wisely. Many governments go to great lengths to tax income earned outside their borders. This approach is bad tax policy and creates friction with other nations that, quite naturally, consider this policy an infringement on their sovereignty.

   But it also has adverse implications for criminal justice. Conscripting law enforcement officials and turning them into adjunct tax collectors diverts resources that should be used by police and intelligence agencies around the world to identify and catch terrorists and other criminals.

THE MISGUIDED ATTACK ON LOW-TAX JURISDICTIONS

There is no evidence that the so-called tax havens attract a disproportionate share of the world's dirty money, but this fact is not stopping politicians from using the recent terrorist attack to push legislation that could undermine the sovereignty of low-tax jurisdictions and hinder international tax competition. This would be the effect of bills approved by the House Financial Services Committee and Senate Banking Committee, ostensibly to fight global money laundering. These bills include similar provisions describing the criteria

13. Gerald P. O'Driscoll, Jr., Brett D. Schaefer, and John C. Hulsman, "Stopping Terrorism: Follow the Money," Heritage Foundation *Backgrounder* No. 1479, September 25, 2001, at *http://www.heritage.org/library/backgrounder/bg1479.html*.

14. United Nations, Press Briefing on Money Laundering, June 5, 1998.

15. Beneficial owners are the people who receive the income generated by assets. Usually, this is the person whose name is on an account, but it also includes people who receive income from a trust account.

by which the Secretary of the Treasury would identify jurisdictions of "primary money laundering concern."

Some of the criteria in the bills are reasonable and appropriate, such as the quality of a jurisdiction's money-laundering laws, the level of corruption, and the existence of—and compliance with—a mutual legal assistance treaty. But three of the criteria have nothing to do with money laundering. Instead, they are designed to give the Treasury Secretary unchecked powers to impose sanctions on economically successful low-tax jurisdictions. (The language in these provisions is virtually identical to that of a bill sought by the Clinton Administration last year.)

The problematic language in these three ill-advised sections is:

1. Section 101(c)(2)(A)(ii) (Senate bill), which would identify as a potential money launderer a jurisdiction that offers special tax or regulatory advantages; specifically:[16]

   "…the extent to which that jurisdiction or financial institutions operating therein offer bank secrecy or special tax or regulatory advantages to nonresidents or nondomiciliaries of such jurisdiction…."

Why This Language Is Wrong. *First*, bank secrecy is not a sign of money laundering. Every nation in the world, including the United States, recognizes this fact and has privacy laws preventing financial institutions from divulging confidential client information. The key question is whether a jurisdiction will suspend those privacy protections when presented with evidence of a universally recognized crime such as the September 11 terrorist attacks. This problem is an argument for MLATs,[17] not an argument against bank secrecy.

Second, tax and regulatory advantages have nothing to do with money laundering. The United States, for instance, has very favorable tax and privacy laws for nonresident investors. These preferential policies have helped attract more than $5 trillion of capital to the U.S. economy,[18] but there is no reason to believe that this investment makes America a jurisdiction of "primary money laundering concern." If this provision is enacted, it will create a precedent that high-tax nations can use to demand changes in U.S. law.

2. Section 301(c)(2)(A)(iv) (House bill) and Section 101(c)(2)(A)(iv) (Senate bill), which target successful economies as potential money launderers; specifically:

   "…the relationship between the volume of financial transactions occurring in that jurisdiction and the size of the jurisdiction's economy…."

Why This Language Is Wrong. A successful financial services industry is not a sign of money laundering. If having a large volume of financial transactions relative to the size of an economy is evidence of money laundering, New York City and London should be padlocked, South Dakota should be shut down because it is home to so many credit card companies, and Tokyo and Hong Kong should be sanctioned as well. If this provision is enacted, it will create a precedent that could be used by America's competitors to undermine its world-class financial services sector.

3. Section 101(c)(2)(A)(v) (Senate bill), which targets the so-called tax havens; specifically:[19]

   "…the extent to which that jurisdiction is characterized as a tax haven or offshore banking or secrecy haven by credible international organizations or multilateral expert groups…."

Why This Language Is Wrong. Congress should not cede power to bureaucracies and "international organizations" like the Organisation for Economic Co-operation and Development, the European Union, and the United Nations. These

16. The most recent House version of this legislation removes the reference to tax advantages.

17. For a list of America's mutual legal assistance treaties, see *http://travel.state.gov/mlat.html*.

18. Harlan W. King, "The International Investment Position of the United States at Yearend 2000," *Survey of Current Business*, U.S. Department of Commerce, July 2001.

19. The most recent House version of this legislation removes the reference to tax havens.

organizations have been fighting to undermine and inhibit international tax competition and have targeted successful, low-tax economies by pushing for "tax harmonization."

The United States is a low-tax country by global standards, with attractive tax and privacy laws designed to lure foreign capital to the economy. As a result, America is the world's biggest beneficiary of tax competition. If this provision is enacted, it will create a precedent that will be used to attack America's fiscal sovereignty and that could result in policies, such as "information exchanges," that would give other governments the power to tax income earned here.

These three provisions should not be used to determine jurisdictions of "primary money laundering concern." Low tax burdens, bank secrecy, and foreign investment have nothing to do with money laundering, and these criteria could be misused by an ideologically driven U.S. Treasury Secretary.

Supporters argue that these provisions—and the implicit threat of sanctions—would give America leverage when seeking information from foreign governments. It is more likely, however, that this approach would cause resentment against the United States. Instead of targeting low-tax economies with successful financial service sectors, legislation should be directed at jurisdictions that shelter criminal activity.

TAX HAVENS AND MONEY LAUNDERING

Those in Congress who would use the recent terrorist attacks as an opportunity to attack low-tax jurisdictions basically argue that financial privacy laws conceal illegal activities.[20] This claim is grounded in a false stereotype: Contrary to story lines in many novels and movies today, low-tax nations are not filled with criminals carrying cash-filled suitcases.

Tax havens do attract wealth, of course, but most of the money is institutional investment. Bermuda, for instance, is the world's largest center for captive insurance companies. Luxembourg leads the world in managing the most mutual fund assets. The Cayman Islands, meanwhile, is second in both of those categories.[21] American corporations also make extensive use of offshore regimes, earning almost one-third of their profits in low-tax jurisdictions.[22]

Individual investors also utilize tax havens, but little of this capital has criminal origins. Instead, it represents legitimate investment by people seeking sound money management, asset protection, and lower tax bills. This last feature is controversial, but only because many high-tax nations assert the right to tax income earned outside their borders and get upset because low-tax jurisdictions usually refuse to act as vassal tax collectors.

This is not to say that there is no money laundering in tax havens, but it does suggest that those who do it are minor players. After all, criminals rarely venture "offshore" because of the added risk. Shifting money across borders—and then back again when the funds are needed—dramatically increases the probability of detection. The United Nations has acknowledged that criminals avoid so-called tax havens because they are a "red flag" for law enforcement.[23]

Ironically, the OECD inadvertently confirms that there is no link between tax havens and money laundering. As part of its "harmful tax competition" initiative, the OECD identified 41 so-called tax havens, which it has threatened with financial protectionism if they do not join its proposed cartel.[24] Yet less than one-fifth of these OECD-identified low-tax jurisdictions—and none of the major offshore financial centers—are on the

20. Senator Charles Schumer, "Websites Enable Terrorist Cells to Launder Money in Off-Shore Banks, Obtain Fake Passports," press release, September 26, 2001, at *http://www.senate.gov/~schumer/state-092601_moneylaundering.htm*.

21. Conversation with John Bourbon, Managing Director of the Cayman Islands Monetary Authority.

22. "Gimme Shelter," *The Economist*, January 29, 2000.

23. United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

24. See *http://www.oecd.org/pdf/M000014000/M00014130.pdf*.

list of 19 "non-cooperative" money laundering jurisdictions put together by the OECD's own Financial Action Task Force.[25]

HIGH-TAX NATIONS AND MONEY LAUNDERING

According to the OECD's Financial Action Task Force, criminal "funds are usually processed relatively close to the under-lying activity; often…in the country where the funds originate."[26] This situation suggests that most money laundering occurs in America and Europe for the simple reason that these are the regions where criminals obtain most of their loot. Indeed, according to an article in *Government Executive*,

> The International Monetary Fund estimates that about $600 billion is laundered each year globally. Estimates of U.S. money-laundering traffic hover at $300 billion, including about $60 billion in drug money alone.[27]

The plethora of laws designed to fight dirty money seems to have little effect. The Treasury Department has estimated that 99.9 percent of the criminal money in the United States is laundered successfully.[28] Other countries such as Germany have reached similar conclusions about their own financial systems.[29]

Part of the problem is that law enforcement resources are not well-targeted. Money-laundering laws already require millions of reports on the financial practices of law-abiding citizens, forcing law enforcement to search for a needle in a haystack. Proposals to expand these laws will make the haystack even bigger. A recent article in the London *Times* outlines this quandary:

> Sifting through millions of financial transactions or placing onerous burdens on banks, accountants and lawyers to report "suspicious" activity is of questionable efficacy in the fight against money-laundering. It makes the obligation of public authorities passive: in this model they await reports from bank managers, accountants, lawyers and other professionals, rather than taking active steps to deploy crime-fighters to identify, pursue and indict criminals.[30]

In the United States, financial institutions filed about 13 million currency transaction reports in 1999 at a cost to the industry of more than $100 million.[31] This "ever-increasing regulatory burden on the banking industry"[32] would be acceptable if it led to less crime, but that does not seem to be the result. According to government figures, fewer than 1/1000th of 1 percent of currency reports are ever used in a money-laundering conviction.[33]

A recent *Washington Post* story uses the September 11 attacks to explain the problems law enforcement faces:

> The FBI has told Congress that terrorists rely heavily on wire transfers, but

25. Financial Action Task Force, "List of Non-Cooperative Countries and Territories," at *http://www1.oecd.org/fatf/NCCT_en.htm.*
26. Financial Action Task Force, "Basic Facts About Money Laundering," at *http://www1.oecd.org/fatf/MLaundering_en.htm.*
27. Julie Wakefield, "Following the Money," *Government Executive*, October 1, 2000, at *http://www.govexec.com/features/1000/1000s5.htm.*
28. Raymond Baker, "Money Laundering and Flight Capital: The Impact on Private Banking," testimony before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, November 10, 1999.
29. Raymond Baker, "The Biggest Loophole in the Free-Market System," *The Washington Quarterly*, Autumn 1999.
30. Graham Mather, "Money-Laundering Fight Could Hit the Wrong Targets," *The Times* (UK), October 2, 2001, at *http://www.thetimes.co.uk/article/0,,37-2001341189,00.html.*
31. Ron Paul, Tom Campbell, Bob Barr, and Walter Jones, "Report Together with Dissenting Views [to accompany H.R. 3886]," International Counter-Money Laundering and Foreign Anticorruption Act of 2000, Report No. 106–728, Committee on Banking, U.S. House of Representatives, 106th Cong., 2nd Sess., July 11, 2000.
32. Edward Yingling, "ABA Statement on House Banking Committee Approval of Money Laundering Act," American Bankers Association, June 8, 2000.
33. Paul *et al.*, "Report Together with Dissenting Views."

> detecting suspicious transfers can be nearly impossible, banking sources say. A large bank might typically handle 10,000 to 125,000 wire transfers per day. About 70 percent are for amounts less than $500,000, though sums of $1 million to $4 million are not unusual. So even the opening money transfer of $100,000 to [terrorist Mohamed] Atta would not have seemed unusual, officials said. Investigators do not believe any bank made a major error in failing to follow guidelines for detecting or reporting suspicious activities. "Nothing they did would have tipped anyone off," said one source.[34]

PUNISHING JURISDICTIONS THAT SHIELD CRIMINALS

New money-laundering laws are not likely to be effective, regardless of whether they target U.S. financial institutions or foreign financial institutions. Instead, the government should improve law enforcement capabilities, particularly in terms of intelligence gathering. This approach would yield names, which then could be used as a springboard for further investigation.

One part of that police work is to follow a money trail. If those investigations lead to another country, the appropriate evidence should be presented to that nation's government in order to secure the cooperation and assistance of relevant foreign agencies and departments.

This raises a question, of course: How should the United States respond if a nation refuses to help America pursue and punish terrorists? President George W. Bush said it best: "Either you are with us, or you are with the terrorists."[35] There is no middle ground.

There are three specific steps that Washington should take:

- Step #1: Make clear that a lack of cooperation from other jurisdictions will not be treated lightly. Law enforcement officials have put together a mountain of evidence on the September 11 attacks, and these data easily should satisfy any legitimate "probable cause" tests that other nations require before waiving financial privacy laws.

  If a jurisdiction fails to provide evidence, either because of outright refusal or foot-dragging, lawmakers should approve sanctions. In particular, financial institutions in uncooperative jurisdictions should be denied access to the American economy and the U.S. financial system. Moreover, policymakers should work with other nations to isolate these regimes. Hiding terrorist money and shielding evidence is no different from sheltering terrorists.

- Step #2: Expand America's network of mutual legal assistance treaties. As a matter of decency, all nations should provide any assistance necessary to track down terrorists and other criminals who violate the commonly shared laws of civilized nations. MLATs facilitate this process by creating procedures for such cooperation.

  This does not mean that the absence of an MLAT precludes assistance. Many allied nations routinely provide information on criminal matters to the United States, and America aids their investigations as well. But an MLAT would improve this process by specifying the obligations of the signatories. This approach would be particularly helpful for jurisdictions with which the United States does not have a long-established pattern of cooperation.

- Step #3: Drop the OECD and EU tax harmonization agenda. Advocates of tax harmonization are trying to exploit the terrorist attack by urging that all low-tax nations should be required to report on the financial holdings of foreign investors. Such an "information exchange" is misguided tax policy, and it is wrong to argue that this type of policy will have any impact on criminal and/or terrorist activities. When tax authorities collect income

34. Dan Egger and Kathleen Day, "The U.S. Ties Hijackers' Money to Al Qaeda," *The Washington Post*, October 7, 2001, at *http://www.washingtonpost.com/wp-dyn/articles/A17934-2001Oct6.html.*

35. Address by the President to a Joint Session of Congress, September 20, 2001.

data, regardless of whether a taxpayer is reporting income earned in another country or income earned at home, that information has very little value to (non-tax) law enforcement unless the government already had a reason to suspect a taxpayer of wrongdoing. And if a government already suspects someone of wrongdoing, there are international mechanisms like MLATs that can be used to obtain the necessary information on their financial affairs.

Punishing jurisdictions for low-tax policies will undermine incentives for governments to cooperate and could encourage institutions to replace legitimate investments with dirty money. Indeed, it would divert resources and therefore hinder efforts to punish criminals and deter crime. But it also is misguided because of the effects it would have on persecuted jurisdictions. A low-tax government threatened with financial protectionism (the OECD proposes to subject "non-cooperative" jurisdictions to a sweeping financial blockade) would be much less likely to help other nations investigate and prosecute criminal activity.

CONCLUSION

Proposals that would reduce America's political and economic ties with other nations would make it even harder to get their cooperation in the fight against crime and terrorism. That is why the money-laundering legislation moving through Congress would do more harm than good.

These draft bills are particularly misguided because they target low-tax nations that have successful financial service industries rather than jurisdictions that actually harbor the illegal funds of terrorists and other criminals. It is worth noting that Osama bin Laden's financial empire is supposedly operated out of the Middle East, with enterprises in places like Sudan and Kenya. Investigations also have revealed dealings in the United States, England, Germany, and Malaysia. None of these jurisdictions is on the OECD's list of so-called tax havens.

Policymakers should focus on identifying and capturing terrorists and other criminals. When these people operate in more than one nation, obtaining the cooperation of other nations is an important part of this strategy. Mutual legal assistance treaties facilitate this teamwork. Expanding this network of treaties—and implementing procedures to get rapid response in high-profile cases—should be a priority.

The OECD's tax harmonization agenda is a barrier to this effort. Low-tax nations quite properly do not want to sacrifice their fiscal sovereignty, yet the OECD "harmful tax competition" strategy is designed to help high-tax nations tax income that is earned in low-tax jurisdictions. Needless to say, extraterritorial tax enforcement should not be part of any MLAT. It would deter countries from signing these agreements and undermine cooperation.

Hindering international tax competition is not only bad tax policy; it will undermine the Administration's ability to secure cooperation in its fight against terrorism and international crime and to counter the radical tax harmonization agenda of international bureaucracies like the OECD and the European Union.[36]

The short-term goal for Washington in pursuing international cooperation should be the punishment of the terrorists and all those who gave them aid. The long-term goal should be implementing policies that make it much more difficult for terrorists and other criminals to operate across national borders. Laws focused on criminal activity—combined with good police work and intelligence gathering—are the right approach. Sweeping new regulations on the financial services sector and unwarranted attacks on low-tax nations are not.

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36. For more information on international tax competition and why initiatives to create a global tax cartel are misguided, see Daniel J. Mitchell, "An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy," Heritage Foundation *Backgrounder* No. 1395, September 18, 2000, at *http://www.heritage.org/library/backgrounder/bg1395es.html.*