FOLLOWING THE MONEY TRAIL TO WHAT DESTINATION? AN INTRODUCTION TO THE SYMPOSIUM

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I. INTRODUCTION

All English speaking countries have, in varying degrees, stepped up their regulation of money laundering. The contributions to this Symposium raise the question of whether this increased regulation has been a good thing. The United States' war on drugs has been the primary force behind this tightening of regulation. The article by Wilmer Parker[1] shows the extent to which drug enforcement has caused this preoccupation in the United States with the money trail. Hence, I will initially limit these introductory comments to the regulation of drug markets and reserve discussion of broader issues until later in this Article. Although the essays in this Symposium make important contributions to the money laundering debate in the widest sense, I believe it is in relation to the regulation of drug markets that they have the sharpest edge.

II. REGULATING DRUG MARKETS

Few would argue that money laundering enforcement alone can stop the drug trade. The contribution by Brent Fisse and David Fraser[2] explains why this is the case. Even perfect enforcement would leave dealers with ample incentive to sell drugs; they would simply hold their money until they were ready to use it. However, perfect money laundering enforcement in perfectly com-

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1. Wilmer Parker, III, *Money or Liberty? A Dilemma for Those Who Aid Money Launderers*, 44 ALA. L. REV. 763 (1993).

2. Brent Fisse & David Fraser, *Some Antipodean Skepticisms About Forfeiture, Confiscation of Proceeds of Crime, and Money Laundering Offenses*, 44 ALA. L. REV. 737 (1993).

petitive markets would cause drug prices to rise by the amount of the foregone interest. Because neither enforcement nor drug markets are perfect, we expect money laundering enforcement to increase the price of drugs by some amount which is less than the foregone interest on drug profits. Thus, the crucial question becomes: How much reduction in the demand for drugs will this enforcement-driven price increase accomplish?

Yet there are some further complications to consider. Effective money laundering enforcement will pose a greater obstacle for some organizations than for others. It seems safe to assume that smaller criminal entrepreneurs will have more trouble getting around the law than the most powerful drug barons. The ease with which powerful drug traders like the Noriega and Escobar organizations were able to use the ubiquitous off-shore bank, BCCI, to escape the scrutiny of every nation's money laundering regulations gives a rare insight into this aspect of the policy analysis.[3] Therefore, we must consider the extent to which increasingly effective money laundering enforcement pushes more and more of the drug market into the hands of the most powerful organized criminal groups. Contrary to popular mythology, until quite recently the drug trade has been characterized by disorganized rather than organized crime, even in the Americas.[4] The question is whether the escalating war on drugs is making this less true every year.

In deciding whether the new money laundering enforcement has been a good or a bad thing, we must consider the cost of increased regulation to banking efficiency. In his article, John Byrne notes compliance cost estimates ranging from $120 million (for small banks alone) to $185 million.[5] To this we must add the cost of the enforcement bureaucracies, prisons, and courts that are involved in money laundering enforcement and the tax revenue foregone when criminal organizations are prevented from laundering their money into legitimate businesses that pay taxes and create honest jobs.

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3. *See* JAMES R. ADAMS & DOUGLAS FRANTZ, A FULL SERVICE BANK: HOW BCCI STOLE BILLIONS AROUND THE WORLD (1992); PETER TRUELL & LARRY GURWIN, FALSE PROFITS: THE INSIDE STORY OF BCCI, THE WORLD'S MOST CORRUPT FINANCIAL EMPIRE (1992); Nikos Passas, *I Cheat Therefore I Exist? The BCCI Scandal in Context*, *in* INTERNATIONAL PERSPECTIVES ON BUSINESS ETHICS (W.F. Hoffman et al. eds., forthcoming 1993).

4. PETER REUTER, DISORGANIZED CRIME: THE ECONOMICS OF THE VISIBLE HAND (1983).

5. John J. Byrne, *The Bank Secrecy Act: Do Reporting Requirements Really Assist the Government?*, 44 ALA. L. REV. 801 (1993).

There are more intangible costs to be weighed as well. One is the privacy loss of innocent customers who have their affairs reported to the police on the basis of erroneous suspicions about the nature of their transactions.[6] If they are put under surveillance, have their telephones tapped, are monitored by secret cameras, or are infiltrated by an undercover operative, this privacy loss extends to all their family and friends. Another more intangible cost of money laundering enforcement is loss of life—occasionally that of an undercover operative, but more often that of an informant who is executed by a criminal organization.

Based on the foregoing considerations, we can formulate a set of questions to be answered by a coherent policy analysis of whether the new money laundering regulation has benefits which exceed its costs.

Benefit Questions

1. What percentage increase in the price of drugs is likely accomplished by the new money laundering enforcement?

2. Given what we know about the price elasticity of demand for drugs, what percentage reduction in demand can we expect from such a price increase?

3. If it is a public benefit to exact retribution against evil people, how many such people get their just deserts (compared with innocents who suffer unjust retribution) as a result of the new money laundering enforcement?

Cost Questions

1. How much additional property crime is committed by addicts who choose to pay the increased price for drugs rather than curtail their demand?

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6. See Michael Levi's comments on the consequences of banks becoming "an unpaid, involuntary High Street Watch scheme of pressed informants." Michael Levi, *Cleaning Up the Bankers' Act: The United Kingdom Experience*, *in* THE MONEY TRAIL: CONFISCATION OF PROCEEDS OF CRIME, MONEY LAUNDERING AND CASH TRANSACTION REPORTING 323, 324 (Brent Fisse et al. eds., 1992) [hereinafter THE MONEY TRAIL]; *see* Kevin O'Connor, *The Relationship Between the Privacy Act and the Cash Transaction Reports Act*, *in* THE MONEY TRAIL, *supra*, at 167.

2. What is the impact on the legitimate economy when drug users pay the higher price, thereby shifting their spending to the drug economy?

3. What is the efficiency cost to the banks of the new money laundering regulation? How much business does this shift to foreign banks not subject to the regulation?

4. What is the cost to taxpayers of administering the new enforcement (e.g., regulatory agency staff, police, courts, and prisons)?

5. What are the costs of increasing monopolization of drug markets by the most powerful groups as a result of enforcement that pushes less sophisticated groups out of the market?

6. How many lives are lost as a result of enforcement operations under the new laws?

7. How extensive is the loss of privacy which results from reporting and surveillance arrangements?

I have no idea what the outcome would be from a searching public inquiry into these questions. There are certainly grounds for doubting that the benefits of the new regulation are substantial in a competitive market for illicit drugs where imprisoned dealers are fungible. One estimate (based admittedly on somewhat old data) is that $0.0062 out of every illegally earned dollar from the drug trade in the United States is subject to recovery action by the state.[7] As Parker points out in his article, "Without question, the most culpable narco-traffickers have evaded arrest."[8] Add to this the fact that the demand for addictive drugs has unusually high price inelasticity, and one might have to be quite an optimist to believe that money laundering regulation has *any* effect on drug consumption. However, that is a question that has not yet attracted the rigorous analytical attention it requires; we should therefore remain open-minded.[9]

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7. Clifford L. Karchmer, *Money Laundering and the Organized Underworld, in* THE POLITICS AND ECONOMICS OF ORGANIZED CRIME 37, 39 (Herbert E. Alexander & Gerald E. Caiden eds., 1985).

8. Parker, *supra* note 1, at 783.

9. Overall, the United States war on drugs has had mixed success in increasing drug prices. Retail cocaine prices fell until 1988, then increased for the next two years. Marijuana prices have risen sharply in real terms during the past decade even allowing for potency increases. It is doubtful, however, that money laundering enforcement has much to do with the latter result. It is generally agreed that the higher price is a result of Colombia (a low-cost producer) no longer servicing the American market because of successful interdiction

The fact that this question has not been addressed is cause for concern. The regulators cannot be trusted to do it because they are rent-seekers in this policy game. They are very unlikely to report, for example, that limited use is being made of the private information that is being handed over to the state. Independent inquiry is needed. It is depressing that the business regulation review units which became a craze throughout the Western world during the 1980s (e.g., the United States Office of Management and Budget) have shown no interest in conducting independent inquiries into these questions in any country in which they have operated. The reason is that the regulation review agencies are rent-seekers too, and they know where their bread is buttered politically: by conservative politicians who support critical scrutiny of regulations advocated by environmental and consumer groups, the women's movement, trade unions, and other business critics. To examine business regulation advocated by the law and order lobby would be to bite the conservative hands that feed them.

III. Analytic Frameworks

In addition to political commitment to critical evaluation of the social costs and benefits delivered by the burgeoning money laundering enforcement community, a suitable analytic framework is also needed. After we secure the most satisfactory possible answers to the ten questions listed above, how do we then go about making the judgment that the benefits exceed the costs? The business regulation review units of the world have a decidedly utilitarian analytic framework—the framework of welfare economics—for evaluating these tradeoffs. One can monetize the answers to each question and ascertain if the benefit-cost ratio exceeds one. However, I do not find this a satisfactory analytic framework for confronting this difficult challenge. There are some good reasons why we hesitate to monetize the suffering of drug addicts and their families, loss of human life, or invasions of privacy. Most troubling of all within this framework are justice concerns, which are supposed to be trumps over utilities: that it is simply wrong to

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and because the Colombian marijuana is being replaced by higher cost marijuana grown in Mexico and the United States itself. *See* Peter Reuter, Hawks Ascendant: The Punitive Trend of American Drug Policy (1992).

criminally convict an innocent who lacks a guilty *mens rea*, regardless of the economic benefits. These justice issues are pointedly raised in the papers by Joseph Mays,[10] Whitney Adams,[11] and Larry Thompson and Elizabeth Johnson.[12] If one of the accusations against the new proceeds-of-crime laws is that they are "the monster that ate jurisprudence"[13] which sacrifice traditional principles of criminal liability,[14] then welfare economics is a framework ill-equipped for evaluating the accusation.

The analytic framework that I favor for such judgments has been outlined by Philip Pettit and myself in *Not Just Deserts: A Republican Theory of Criminal Justice*.[15] This framework is quite accepting of monetizing things that can sensibly be monetized. Final judgments about whether we are better off with or without certain regulatory arrangements are made under this framework after a dialogue about whether the gains exceed the losses according to the yardstick of republican liberty, which we call dominion. Essentially, the process is to weigh the pros and cons in such a way as to answer the question whether we would be a freer society, a society in which citizens enjoy more dominion, were we to abolish these regulatory arrangements. Our republican theory provides neither an algorithm for policy choice nor a quantitative scoring system for weighing one benefit against another cost. It supplies only a deliberative framework for choosing between goods that might be utterly incommensurable and beyond reasoned choice under other frameworks. Open dialogue within a democracy about the relative importance of empirically established costs and benefits of a policy is a simple procedure for informing policy choice. Of

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10. Joseph Mays, *The Mens Rea Requirements in the Money Laundering Statutes*, 44 ALA. L. REV. 725 (1993).

11. Whitney Adams, *Effective Strategies for Banks in Avoiding Criminal, Civil, and Forfeiture Liability in Money Laundering Cases*, 44 ALA. L. REV. 669 (1993).

12. Larry D. Thompson & Elizabeth B. Johnson, *Money Laundering: Business Beware*, 44 ALA. L. REV. 703 (1993).

13. Brent Fisse et al., *The Money Trail*, *in* THE MONEY TRAIL, *supra* note 6, at 1, 2 (quoting Judge David Sentelle, United States Court of Appeals for the District of Columbia Circuit).

14. *See generally* Brent Fisse, *Confiscation of Proceeds of Crime: Funny Money, Serious Legislation*, *in* THE MONEY TRAIL, *supra* note 6, at 74 (discussing the various ways in which such laws depart from the traditional principles of criminal liability).

15. JOHN BRAITHWAITE & PHILIP PETTIT, NOT JUST DESERTS: A REPUBLICAN THEORY OF CRIMINAL JUSTICE (1990).

course, one does not have to be a republican to support the procedural frameworks derived from republican premises.

Whatever evaluative framework one settles upon for weighing the answers to my ten questions, the final choice does not have to be between sustaining the new money laundering regulation or abandoning it. Within a utilitarian framework, one can eschew the calculation of a single cost-benefit ratio in favor of comparing the likely cost-effectiveness of a number of different policy packages, of which the status quo is only one. For example, how much drug abuse might be prevented by devoting the total economic costs of the new money laundering regulation to drug education? For the republican, the question here is whether dominion would be better served in a society where these resources were devoted to drug education rather than money laundering regulation.

Indeed, the republican is required to address such alternatives because republicans are committed to a principle of parsimony concerning criminal justice interventions: if in doubt about the benefits of a criminal justice intervention that restricts freedom, do not interfere.[16] If there is an alternative for achieving a policy objective that is as efficacious as criminalization, abandon criminalization in favor of that alternative. Spending on drug education is only one alternative. Another to consider would be to rely more on bank self-regulation than on criminalizing the conduct of banks under a regime of direct government regulation. This alternative is developed in more detail in Part IV of this Article.

Before embarking on this journey, it should be noted that even if the new money laundering regulation does more harm than good with respect to the drug problem, this may not be the case regarding other problems such as international tax evasion. Each targeted problem requires development of a unique set of questions similar to the ten that I have posed with respect to drug regulation. For all targeted problems, there is a self-regulatory alternative to the command and control regulation of banks that has prevailed in countries such as the United States and Australia.

16. *Id.* at 87.

IV. An Enforced Self-Regulation Alternative

All banks are different. They deal with different sorts of clients. They have different histories of how they have successfully solved their problems and what has failed to work for them in the past. In addition, they have disparate corporate cultures. Consequently, a strategy for detecting money launderers that works well in Bank *A* may fail in Bank *B*; a strategy that has a low cost for *A* may have a high cost for *B*. The problem with government command and control regulation is its commitment to the public law principle of consistency; it would be unjust to regulate *A* more aggressively than *B* unless *A* has engaged in conduct that makes it deserving of extra intervention. Therefore, the same regulatory requirements are imposed on Banks *A* and *B*, irrespective of their likely effectiveness and costs in the context of those organizations.

Enforced self-regulation is an alternative to command and control that gives all banks the same performance objectives, or similar overarching standards of regulatory adequacy, and leaves it to the banks to decide how to achieve those objectives or standards.[17] Once the bank has come up with a money laundering control plan that satisfies the government that it is likely to meet its objectives or standards, the state motivates the bank to enforce its plan through the threat of enforcement action against the bank for failure to do so. The idea, therefore, is privately written and publicly ratified rules. These rules are then primarily privately enforced, with secondary public enforcement where private enforcement fails. It is thus an attempt to improve on the inflexibilities and costs of command and control regulation while responding to the naivety of trusting business to regulate itself. The privately written and publicly ratified rules have a specificity which might avert the vagueness and overbreadth concerns that animate so much of the discussion in Thompson and Johnson's contribution to this Symposium.[18] Equally, compliance with these private rules can effectively constitute the safe harbor requested by John Byrne[19] to protect diligent banks from unreasonable criminal prosecutions for failures to report suspicious transactions.

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17. *See* Ian Ayres & John Braithwaite, Responsive Regulation: Transcending the Deregulation Debate 101-32 (1992).

18. *See* Thompson & Johnson, *supra* note 12, at 706-20.

19. Byrne, *supra* note 5, at 832-36.

This enables the bank to design rules that are in tune with what works within their corporate culture and that will impose minimum costs given the way they are set up to do business. Trust-based corporate cultures may rely more on work groups meeting together to share "know your customer" suspicions and leads that might detect the laundering of proceeds of crime. Conversely, rule-based corporate cultures with a strong educative emphasis may rely on very detailed rules for reporting specified types of transactions where those rules are the subject of elaborate corporate training programs. Rule-based corporate cultures with a strong disciplinary emphasis may rely less on in-service training than on a corporate track record for immediately firing employees who have failed to teach themselves the rules and to implement them.

One advantage of enforced self-regulation is that it harnesses the management creativity of the private sector to come up with tailor-made regulatory solutions that can deliver superior benefits at a lower cost than the solutions that emanate from the limited imagination of legislators. In other words, enforced self-regulation enables diversity of problem solving and innovation to flourish, while maintaining a state enforcement capability. The advantage of this is not just the discovery of new control technologies (e.g., new computer software for analyzing patterns of suspect transactions), but also the inherent advantage of diversity and inconsistency. If every bank has a very different methodology of detection, it is much more difficult for money launderers to plan their transactions around the controls. Take the problem of "smurfing" or structuring, discussed in the articles by Byrne[20] and Sarah Welling,[21] which has cropped up in response to the uniform $10,000 reporting requirement in the United States. Because all banks must report transactions over $10,000 to the state, criminals smurf funds into many smaller transactions. In a world where different banks have thresholds established for reporting to the state, indeed where some banks may have agreed to diagnose intensively (and electronically report) transactions over $3000 during June

20. *Id.* at 808-09.

21. Sarah N. Welling, *Money Laundering: The Anti-Structuring Laws*, 44 ALA. L. REV. 787 (1993).

and those over $20,000 during July, criminals do not know how, where, or when to smurf their money.

Defenders of the status quo might complain that it would be an unwieldy and costly system for the state to have different banks reporting different thresholds. This would be true only if the information were being provided in incompatible formats or on paper. Once the data are computerized, the state can conduct searches based on any monetary threshold it likes at the push of a button. With access to a more diverse range of reporting thresholds, the state can improve its learning as to which thresholds are useful for a particular analytic purpose, an issue that Byrne laments in his paper has not been subject to any serious discussion.[22]

Tailor-made money laundering detection plans might not only be less costly and more effective in terms of the detection of money launderers, but also more effective in preventing unnecessary invasions of privacy. Instead of reporting all suspicious transactions to the state so that huge numbers of citizens have their affairs listed on criminal intelligence data bases for quite insufficient reasons, banks can design their own procedures for internal investigations of suspicious transactions in their money laundering prevention plans. These procedures would be approved by the state, thereby limiting the number of reportable cases to those which continue to be suspicious after the agreed upon in-house tests have been applied. More citizens could have knowledge of their financial affairs confined within the walls of the banks to which they entrusted that knowledge.

Would smaller banks want to come up with their own tailor-made systems? If they are well-managed, they generally would. This does not mean they would design their money laundering control systems themselves. Enforced self-regulation would foster a money laundering control systems consulting industry.[23] Such consultants would supply a variety of off-the-shelf control systems, the choice from competing systems being guided by the size, history, customer base, and corporate culture of the particular bank. Hence, the innovation that would be harnessed by enforced self-

22. Byrne, *supra* note 5, at 822-23.

23. *See* AYRES & BRAITHWAITE, *supra* note 17, at 101-32 (discussing contracting around defaults).

regulation would not be solely the innovation of the banks, but also that of a private consulting industry.

Innovation would not only be in the software of detection diagnostics and in "know your customer" information exchange, but in performance evaluation strategy as well. Banks could be required to undertake triennial reviews of how many true and false money launderers they had detected as part of their approved control plan. Moreover, the reviews could diagnose the aspects of their plans that were responsible for the true positives versus the false positives as well as the characteristics of false negatives—customers who were detected to be money launderers by some means other than the money laundering control plan. Performance indicators for such evaluations could relate not only to detection, but also to cost and privacy-protection indicators. Indeed, true-positive/false-positive ratios might be designed to incorporate all three of these performance criteria.

The enforced self-regulation approach is not such a radical alternative. Under 12 U.S.C. § 1818(s), banks are currently required to have written Bank Secrecy Act compliance programs, as discussed in Whitney Adams' paper.[24] Expanding the scope of such written programs from mere compliance policies to substantive rules, publicly ratifying such plans, and giving them the force of law are not such huge steps.

V. Toward a Coherent Policy Analysis of Money Laundering

The articles in this Symposium issue supply a dazzling variety of contributions to rethinking the law of money laundering. My problem, however, is that I am rather too dazzled by the internationally variegated legal detail of the money laundering debate. Therefore, my critique of all the papers in this issue, not least of all my own, is that they fail to work through a coherent analytic framework for evaluating the net benefits of existing money laundering laws compared with possible alternative means of pursuing the same policy objectives.

While the social science journals devoted to evaluation research are full of empirical evaluations from other policy domains

24. Adams, *supra* note 11, at 677.

(e.g., health, education, social welfare, and environmental protection), one does not find evaluations of money laundering policy in these journals, even though one encounters endless evaluations from other domains of crime prevention such as delinquency or even street lighting, other domains of drug policy such as drug treatment and education, and every other domain of business regulation. The dearth of empirical evaluation reflects the fact that money laundering law may be law without clear objectives and certainly law that was not the end product of a coherent policy analysis.

Our primary task in the academy is to see if there is a defensible analytic framework that can be constructed and applied to money laundering. My reading of the articles in this issue suggested ten questions that might orient such an analysis. In such an analysis, I have suggested that the status quo of money laundering laws might be evaluated against the yardsticks of alternative policy instruments. I chose the instrument of enforced self-regulation to illustrate the alternatives not because I necessarily believe this to be the superior alternative. That is a matter for empirical investigation. I chose it because it illustrates how policy frameworks can be designed to structure ongoing evaluation of alternative policy instruments. Indeed one of the strengths of enforced self-regulation is that it enables governments to require banks to generate evaluation research that should be generated, but that governments have been too defensive to require themselves to produce concerning their own law enforcement performance.

Among the few enemies of the state that we can be sure have been incapacitated by the war on drug money laundering are systematic policy analysis and rigorous evaluation research. This issue of the *Alabama Law Review* takes some preliminary steps toward liberating these analytic capabilities.