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May 10, 2000 No. 63

End the "Bank Anti-Secrecy" Assault on Financial Privacy

by Richard W. Rahn[1]

Treasury Secretary Lawrence Summers recently announced plans to ask Congress to greatly expand the powers of the Treasury Department in order to combat money laundering.[2] The proposed legislation would give the Treasury Department "a broad range of powers to investigate and in serious cases forbid transactions between American financial institutions and individual foreign banks or entire foreign countries."[3] This new proposal comes in the wake of the very prominent Russian money laundering scandal involving the Bank of New York last year.

In the years since the first anti-money laundering legislation was put into effect, later versions of regulations have become more burdensome on banks and financial institutions as initial regulations failed to end money laundering. In light of this latest request to broaden the Treasury Department's powers, it is important to take a serious look at anti-money laundering legislation and enforcement, and to assess whether current regulations are cost effective and in the best interest of the American people.

Inefficient, Costly, and Dubious. The criminalization of money laundering rests on a questionable premise—that it is the most efficient means of breaking into serious criminal organizations. First, as former Secretary of the Treasury Robert Rubin pointed out in a 1995 speech to the Summit of the Americas:

> ...the acts through which laundering occurs are, in isolation, often not only legal but commonplace—opening bank accounts, wiring funds, and exchanging currencies in international trade. The funds employed and the launderer's motives make the activity criminal, so sorting out the launderers from the others in the bank line is not easy.[4]

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[2] The President's Commission on Organized Crime defined money laundering as the "process by which one conceals the existence, illegal source, or illegal application of income, and then disguises that income to make it appear legitimate." J. Orbin Grabbe, "The Money Laundromat," *Liberty* (November 1995), p. 33.

[3] Joseph Kahn, "Money Laundering Prompts U.S. Drive for a Tougher Law," *New York Times*, March 2, 2000.

[4] US Department of the Treasury and US Department of Justice, *The National Money Laundering Strategy for 1999* (http://www.treas.gov/press/releases/docs/money.pdf, September 1999), p. 14.

Because of this difficulty in distinguishing the acts of a money launderer from the acts of a law-abiding citizen, law enforcement officials have found that they must enlist bank personnel in their fight to detect money laundering. To this end, financial institutions are required by law to do a great deal of record-keeping and information generation regarding certain types of transactions. These include currency transaction reports (CTRs) and suspicious activity reports (SARs). In the ten-year period from 1987-1996, banks filed more than 77 million CTRs with the US Treasury.[5] Bank personnel must be trained to correctly adhere to the reporting requirements and implementation of the Know Your Customer guidelines.

The financial cost to the banks is significant. According to the American Bankers Association, the cost of meeting all the money laundering regulations required by the US government may total $10 billion a year.[6] All of this cost and intrusion by the FinCEN (Financial Crimes Enforcement Network, an agency of the US Treasury Department charged with overseeing the anti-money laundering laws) resulted in only 932 convictions for money laundering during 1998. This means that the private sector cost per conviction alone, not counting the public sector cost, was more than $10 million.

While anti-money laundering laws have not sent great numbers of money launderers to prison, they have had a significant impact on the operations of banks and other financial institutions. Barry Rider, Director of the Institute for Advanced Legal Studies at the University of London, has noted:

> ...virtually every jurisdiction today is concerned with enacting laws or amending its existing provisions, to provide for the identification, freezing and seizure of the proceeds of serious crime, whether that activity has occurred within its own jurisdiction or elsewhere. Although in practice these laws have so far had little effect, if judged on the basis of how much money has been removed from the criminal pipeline, the impact of in particular the regulatory and compliance requirements that need to be put on any one who handles another's wealth is profound. *The development of such obligations on financial intermediaries and their professional advisors has had serious implications for the way in which business can be properly conducted.*[7] (Emphasis added.)

Customer "Profiling." Anti-money laundering regulations force bank personnel to become agents of law enforcement. Bank personnel who fail to file the correct forms, or who even alert a customer that a report has been filed against him, are subject to legal penalties. As the liability for enforcement is passed to banks, they are put in the untenable position of discriminating among their customers. Individuals initially charged with a duty to serve their customers must become "judges" of those customers. These bank employees must have some means and criteria to distinguish between potential launderers and legitimate depositors. Hence, they use profiles and must make assumptions based upon visible and background information gathered from the customer.

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[5] Lawrence Lindsey, "Should Money Laundering Be a Crime?" Cato Institute speech, Washington, DC, December 5, 1997.

[6] "Clean Getaway for Money Launderers," *Journal of Commerce*, December 10, 1996.

[7] Barry Rider, "The Crusade Against Money Laundering—Time to Think!" *European Journal of Law Reform*, vol. 1, no. 4 (1999), pp. 502-503.

A civil society depends on the separation of duties and responsibilities of institutions. By passing the responsibility of detecting money laundering on to banks and their personnel, the government destroys this separation. Loyalties become muddled. Bank employees who are expected to spy upon their customers will lose the bond of trust that is necessary for a civil society.

Money "Crimes" Still Pay. Advocates of anti-money laundering laws try to justify them on the basis that, by seizing the proceeds of crime, law enforcement can make crime unprofitable for the criminals and thus reduce incidents of criminal activity. Again, the distinguished English law professor, Barry Rider, has done some calculations and noted that, although it is difficult to estimate the total amount of funds laundered globally, US officials have estimated the figure to be in the range of £2000 billion [$3.2 trillion] annually. By comparison, roughly £250 million [$400 million] of funds were confiscated around the world in 1997. Taking a look at the figures for Britain alone, Rider concludes:

> ...since the introduction of confiscature laws in Britain in 1986...well over £1,000 billion sterling have been 'laundered'. The amount of money 'interdicted' during this period is in the region of £40 million. In very rough terms, this means that the British state has been able to take out 0.004 per cent of the criminal money that has flowed through London....If you look at the picture from an international perspective, the belief that confiscature of the proceeds of crime can play the sort of role that the Americans and the various international agencies contend, is seen to be ridiculous.[8]

The amounts of money and assets seized as a result of anti-money laundering efforts indeed are minimal when compared to the estimated amounts of funds laundered. Thus, because money launderers do not have a statistically significant chance of being caught and losing the profits from their misdeeds, the deterrent effect of such laws is negligible. Money laundering laws instead encourage money launderers to devise new and more innovative ways to move the profits of their criminal activities into the legitimate economy. For every avenue that is blocked by law enforcement efforts, money launderers will find another one. Even FinCEN concedes on its website that "as soon as law enforcement learns the intricacies of a new laundering technique and takes action to disrupt the activity, the launderers replace the scheme with yet another, more sophisticated method." The bottom line is that, despite countless amounts of money spent in trying to enforce money-laundering laws, criminals do find ways to "clean" their money. In the digital age—the age of the Internet and public key encryption—the ability to launder money will become easier and easier.

Stimulating a Market for Money Laundering. Advocates of anti-money laundering legislation assume that this type of legislation is vital in combating organized crime. Yet there is as much evidence that anti-money laundering activities by the government are more apt to *create* organized crime than to curtail it. Overzealous law enforcement creates a market for more sophisticated money handlers, thus increasing the size of the criminal network. Hence crime groups are strengthened by having the additional "product line" of money laundering services to offer the common criminal. To expand their money laundering business, the organized crime leaders have a vested interest in increasing the number of local drug pushers and common thieves. FinCEN has claimed that the precious metals industry has been criminalized by money launderers. If true, it is

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[8] Ibid., p. 515.

likely that the increased presence of the anti-money laundering cops helped turn a non-criminal industry into a criminal one.

Undermining Financial Privacy. Anti-money laundering legislation is not only ineffective and counterproductive, it also undermines the financial privacy of individuals. Again, as former Secretary Rubin said, *commonplace* activities are the very ones in which launderers engage. Thus, everyone's commonplace activities must be monitored and regarded with suspicion. While professing an understanding of the need to protect individual privacy, FinCEN belies its true intents. The US Treasury and Justice Departments' *National Money Laundering Strategy for 1999* clearly reveals the ultimate goal: "Regulatory efforts to fight money laundering rest on the elimination of bank secrecy..."[9] If these bureaucrats and their political supporters have their way, all financial privacy will be sacrificed in the war on money laundering.

Global Overreach. The ill effects of US money laundering legislation extend worldwide. As business, trade, and financial services are globalized, money laundering also becomes increasingly an international business. Thus, money laundering laws, and the attendant ever-escalating need for more effective enforcement, propel the US to adopt attitudes insensitive to foreign countries' rights to self-determination, and to violate the sovereignty of foreign states. Current US attitudes towards the financial privacy choices of foreign governments are wrong-headed, arrogant, and downright counterproductive. For example, the US Treasury and Justice Departments' *National Money Laundering Strategy for 1999* states as one of its goals that it must:

> Propose, in the Money Laundering Act of 1999, provisions to strengthen the international reach of US enforcement efforts, by...making it illegal to launder criminally derived proceeds through foreign banks; giving federal prosecutors greater access to foreign business records located in bank secrecy jurisdictions; and giving US district courts jurisdiction over foreign banks that violate US money laundering law.[10]

These proposals illustrate how far US government officials will go. Not only are they willing to violate the civil liberties of US citizens, they also believe that foreign jurisdictions should have no right to provide their citizens protection from the far-reaching hand and eye of US law enforcement.

The plans announced by Secretary Summers to expand the Treasury Department's discretion over restricting the access of foreign banks and/or the financial institutions of entire countries to the US banking system once again highlights the Treasury Department's overreach. Not only will US banks be required to generate a paper trail, but also in some cases they will be forced to curtail correspondent banking relations with banks targeted by the Treasury Department. This could impede the *legal* transfers of funds internationally, along with other funds transfers related to money laundering.

Hampering New Technologies. Anti-money laundering laws also multiply the potential for law enforcement to needlessly hamper the integration of new technologies that have the ability to benefit the public. FinCEN's concerns regarding the development of the new technologies are evident on its website:

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[9] US Dept. of the Treasury and Dept. of Justice, op. cit., p. 37.
[10] Ibid., p. 10.

> The speed that makes the systems efficient and the anonymity that makes them secure are positive characteristics from the public's perspective as well as law enforcement's perspective in protecting the systems from being compromised. However, these same characteristics make these systems equally attractive to those who seek to use it [sic] for illicit purposes and increased anonymity while providing security [sic], may actually impede law enforcement from obtaining necessary information to detect illegal activity.[11]

Based upon previous experience, it is not hard to imagine that FinCEN and other law enforcement organizations will step in and attempt to curtail the widespread use of the new technologies for as long as possible.

Cyberpayments and smart cards can facilitate payments from person to person, without regard to geographic location. Particularly if they can be operated within anonymous systems, they do have the potential to hide transactions from the peering eyes of the government. However, the US Constitution was designed to protect the American people from an overzealous government in order to preserve their liberty.

FinCEN's website makes clear its hostility to new technological bypasses around information surveillance:

> Historically, law enforcement and regulatory officials have relied upon the intermediation of banks and other types of financial institutions to provide "chokepoints" through which funds must generally pass. In fact, the Bank Secrecy Act, administered by FinCEN, is designed specifically to require financial institutions to file reports and keep certain records to ensure that such a paper trail exists.
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> In an open environment like the Internet or "peer to peer" transactions, exchanges of financial value may occur without the participation of a financial intermediary like a bank, and thus, the existing chokepoint is eliminated. Therefore, as more is known about the operations of these systems, the government must identify what regulatory measures, if any, should be considered.[12]

Cyberpayments and smart card systems hold immense promise for legitimate business transactions. It would be a very sad fate if the implementation and widespread use of such systems were impeded in a fruitless attempt to regulate against the *possibility* that criminals would also use such systems. Although criminals might exploit these same systems to their advantage, there is no reasonable way to prevent this without the wholesale destruction of the beneficial uses of the new technologies. Criminals also use automobiles and telephones in illegal activities, but most people understand that banning their use would cause more harm than good. The same is true of the new digital money technologies.

Digital Money Reduces Crime. Indeed, crime rates could be sharply reduced if the US government *stopped* blocking the utilization of digital money. A large portion of all crime is committed by criminals trying to steal someone else's physical paper currency. Almost all robberies,

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[11] Financial Crimes Enforcement Network website, http://www.treas.gov/fincen/cybpage.html.
[12] Ibid.

and most larceny thefts, occur as a result of criminal attempts to steal *cash*. A significant number of the approximately 18,000 murders in the US each year are motivated by the desire to steal cash, and hundreds of thousands of people are severely injured each year as a result of theft attempts. Criminals snatch ladies' purses, hold up gas station attendants, and rob banks to get cash. If there were less physical cash, there would be less crime. Electronic digital money could quickly largely replace paper currency if people could be assured that they would have the same degree of anonymity they have with paper money.

Smart card transactions are far less costly (under three cents per transaction) than credit or debit cards, checks, or even cash. They are almost impossible to counterfeit and, to a thief, they are far less appealing than cash. If a card with a good security device (i.e., pin code) is stolen, it cannot be used by others, thus reducing the incentive for theft. The theft of digital money is not impossible, but it is very difficult. Most crooks in the real world (unlike the movies) will lack the skills to do it.

Electronic payments do not have to be made with a smart card; they can also be made directly from computer to computer over a phone line, wireless device, or the Internet. In the same way that money is downloaded from a bank account into a smart card, it can be downloaded directly to the hard drive of a PC. The "money" on the hard drive can then be sent to someone else's PC and eventually back to the bank for clearing. All of these transactions can be secured by utilizing virtually unbreakable encryption.

These technological developments appall those in Washington who love government control and the ability to fully monitor their fellow citizens. They are desperately trying to prevent anonymous systems. On the other hand, despite all of the great advantages of digital money, citizens will not accept it unless they have the ability to remain anonymous in their purchases. FinCEN and its allies in the Administration and the Congress have effectively delayed the widespread adoption of anonymous digital money systems through their wars on the use of encryption and financial privacy.

People have many very legitimate reasons for not wanting to have a public record of every expenditure they make. The pharmaceuticals, food, reading material, clothing, and other things that one purchases are no one else's business, particularly government agents. People are neither stupid nor naïve—they know perfectly well that if government agents know all of their spending habits, they may abuse the knowledge, despite pledges that they won't. Recall similar past promises that the IRS, FBI, ATF, and White House would never violate the law, our security, or our privacy.

We should not allow the Treasury Department to expand its losing war on money laundering at the expense of financial privacy. A civil society depends on a government that does not unduly restrict liberty and economic opportunity. The domestic and international campaign on money laundering is incompatible with a free and prosperous society.