Free critical thinking on money laundering, corruption and the international fina...

Government, Corruption

Introduction

The inter linkages of the international finance systems cannot be denied nor overemphasized. A movement in one major stock market signals either a threat or an opportunity in another stock market. For instance, a boom in the New York Stock Exchange will also signify the upbeat in the other foreign stock markets such as in Asian and Latin American markets. Conversely, the fall of the U. S. housing markets led to the credit crunch felt by most financial centers in the U. S., Great Britain, and other European markets. Hence, any threat to the global financial market may mean a single threat to the wider, international markets.

This paper aims to explore the risks posed by money laundering and corruption to the global financial system and international business. It defines money laundering and corruption and identifies its immediate and long term influence on the global financial markets as well as the threats they carry. Money laundering and corruption, on the surface, seem not to carry serious risks to the international businesses and the financial system. Albeit, a thorough analysis of its influence in the flow of financial resources will show how it must be thoroughly considered and how the indirect and immediate effects will be felt by the economic and commercial institutions worldwide. More importantly, global security is also at stake when money laundering occurs. This is because global terrorism has also been linked with financial anomalies such as money laundering and corruption in the global money markets. As such, this paper will also evaluate the sufficiency of the current international efforts in dealing with these threats. This is to ensure that the financial systems around the world are safe, secured and legally functioning.

What is Money Laundering?

A simple definition of money laundering is presented by Investopedia (2012, p. 1) as “ the process of creating the appearance that large amounts of money are gained legally when in fact it was obtained from serious crimes, such as drug trafficking or terrorist activity.” McDowell & Novis (2001, p. 1) defined money laundering as “ a series of multiple transactions used to hide the source of money so that these money may be used without revealing the criminals who are seeking the money underground.” There are typically three levels of transactions involved in money laundering: (1) placing the unlawful financial assets into formal financial institutions through deposits, wire transfers, or other methods; (2) separating the proceeds of criminal activity from their origin by the use of complex financial transactions on the surface; and (3) integrating the financial assets with an apparent legitimate transaction to hide illicit proceeds (2001, p. 3). By these processes, the criminals are able to transform the monetary proceeds derived from illegal activities into funds with a seemingly legal source.

Money laundering also depends to some extent on the present financial systems and operations, there is creativity involved by how the criminals and underground money movers will transform the sources of funds legally. There are ways by which money is laundered and these are accomplished through automobile dealers, casinos, currency exchange houses, gold dealers, insurance companies, stock brokerage agencies, and trading companies (Pande, 2008, p. 2). They also mask illegal operations through free trade zones, private and offshore banking facilities, shell corporations, trade financing, and wire systems. By these means, the criminals manipulate different financial systems all over the world (McDowell, 2001).

Money laundering is specifically masking the origins of illegal money which was actually derived through illegal activities such as corruption, drug trafficking, human trafficking, smuggling, and others. They try to avoid the risk of drawing attention to their huge sum of money and thereby exposing themselves to criminal prosecution (IMF Website, 2012).

Money laundering is often related to terrorist financing but they are two distinct activities. Terrorist financing is “ the collection or the provision of funds for terrorist purposes” (IMF website, 2012). As compared with money laundering, its sources are both from legal and illegal means whereas, in money laundering, the funds are always of illegal sources. The primary goal in terrorist financing is not really to hide the sources of the financial assets but to hide the nature and the purpose of the funding activity (IMF Website, 2012).

However, the techniques used to launder money and to finance terrorist activities are very similar. In any of these illegal activities, an effective anti-money laundering and anti-terrorist financing should be installed in order to address both risk issues. There must be mechanisms to detect suspicious financial transfers at all times (IMF Website, 2012).

What is Corruption in the Global Financial System?

Corruption is a source of money laundering since it generates large amounts of proceeds to be concealed and transferred by illegal means. Corruption also induces commission of a money laundering offense and conceals its detection since it can obstruct the effective applications of a country's legal, criminal and legislative frameworks (IMF Website, 2012).

This is why the International Monetary Fund is advising that countries establish corruption as a predicate offense to money laundering cases. The international money agency believes that this would effectively address money laundering as a corrupt activity. When government authorities are given the power to investigate and prosecute corruption and money related cases, they can immediately freeze and confiscate assets and property that is generated out of the corruption made. International cooperation is also needed to fight corruption (IMF Website, 2012). Both corruption and money laundering are given focus by the IMF since it disrupts both the national and regional economies (IMF Website, 2012).

The Risks and Consequences of Money Laundering and Corruption

Because of the rapid developments in the technology used by international financial institutions and the ensuing contexts of global business and trading, the financial aspects of crime have been more sophisticated and its adverse effects have been more severe. Money related crimes such as corruption and money laundering have become increasingly international in scope. Money laundering carries severe threats to the economic and social well being and security of both national and international entities. According to Reuter &

Truman (2004), it fuels drug dealerships, terrorism, illegal arms trade, government corruption, and provide funds for others to operate and widen criminal activities.

If money laundering and corruption are unchecked, these can erode the integrity of a country's financial system. As the national and international capital markets are now highly integrated, money laundering can also threaten national currencies and interest rates (McDowell & Novis, 2001). They are also very detrimental to the global financial systems since most launderers do not put huge amount of money in funds with high returns. They put the money where it would be less detected. As such, money laundering can multiply the threat of monetary instability due to the misallocation of resources from superficial distortions in asset and commodity prices (Aidt, 2009). Hence, money laundering and corruption in the financial system are not just a law enforcement problem. They pose serious risks for national and international security (McDowell & Novis, 2001).

Money laundering is not just an international concern for the linked economies of highly developed markets. It is also a very imminent threat to less developed markets and to the emerging markets as well (Aidt, 2009). This is because almost all of the financial systems and various stocks, capital and commodities markets are all interlinked nowadays.

It can make a financial system unstable since financial institutions depend on the amount of money they receive. If laundered proceeds enter into a financial institution and it suddenly disappear (either through wire transfers and legal withdrawals), this will be a great challenge for them. Major challenges in this case are liquidity problems and bank runs (McDowell & Novis, 2001).

According to Michel Camdessus, ex-managing director of the International Money Fund, the magnitude of money laundering is between 2 and 5 percent of the world gross domestic product (2001, p. 4). In estimation, this is at least $600, 000 million (2001, p. 4). In terms of losses in emerging markets, the illegal proceeds may dwarf government budgets which can result in a radical adjustment of the nation’s economic policies which can eventually result to a loss of control of the outcomes (p. 5). A huge accumulated asset base of laundered money can also be used to halt an emerging or a small economy in one corner (Aidt, 2009).

Money Affairs and its Impeding Security Threats

“ Money is the lifeblood of terrorist operations.

Today, we’re asking the world to stop payment.”

President George W. Bush, 24 September 2001

Transnational networks connect businessmen, families, scientists, and academicians. These complex links also include criminals, terrorists and the other darker members of the global society such as the terrorist networks and criminal organizations. Financing is crucial for all these organizations and its activities. Sadly, this is also true of the global terrorist networks. This is the main threat related to money and corruption in the global financial system (Chaikin, 2010).

Global terrorist operations involve a lot of money. The best way they raise and sustain funds is through collective financial operations such as those gathered by money laundering and corrupt activities. Terrorist groups sue these large sums of money for their operational and support activities. Napoleoni (2010) distinguished terrorist activities as operational and support operations. Operational activities consist of surveillance and reconnaissance, rehearsal, final preparations, and the actual attack. Meanwhile, support operations involve communications, fund-raising, multiple identities, procurement, propaganda, recruitment, transportation and travel, safe havens, and training (2010, p. 1). All of these subvert activities require financing.

While the real costs of a terrorist attack can just sum up to thousands of dollars, the development and the maintenance of a terrorist network need millions of dollars. Hence, they mainly rely on money laundering. It is the principal monetary activity in their large spectrum of financial methods to sustain their global links and operations (2010, p. 2).

While money laundering gives them sufficient funds, their money is not purely collected from illegal means. They also have various individual and state sponsors. The historic September 11, 2001 attacks made the international financial markets realize how significant is money laundering in terms of preventing security and commercial as well as military and economic threats. It instituted and solidified greater stringent controls over the traditional banking sector to fight money laundering, corruption and terrorism. However, with these new security measures, the terrorists have also made their money and funding sources and methods more sophisticated so that they can circumvent these extra measures and added security features in financial transactions worldwide (2010, p. 2).

In the other side of the security contentions, not only the global terrorist networks are linked with money laundering and other corrupt financial practices. According to Napoleoni (2010), the American government was also guilty of using money in its ambitious military funding and expenditures. He contended that in order to raise funds, the Bush administration utilized the international capital market through the sales of billions of dollars worth of treasury bonds several years ago (2010, p. 2).

The author also contended that in order to make the US debt competitive, the U. S. Federal Reserve continuously slashed interest rates by lowering it to 1. 2 percent in the middle of 2003 from 6 percent after September 11, 2001. This countered the world economic conditions as the international markets have been growing fast. The US Federal Reserve Chairman, Alan Greenspan, collaborated with this financial strategy so as to prevent financial bubbles (which eventually burst in the later years). As outcomes, the terrorist attacks led to a mini recession in the Western World markets. It also suspended the recurrent economic crises of globalization. At hindsight, the use of interest rates, which can be considered illicit in this respect, hid the financial crises which are now being felt by almost all of the economies in the succeeding turn of financial disruptions experienced by almost all of the financial markets globally.

Napoleoni (2010) also added that the inter linkages between terrorism and the global economy go beyond the credit crunch, the recession and the euro crisis. Since September 11, this has been extended to the “ boundaries of a shadow world” (p. 1). Money and terrorism has been intertwined in the global financial system and this makes it more disruptive and highly threatening.

Are the Current International Security Efforts Sufficient?

The global financial community has made the fight against money laundering and corruption and ensued to protect the worldwide monetary system. Initially, the IMF made stringent measures to protect the integrity and stability of the global financial system, cut off the financial resources available to terrorists, and made sure that criminal activities will not be able to infiltrate the legal sources of money (IMF Website, 2012).

In 2000, the IMF strengthened its anti-money laundering (AML) measures and also monitored the abuses of Offshore Financial Centers (OFC) through various initiatives, measures and programs. It also intensified its efforts in combating the financing of terrorism (2012, p. 1). They also conducted various technical assistance to actively work with national economic systems to ensure compliance and enforcements to improve anti money laundering measures and monitoring. As it is, the IMF is very much concerned with the possible consequences of money laundering and the financing of terrorism on its member countries.

There are also Financial Intelligence Units (FIUs) which were activated as prime agencies to address money laundering cases. These agencies receive reports of suspicious transactions from financial agencies and other persons and organizations. They evaluate the transaction/s and disseminate the gathered intelligence to local law-enforcement agencies and FIUs to prevent money laundering (2012, p. 1) There are now 101 countries at present which are recognized as operational FIU units (2012, p. 1)

In one of the most extensive financial system, the United States has also strengthened its fight against money laundering and corruption way before the terrorist event. In 1998, as initiated by its U. S. Congress, the U. S. government enjoined 33 other national economies to act against the bribery of foreign officials, particularly of government officials in an attempt to reduce corruption and money laundering in the global financial system (FCPA Website, 2012). Corrupt political officials and those in high army office are the focus of this initiative. It aims to prevent government officials from abusing their positions to gain unfair commercial advantage. This has a profound impact in the way that government and private enterprises do their business both locally and internationally.

However, even with the institutionalized measures, there are institutional and technical problems and gaps which make the financial system still largely susceptible to money laundering and corrupt practices. Hence, its security is not intact. According to FitzGerald of the Finance and Trade Policy Research Center at the University of Oxford (2000), despite extensive acknowledgment of the problem, there are mismatches in the intergovernmental power and the requirements of involved institutions to address the issues and problems in a global market. Inherently, the international financial markets are unstable because they deal in expectations. Hence, the strong regulation to underpin anomalous contracts and prevent systemic collapse is lacking.

Even U. S. Senator Carl Levin (2012) believes that their highly institutionalized banking system still have inadequate safeguards against money laundering. The U. S. banks are still vulnerable in facilitating money laundering transactions and funds gained through corrupt and illegal means. These huge amounts of money can be used to fund terrorism, drug cartels, corrupt governments, tax evasions, etc. They use the largest financial system, the U. S. financial system, to transfer their money to commit crimes, arm terror groups, produce and move illegal drugs, loot government coffers, even purchase weapons of mass destruction (2012, p. 1).

There are enormous problems in the security of the financial system which have not been addressed. These include the massive backlog of unevaluated notifications identifying potentially suspicious activity; the lack of monitoring in the $60 trillion wire transfers and account activities; a failure to examine risks at HSBC’s overseas affiliates (the biggest gateway to the U. S. financial system) before providing them proper banking services; and a three year period of failing to conduct anti-money laundering checks on more than $15 billion in bulk-cash transactions with the U. S. banks’ old affiliates (p. 1).

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