Corruption, Organized Crime, and Money Laundering

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The relationship between private wealth and public power frames the discussion of corruption and embraces not only explicit quid pro quo deals but also lobbying, campaign donations, and other forms of pressure exerted by both private individuals and businesses. Some use the term “corruption” to cover all the ways that concentrated wealth influences political choice. I am sympathetic to such concerns, but I am not convinced that extending the corruption label to all these issues is the most productive route to understanding and reform. Thus, my own work has concentrated on quid pro quo trades that violate legal or institutional rules where the benefits from making a payoff are concrete and specific (Rose-Ackerman 1978, 1999; Rose-Ackerman and Palifka 2016). Once one understands such situations, the debate can move to gray areas that are not per se corrupt in that sense but that can slide into outright illegality and can undermine public institutions. Of course, different legal systems and cultural norms draw the lines between acceptable and unacceptable influence in different ways. However, even payoffs that are entrenched and routine may be deeply destructive of human development and political legitimacy.

Corruption highlights underlying problems at the state/society interface. Decisions that should be made on the grounds of efficiency, equity, or citizen accountability are instead influenced by benefits provided directly to public officials and their kin, or perhaps to their political parties and allies. A targeted quid pro quo substitutes for actions that are officially required of the person accepting or extorting the payoff. Even if the recipient of the payoff follows the rules on allocating public benefits and costs, the payoff is itself illicit. The transaction is corrupt. Of course, in some cases paying for a government benefit may be the best way of allocating a scarce public service, but then the payments should be legal and public, and the funds should go into the government treasury.

Some forms of corruption are well studied, and reasonable reform proposals can constrain the underlying incentives for corruption. These include low-level payoffs by households and small businesses to obtain scarce government benefits, to qualify for benefits or licenses, and to lower the costs of taxes and fines. Reforms focus on eliminating rules that serve little purpose beyond generating payoffs, permitting the legal sale of a scarce benefit, streamlining programs to reduce official discretion (perhaps through e-government), plus a range of monitoring and transparency initiatives open to those harmed by corruption. Tradeoffs exist between limiting official discretion as an anti-corruption measure and assuring that public programs are sensitive to legitimate demands for individualized treatment. Similarly, “grand” corruption in procurement, privatization and the allocation of concessions arises because deals are complex and opaque and involve those at the top of the state. They cannot be controlled without the help of those in positions of domestic power or those with external leverage. One response is to streamline procedures and to benchmark behavior against outside measures. Programs that make government more transparent and accountable can help in both cases, but the exact forms these reforms should take have not been well tested. Of course, the criminal law of bribery stands in
the background, but it is not sufficient taken by itself. The structural changes and the increases in oversight that I stress in previous work remain the key to successful reform.

But sometimes whole institutions or even states are so permeated by corruption that partial reforms are ineffective. The most vexing problem for those seeking to reform a state where corruption has become entrenched is deciding where to begin. Insiders point to a “culture of corruption”, often despairing of the possibility of change. But cultural norms do change for both better and worse, and the task for reformers is to figure out what policies might succeed and which could provoke a backlash that exacerbates the situation. One important self-reinforcing spiral of corruption is a polity where organized crime influence has deeply infiltrated state institutions, such as the police and judicial and law enforcement structures. In such cases or if political leaders are directly extracting large-scale private benefits, the global financial system may facilitate their grand corruption by easing the cross-border flow of funds and by supporting financial havens, both on small islands and in global money centers. Abstracting from the overall problem of corruption and governance, this essay concentrates on the interface between corruption, organized crime, and money laundering.

I. Organized Crime

Corruption and organized crime often go together. Organized crime dominates illegal businesses, but it may also control legal businesses to gain monopoly profits and exclude competitors. Large-scale illegal businesses or Mafia infiltration of legal activities are both likely to have a corrupting influence on government, especially law enforcement and border control. Corrupt rulers and illegal businessmen feed on each other. Bribes reduce the cost of illegal business ventures and help them raise capital, fueling their growth and generating more corrupt arrangements. If a strong symbiotic relationship exists, anti-corruption policy needs explicitly to target organized crime. Otherwise it will ignore one key root of the problem.

An Organized Crime Group (OCG) “has some permanence, commits serious crimes for profit, uses violence, corrupts officials, launders criminal proceeds and reinvests in the licit economy (Buscaglia and van Dijk 2003:5).” Europol or the European Police Office (2013: 6) has identified approximately 3600 OCGs operating in the European Union, many connected via the drug trade and human smuggling to Latin America. Due to globalization and the internet, many of these groups are international in membership, crimes, products, markets, and routes. The emergence and persistence of organized crime are influenced by historical, societal, and cultural factors (McIlwain 1999, Varese 2015). Organized crime is often traceable to a time when some groups were underrepresented or disenfranchised, such as during foreign occupation, civil war, or mass immigration. In these circumstances, political groups have employed criminals to advance their agenda, and OCGs have used the political system to advance theirs or have infiltrated or replaced weak state institutions (Center for the Study of Democracy 2010; Beare 1997; Feldab-Brown 2011; Gambetta 1993; Schneider and Schneider 2005).

Buscaglia and van Dijk (2003) studied the conditions under which organized crime flourishes. In cross-country research they found that high levels of organized crime were associated with a weak state, high tax evasion, an ineffective customs service, protectionism, high financial risk

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1 This section is a condensed version of chapter 9 of Rose-Ackerman and Palifka (2016). Palifka made a major contribution to that chapter and to the material cited in this section.
ratings, lack of democracy, a poorly functioning judicial system, politicization of the civil service, and state capture. Where organized crime is stronger, there tend to be more police and prosecutors, yet fewer arrests for drugs and lower conviction rates overall. They argue that ineffective law enforcement encourages organized crime, as ordinary people distrust formal institutions, turning, instead, to “illegal organizations, such as mafia-type groups, to deal with minor crimes” (Buscaglia and van Dijk 2003:10). Likewise, when the banking system fails to serve the needs of citizens, they turn to underground options for loans. Although a strong state can resist infiltration by organized crime, the causal arrow could go the other way with organized crime itself undermining the effectiveness of the state and producing a vicious cycle. In such situations corruption is likely to be endemic even if organized crime has not infiltrated legal and illegal markets.

Although organized criminal groups operate on the margin of formal markets and outside legal norms, they behave very much like business firms, often operating like franchises loosely linked to a central organization. They produce where costs are lowest and sell where the return is highest. Instead of paying taxes, they make direct payments to government representatives in the form of bribes. They tend to be organized hierarchically, although horizontal networks have started to develop (Center for the Study of Democracy 2010), and frequently, those in the lower ranks cannot identify their superiors (Thoumi 2003: 80). They face competition, but their methods are often based on threats of violence, rather than on advertising and creative marketing (Reuter 1987). Because the environment in which OCGs operate changes constantly, they must be entrepreneurial, adapt their business to develop new and better products and delivery methods. For example, in response to the 2008-2011 economic crisis, organized crime in Europe increased trafficking in counterfeit and substandard consumer goods (Europol 2013: 11).

Established organized crime groups can corrupt and undermine state institutions and, once they have infiltrated public institutions, a vicious cycle can develop between the two. As OCGs mature and become increasingly intertwined with civil society and the state, they may engage in state capture, manipulating the law to favor their business. This includes customs duties, regulation of mafia-dominated sectors, and laws regarding the illegality of certain activities or statutes of limitations (Beare 1997). In the extreme, the result is a mafia-dominated state.

In Italy whenever an investigation into either corruption or organized crime is undertaken, it leads to the other (Center for the Study of Democracy 2010: 18). In Mexico using plata o plomo (bribe or bullet) techniques, drug cartels corrupt the police, judges, politicians, prison guards, and bureaucrats in many parts of the country. In an effort to override corrupt local officials, the military and federal police have been moved from one hotspot to another in an attempt to capture key members. This policy, which effectively reduced the impact of the mafia in the United States during the 20th century, has proven less effective in Mexico.

The links between corruption and organized crime can be gleaned from the Global Competitiveness Report, which asks international business leaders about the conditions (costs to business) in 144 countries; responses are recorded on a scale of 1 (very poor) to 7 (very good). Higher bribery is associated with the higher costs associated with organized crime, higher costs to business of violence, and lower levels of trust in the police. There is also a relationship between public sector embezzlement (one type of grand corruption) and organized crime.
Because the data are cross-sectional, these graphs do not reveal cause-and-effect, but they are suggestive of the vicious circles or spirals present when OCGs are strong. (See: *Global Competitiveness Report 2014-2015* dataset, http://www3.weforum.org/docs/GCR2014-15/GCI_Dataset_2006-07-2014-15.xlsx.)

If OCCs have infiltrated, corrupted, and undermined the state, this opens up profitmaking opportunities beyond their core illegal businesses, such as drug trafficking. One very lucrative activity is extortion. Legal businesses that benefit from prime urban locations are especially at risk in countries with weak or corrupted police forces. This includes restaurants and shops serving tourists and business travelers. Manufacturers can hide in out-of-the-way locations (Charap and Webster 1993), but service businesses cannot “go underground.” If the police are bought off or unreliable, criminal groups may demand protection money where the funds are, in part, protecting the business from attacks by the group itself (De Melo, Ofer, and Sandler, 1995; Webster 1993; Webster and Charap, 1993). In Northern Mexico, due to violence-backed demands for payment (called *piso*, literally “floor” but implying the right to occupy the space) in 2008-2011, many businesses closed and many entrepreneurs moved to the United States or less affected parts of Mexico, rather than pay or risk kidnapping or execution.

A second option is to engage in legitimate business activity backed by the threat of violence to discourage competition and by payoffs to public officials to look the other way. Even in developed countries some legitimate businesses are especially vulnerable to criminal infiltration. Diego Gambetta and Peter Reuter provide a list of the factors supporting the emergence of mafia-controlled cartels (Gambetta and Reuter 1995: 128). In the most favorable cases product differentiation and barriers to entry are low; technology is unsophisticated and labor, unskilled; demand is inelastic, and the industry consists of a large number of small firms. In other words, cartelization would not be possible without the threat of violence as a backup. Private garbage collection provides a good example. Entry is inexpensive—one need only purchase a truck. However, because garbage trucks operate alone on the public streets, it is relatively easy to intimidate unwanted rivals by attacking their trucks without attracting police attention. To minimize their risks, the mafia pays the police to look the other way (Reuter 1987).

Third, organized crime groups may take over the sale of legal but pirated goods, for example, unauthorized copies of music, movies, and other products. Organized crime groups maintain such businesses and limit competition by bribing public officials, such as the police and other inspectors. The profits, earned without paying taxes, can then be reinvested in legitimate business and in obtaining public contracts via payoffs (Gambetta 1993; Varese 1994).

Fourth, organized crime groups can become government contractors, using their criminal muscle to win tenders. Businesses, such as road repair and building construction, which do a heavy business with the state, are prime candidates for organized crime influence. If a government has been corrupted by organized criminals seeking protection for their illegal businesses, it may be a relatively short step to make payoffs to obtain public contracts. For example, drug cartels in

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2 Olken and Barron (2009) document Indonesian truckers paying organized crime to allow them safe passage, or paying to travel in convoys protected by the military or police.

3 See, for example, Feldab-Brown 2011. In Russia the same type of extortion payment is called a “roof” or “krysha” rather than a floor (Varese, 2001).
Mexico have used both extortion and campaign funding to obtain government contracts on very profitable terms. In the extreme, organized crime groups manage cartels that share contracts and pay off public officials to buy their complicity or at least their silence. In Southern Italy, for example, a 1990s survey of small- and medium-sized businesses found that over half reported that they had withdrawn from a public tender after pressure from criminal groups or their political allies.

Finally, consider regime transformation. When the Soviet Union collapsed, the benefits to both legitimate investors and organized crime groups were extremely high as the entire wealth of the state was up for grabs. In some cases, organized crime managed to create an atmosphere of uncertainty and the threat of violence that drove competitors away, leaving the criminal groups with a free field (Shelley 1994). The weakness of state institutions created an environment ripe for the development of organized crime and allowed them to use corruption to infiltrate government and business. In Georgia, for example, in spite of success in limiting corruption in some parts of the bureaucracy, organized crime took advantage of a voucher program—designed to enable citizens to participate in the privatization process—to obtain privatized assets (Kukhianidze 2009). As the Center for the Study of Corruption (2010: 40) concludes, “[i]n its most advanced form, organised crime is so thoroughly integrated into the economic, political, and social institutions of legitimate society that it may no longer be recognizable as a criminal enterprise.” According to Europol (2013: 15) “Social tolerance towards certain crimes reduces risks for OCGs and increases public demand for illicit commodities.” In coca-, poppy-, or marijuana-producing countries, the criminalization of traditional activities calls into doubt the legitimacy of the state and further marginalizes indigenous groups (OAS 2013a: 25). If the production of traditional crops is criminalized and prosecuted while more powerful criminals or corrupt economic and political actors are allowed to continue operating, the populace loses faith in the government as an advocate for the people (Organization of American States 2013a: 82).

Organized crime also corrupts private businesses into facilitating their illicit production or smuggling operations. For example, cigarette, clothing, or medicine manufacturers could be paid to produce after-hours to supply OCGs with goods; truck drivers to smuggle illicit goods or people; and the employees of restaurants, night clubs, bars, and retail stores to allow the sale of counterfeit or contraband cigarettes, alcohol, and drugs (Center for the Study of Democracy 2010: 113-116). Alternatively, OCGs may take advantage of other widely-accepted illegal activities. For example, in Colombia, drug trafficking organizations used existing contraband networks to launder their drug proceeds (Thoumi 2003: 85). As private businesses cross the line into illegitimate activity, and the public welcomes access to these goods (low-cost contraband or new psychotropic substances, for example), the law in general becomes less relevant.

Corruption “enables” organized crime, but organized crime also feeds corruption. OCGs often actively try to corrupt customs officials, immigration authorities, law enforcement, the judiciary, procurement processes, and access to sensitive information. They seek not only immunity from prosecution for themselves but also assurance of monopoly power in the illegal market. In many parts of Italy, OCGs control local politics and, by extension, police forces (Center for the Study of Democracy 2010: 90). Mexican cartels have more public officials on the payroll than rank-

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and-file traffickers or foot soldiers: information from confiscated ledgers indicates that a single plaza (controlled area) in Mexico may have 1-600 “employees” but 109-1,000 officials on the payroll (OAS 2013b: 24-25). Thus, OCGs corrupt low-level bureaucrats, law enforcement, and politicians alike, as they extend their reach and debilitate institutions (OAS 2013a).

OCGs commonly use bribery, threats of violence, and blackmail to corrupt the police, customs officials, judges, politicians, and military in order to gain not only prosecutorial immunity, but outright cooperation and assistance, especially in smuggling operations (Center for the Study of Democracy 2010).6 As some parts of government become corrupt, transparency becomes increasingly difficult, thus enabling more corruption in other sectors and feeding a vicious spiral (OAS 2013a: 56). When organized crime has a strong foothold many of the standard reform proposals outlined above will have only minor effects. Deeper changes are needed.

II. Money laundering7

Most corrupt proceeds eventually end up in the legitimate global economy, either deposited in financial institutions or invested in real estate or business ventures. Much of it flows across national borders into assets and financial institutions located in money centers in wealthy countries or in so-called “financial paradises.” Hence, the international control of money laundering and of investment vehicles with opaque ownership could make corruption more expensive and troublesome even if domestic law enforcement is weak.

Money laundering is the process by which illicitly gained funds are made to look legitimate—facilitating illicit activity by hiding it. The magnitude of money laundering, like all secretive activity, is difficult to measure. Global Financial Integrity (2014) estimates that illicit financial outflows from developing countries totaled US $991.2 billion in 2012, over ten times the official development assistance received by these countries; over the period 2003-2012, nearly US $6.6 trillion left these countries illicitly. The flow of illicit funds increased by 9.4% per year in this period, faster than the growth of these economies. The UNODC (2011) estimated that 2.7% of global GDP is “available” for laundering, including 1.5% of global GDP laundered in connection with drug trafficking and organized crime. Peter Reuter (2013) argues, however, that it is not only impossible to measure money laundering, but also useless because money laundering itself has not been shown to cause significant damage on a macroeconomic scale. The real damage, according to Reuter, is perpetrated by the crimes that money laundering supports. But tracking down, arresting, and prosecuting criminals successfully is difficult, so Anti-Money Laundering (AML) efforts offer a trail and a means to apply justice that may be more cost-effective than seeking out the predicate offences. The OAS (2013b: 32) argues, in contrast to Reuter, that money laundering itself causes economic damage, including price distortion, unfair competition, speculative bubbles and crises, and considerable movements in the value of currencies, leading to either “Dutch disease” (for example, exchange rate appreciation in offshore financial centers) or rapid devaluation. Unfortunately, however, definitive evidence is lacking.

The traditional model of money laundering involves three steps: placement, layering, and

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6 In Afghanistan, for example, organized criminals have used bribery and kidnapping of customs officials to enable their smuggling activities. See Special Inspector General for Afghanistan Reconstruction (2014).

7 Some of the material in this chapter is derived from Rose and Ackerman and Palifka (2016), chapters 9 and 15.
integration. The entire process may absorb some 15% of the value of the funds laundered (Organization of American States 2013b:27). In the placement phase, illicit funds are introduced into the financial system. Funds may be deposited (in cash) in a bank or invested in another financial institution, or transferred from one account to another. AML efforts have identified certain red flags and persuaded some countries to place a limit on the size of transfers permitted without providing identification or filling out additional paperwork. To escape scrutiny, the launderer may make many small deposits and employ a third party, rather than make large deposits directly. During layering, the funds are transferred among multiple—often offshore—accounts, sometimes using shell companies or fake NGOs to create the illusion of payment for services. This helps to obscure the source of illicit funds. With integration, the funds are delivered to the final beneficiary in a form that seems perfectly legitimate. Even if the financial industry has not broken any laws, it facilitates the underlying crime, be it the illegal drug trade or bribery, by allowing individuals to establish firms or open accounts without identification of the owners (Platt 2015).

Offshore banks are responsible for large volumes of laundered money. So-called “financial havens” are countries that do not tax interest on deposits, have low or nil corporate taxes, and have minimal controls on financial flows. In many cases, the owners of the accounts or companies registered in these districts need not even identify themselves. The Cayman Islands, the British Virgin Islands, and the Bahamas are well-known examples. Dubai is also an important money laundering and tax fraud center (Europol 2013: 13). Even within the United States, certain states, such as Delaware, offer corporate registration and tax options that are attractive to both legitimate businesses and criminal elements (Platt 2015: 58). One common practice is to establish a shell company in a favorable district; payments are made to the shell company for “services rendered” and the shell company makes payments to Politically Exposed Persons (PEPs) or others. Incorporation creates the illusion of distance between the responsible parties and the money.

The large commercial banks of the United States and Europe are also involved in money laundering. Indeed, many critics in developing countries argue that the OECD countries are responsible for both generating bribes and laundering the funds (Levi, Dakolias, and Greenberg 2007:407). For example, ill-gotten funds deposited in a subsidiary in Mexico can be moved to an account in New York. Conversely, funds could be deposited in the United States, and then transferred to accounts in Mexico to pay for drugs delivered. In the wake of a major money laundering scandal involving London bank HSBC in Mexico (HBMX), it was alleged that HBMX was responsible for 60-70% of laundered funds in Mexico (Platt 2015: 16). Between 2005 and 2007, U.S. bank Wachovia reportedly transferred US$14 billion in cash from Mexico to U.S. branches on behalf of foreign exchange houses “and other foreign correspondent bulk cash customers”; HSBC’s Mexican subsidiary laundered $881 million or more from Mexican and Colombian drug cartels (Platt 2015: 75-76).

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8 Stephen Platt (2015) provides step-by-step examples of laundering schemes. He challenges the traditional model, arguing that it is too narrow, and proposes instead a non-linear (“enable, distance, and disguise”) model in which money laundering allows “disconnects” between the criminal and the crime, the crime and the property, or the criminal and the property. In either model, the financial sector may or may not play a prominent role.

9 Until recently, Switzerland did not require identification to deposit or access funds and was a popular destination for corrupt funds paid to or embezzled by the political leaders of various countries. Also in Europe, the island of Jersey has been the subject of criticism.
Although organized crime profits are a major source of funds that are laundered, in many small developing countries, corruption may be the most important source (Chaikin and Sharman 2009: 27). Some laundered funds are profits that were made possible by bribes paid to government officials. Both the bribes themselves and the illicit gains they made possible may end up being laundering through money center banks with severe consequences for the states subject to these illicit outflows. Corruption, organized crime profits, and money laundering feed on each other and need to be attacked simultaneously. As Chaikin and Sharman (2009: 151) state, “… the proceeds of grand corruption end up in international financial centers, such as New York, London, Zurich, and Geneva.” Under their own names or those of associates or shell companies, corrupt high ranking officials or “politically-exposed persons” (PEPs) open accounts in these banks and receive deposits via wire transfer. Procurement officers, police chiefs, members of the legislature, and heads of state have the potential to receive large quantities of cash and other “gifts” in return for their influence. For instance, in 2012 a former governor of the Mexican state of Quintana Roo pled guilty in a US court to charges of money laundering. He had apparently accepted bribes from the Juárez drug cartel and laundered them through Lehman Brothers (Platt 2015: 69). Teodoro Nguema Obiang Mangue (“Teodorin”), the son of Equatorial Guinea’s president and a high-ranking member of the government, amassed a fortune in overseas real estate and other assets with the assistance of estate managers and lawyers, who helped him set up shell companies and bank accounts (Platt 2015: 84-95). It may not be necessary for the PEPs to launder the funds themselves. In a study of 21 (not necessarily representative) cases from around the world, Gordon (2011:5, italics in original) finds that in the majority, “…the proceeds of corruption had already been laundered before they were received by the PEP.”

Organized crime often owns the institutions used to launder funds in the “layering” phase and supports informal international money transfer systems. Money launderers in the Middle East use hawala networks (informal, but not necessarily illegal, money transfer systems) to make payments internationally (Varese 2015); heroin traffickers based in Afghanistan have used these to circumvent an international financial blockade (Platt 2015: 70). The system itself is neither illegal nor corrupt, but it can be a route for the transfer of illicit funds.

In the formal sector, casinos offer an especially attractive option for OCG ownership because cash transactions are large and common, hence accounts are easy to manipulate. Where gambling is illegal, OCGs work to change the laws and legalize gambling. In some cases, OCG members actually run for elected positions to change the laws from the inside. (Center for the Study of Democracy 2010; Johnson 2002). In order to guarantee returns in gambling on sports, OCGs corrupt professional and amateur athletes, as well as sports officials, persuading them to engage in match-fixing (Europol 2013); these funds may need to be laundered. Money laundering also leads to corruption in private businesses, as the launderers bribe employees to turn a blind eye to their unusual practices (Center for the Study of Democracy 2010: 17).

International initiatives historically have focused on only one or two of these phenomena, although this has improved in recent years as the links are more fully appreciated. More problematically, national bodies (often created to comply with one Convention or another) still tend to be limited to the jurisdiction of one of the three. Yet combining efforts could lead to economies of scale, higher conviction rates, and more funds recovered to be used in further law enforcement efforts. Countries and IOs should encourage inter-agency cooperation by training the members of all agencies in anti-corruption, AML, and anti-organized crime laws and
procedures. Judges and prosecutors should be aware of the links and laws should reflect the connections, enabling prosecutors not only to convict the guilty but also to recover the corrupt or criminal funds to compensate victims or fund public programs.

Introducing legislation is necessary, but not sufficient. If the judiciary is corrupt or otherwise ineffective, no amount of legislation or policing will reduce illicit activity. It is essential, therefore, to take measures toward a professional, trustworthy judiciary and transparency in judicial proceedings. A professional police force, trained in all three areas, will be better prepared to collect evidence that can be used by the prosecution. In short, many anti-corruption strategies will also serve to combat money laundering and organized crime. Knowledge of AML and anti-organized crime protocols, however, will enable the law to more effectively detect, arrest, prosecute, and convict the guilty.

The control of money laundering and the fight against organized crime require international cooperation along several dimensions. First, many countries now share investigative capacity and results under the auspices of Mutual Legal Assistance treaties. In 2006, for example, under a bilateral treaty, Switzerland shared financial information with the corresponding authorities in the U.S., enabling the prosecution of a U.S. citizen who had acted as an intermediary in corrupt oil deals in Kazakhstan. Second, in order to prosecute a foreign individual or a national who is in a foreign country, a government must request that he or she be extradited by the foreign government. Many countries now have signed bilateral extradition agreements.

Another area for fruitful cooperation is information-sharing. Cross-debarment could work for countries, as well as International Financial Institutions: when a firm is debarred from working with a particular government, it would be debarred from working with any government. Coordinated investigation of cases that cross borders, and making other countries’ authorities aware of firms and individuals who are under investigation for corruption, is essential. The list of politically-exposed persons (PEPs) that governments must provide to banks, should also be provided to foreign governments.

International cooperation and the laws that support it allow the United States and the European countries to fill an important lacuna when other governments are unable or unwilling to pursue the corrupt. Where corrupt politicians enjoy prosecutorial immunity, they can be brought to justice abroad through money laundering charges. Where civil servants take or extort bribes from multinational firms, the firm can be prosecuted by the S.E.C. or equivalent body; if the civil servants launder their bribes using dollar-based instruments, the money laundering laws in the U.S. also apply to them. Where local law enforcement is subject to “plata o plomo” demands, extradition to the United States is a more credible threat.

At present, eight international and regional initiatives seek to limit money laundering, sometimes under an anti-corruption umbrella. A summary of these efforts and their history is in Rose-Ackerman and Palifka (chapter 15, 2016). Unfortunately, there is little solid evidence of the success or failure of these initiatives, in part due to the difficulty of measuring the amount of money laundered at any given time. In one cross-country study, Buscaglia and van Dijk (2003) found that organized crime (measured by an index that they created) was significantly higher in

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countries with low AML regimes versus strong AML regulation. However, they have not measured the marginal effects of recent efforts, and much has been done since that study was published.

Although it is difficult to demonstrate whether AML policies have prevented the transfer of illicit funds, there have been notable—although insufficient—successes in repatriating corrupt funds ex post. Even the Swiss have recently frozen questionable assets of deposed rulers and have transferred them to incumbents who claim that the funds belong to the state. General Sani Abacha reportedly stole approximately $4 billion from Nigeria; Switzerland froze some $660 million in Swiss bank accounts, and the Federal Supreme Court ruled in 2005 that $505.5 million of that total should be repatriated to Nigeria—the first such case of an African country receiving repatriated funds. Similarly, Switzerland and the US repatriated $100.7 million to Peru in relation to the corruption of Vladimir Montesinos, former top advisor to President Fujimori who was imprisoned for taking defense contract kickbacks (Levi, Dakolias, and Greenberg 2007: 400, 403). The World Bank’s Stolen Asset Recovery Initiative (StAR) aims to assist countries seeking to recover illicitly appropriated assets, but the task is difficult. However, there is some reluctance to repatriate funds to countries with persistently high levels of corruption for fear that the funds would simply be embezzled by the new leaders.

There are other limitations to AML, as well. For starters, the onus of detection is on financial institutions and others in the private sector, and AML legislation is not necessarily backed up with enforcement, leaving the firms to turn a blind eye in the interest of profit (Levi, Dakolias, and Greenberg 2007). Indeed, Financial Intelligence Units (FIUs) are rarely responsible for bringing money laundering cases to light. Banks may even find paying the non-compliance fines to be an optimal response, rather than playing an active AML role, so that the level of scrutiny applied is inversely related to the profitability of the client, rather than vice-versa. Even when banks apply due diligence, they will not necessarily discover the launderers. For example, the UN Oil-for-Food investigation of Saddam Hussein’s Iraq concluded that “the banks had used acceptable levels of due diligence in vetting the oil contracts they financed and did not have access to information that would have shown that some of these contracts involved bribes.” (Levi, Dakolias, and Greenberg 2007:411).

The existence of enabling jurisdictions makes AML efforts more difficult. It is not enough to keep most developed countries pure. At issue is both the ease with which corrupt officials in one country can hide their gains in another, and the possibility that money laundering activities can undermine the credibility of a country’s financial structure (Scott 1995). To further complicate matters, the traditional model of money laundering, outlined above, does not apply to all money laundering schemes, rendering the “red flags” next to useless in those cases. Platt (2015: 79-83) describes a scheme in which clients who want to launder large quantities of cash are matched with others who would like to withdraw funds from their overseas stashes without drawing attention to themselves. The broker shifts the cash from the one to the other, all the while keeping the older funds in the same bank account and merely making a bookkeeping transaction to show that the funds have changed hands.

Even as the various governments and organizations seek to limit money laundering, new methods emerge. At present the development of electronic payment systems and virtual

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currencies like bitcoins provide another way for funds to move across borders without the involvement of conventional financial institutions that must comply with national and international rules. Virtual currencies offer anonymity, which is invaluable when illicit transactions are involved. The FATF has only just begun to address the risks involved, issuing a report and guidelines in 2014, five years after bitcoins were launched (in 2009) as the world’s first convertible virtual currency. Several cases have been prosecuted successfully in the United States, including Liberty Reserve, a virtual money transfer “bank” which operated out of Costa Rica; Silk Road, an online black market that used encrypting and virtual currencies to ensure anonymity; and Western Express, an identity theft clearinghouse operated out of Manhattan.

One role for international organizations and for law enforcement agencies in developed countries is the compilation of information on questionable transactions, combined with the prosecution of individuals and organizations based in developed countries that do business in developing countries. International efforts to control illegal businesses are a second important option that complements the anti-corruption instruments. If corruption is combined with organized crime, the problem for international aid organizations is especially difficult. If the entire state is permeated with crime, there is probably not much outside organizations can do except wait in the wings and hope for the best. In less extreme cases, the experience of developed countries in fighting organized crime may be useful. In developing countries, unused to confronting organized crime, a combination of training and law reform is a useful first step. But such reforms are unlikely to be sufficient unless the economy is strong and competitive. The state may need to make more direct efforts to reduce the excess profits available to criminal entrepreneurs in legitimate business. One way to do that is to promote the entry of well-capitalized legitimate businesses that, with some state help on the law enforcement side, can compete with mob-dominated firms. The corruption generated by the illegal drug trade is one argument in favor of legalization so as to produce a more competitive and less corrupt market (Global Commission on Drug Policy 2011).

III. Conclusions

One of the greatest dangers of corruption is a vicious spiral that enables organized crime to get a foothold and propagate. Once some of the police, legislators, court clerks, and judges are identified as “for sale”, members of organized criminal groups will take advantage of this weakness in the rule of law, and such activity will escalate. Some of their most lucrative businesses will be illegal—such as trafficking of drugs and people. Others may be legal with high profits (running casinos or “winning” public tenders) or opportunities to launder ill-begotten gains. The danger is that, rather than being a stage of development that will wither away over time, criminal activity may become so intertwined with politics and legitimate business, that it is difficult to tell them apart.

14 Ibid., 32-35.
Hence, anti-corruption reformers need to confront organized crime networks if they seek realistic reform. Some policies will be infeasible if those who pay bribes are members of organized crime groups and if public officials have become their collaborators. However, marginal progress may still be possible through limits on money laundering. This indirect approach targets neither corruption nor illegal business directly, but rather it concentrates on a factor that makes each one profitable—the ability to transfer funds across borders and invest illicit gains in global financial markets. One aspect of this practice is the relative ease with which individuals and firms can create shell companies in both developing and developed countries (including many US states) without having to disclose the beneficial owner or, indeed, much else (Findley, Nielson, and Sharman 2014).

Because corruption is often intertwined with international organized crime and is facilitated by money laundering, cooperation among countries, IFIs, and agencies is essential. Otherwise, the proceeds of corruption and organized crime will be hidden abroad or in cyberspace. Too many countries still have lax financial regulations or limited enforcement, and there is not enough cross-country investigative sharing and extradition.

Coordinated efforts that link anti-corruption, organized crime investigations, and anti-money laundering are likely to yield better results than each operating in isolation. Because anti-corruption agencies are often under-funded and under-staffed, drawing on other agencies for support is one way to maximize their effectiveness. At the international level, several initiatives already recognize these interactions and include two or three of these concerns.

In short, specific anti-corruption policies are likely to be necessary but not sufficient in highly corrupt sectors, industries, and countries. Anti-corruption policies need to remove the background incentives for payoffs that arise from poorly designed and monitored public programs. They need to limit the opportunities for bureaucrats, judges, and elected officials to seek personal financial gain. However, large, specialized infrastructure projects or defense contracts cannot be converted into pure competitive bidding processes, and organized crime activities cannot simply be legalized as an anti-corruption strategy. Anti-corruption proponents need to confront the global nature of both big business and organized crime, with their corresponding roles in corruption.

In light of these concerns, how should the governance reform and anti-corruption programs of the World Bank and the other IFIs adjust in the light of the risks of terrorist attacks? Such attacks focus public attention on immediate dramatic events and on the need to prevent their recurrence, to locate those responsible, and to care for those who suffer harm. Systemic problems that persist over time may be shoved off the table at such times. Dramatic events have great salience, even though everyday malfeasance and simple incompetence likely cause at least as much social harm over time. Some dramatic events signal deeper underlying problems in the operation of public and private institutions that could be overlooked absent a crisis, but news reports of crises often concentrate on the personal failings of politicians and powerful private individuals, not systemic factors.

The problem is analogous to a familiar difficulty for policy analysts. In many policy areas, ex ante preventive measures to increase safety and health take a back seat to dramatic rescues ex post when, for example, several people are trapped in the coal mine or submerged in a defective submarine. Once the rescue has been attempted, whatever its outcome, politicians may sideline
systematic efforts to prevent future accidents. At the same time, the long-term policy response may be an overreaction. If a crisis, such as a terrorist attack, creates widespread fear, policymakers may put in place extensive preventive measures that go beyond any reasonable measure of the risk and its consequences. In short, there is a real danger that policies taken in response to crises will be ill-advised and poorly targeted. They may even build in more incentives for corruption if those subject to controls make payoffs for exemptions.

Dramatic corruption scandals can invoke similar pathologies. That is, they spotlight a particular instance of corruption, and they lead to aggressive prosecutions—neglecting both the systemic factors that produced the scandal in the first place and other types of corruption that are entrenched and less dramatic. Even without terrorism threats, anti-corruption policy may not focus on the most harmful ways that corruption undermines growth and delegitimizes government.

The goals of international aid and lending organizations should be to improve the lives of people living on the margins and to enhance the functioning of their government so that they benefit their populations. If these goals can be achieved, fewer people will predictably be drawn into both organized crime or violence—both for motivational reasons and because the polity is better able to provide security.

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