



Dirty Money and Its Global Effects

By Raymond Baker

Brionne Dawson, Research Associate

Ilya Shulman and Clint Brewer, Interns

Preface

The globalizing era has produced an explosion in the volume of illegitimate commercial and financial transactions. North American and European banking and investment institutions have been flooded with laundered and ill-gotten gains. Amounting to trillions of dollars, most of these sums are generated through secretive arrangements between cooperating but distant private-sector entities. Lagging legal codes have proven inadequate to deal with the situation. Much of this subject is taboo in business and government circles, yet this torrent of stolen, disguised and hidden resources poses a major risk to state security, corporate stability, democracy, free enterprise, the effectiveness of international aid programs and the lives and well-being of billions across the world.

International financial statistics can neither clearly trace the flow of illegal money nor firmly establish its total magnitude. However, we do know its effects. We know, for example, that it drives the drug trade, has moved hundreds of billions of dollars out of Russia in recent years, has shifted vast

sums from the southern hemisphere into the northern hemisphere, finances current wars and conflicts in Latin America, Africa and Asia, and played an enabling role in the events of September 11, 2001. That tragedy led to the greatest assault ever on a network that generates and utilizes money for

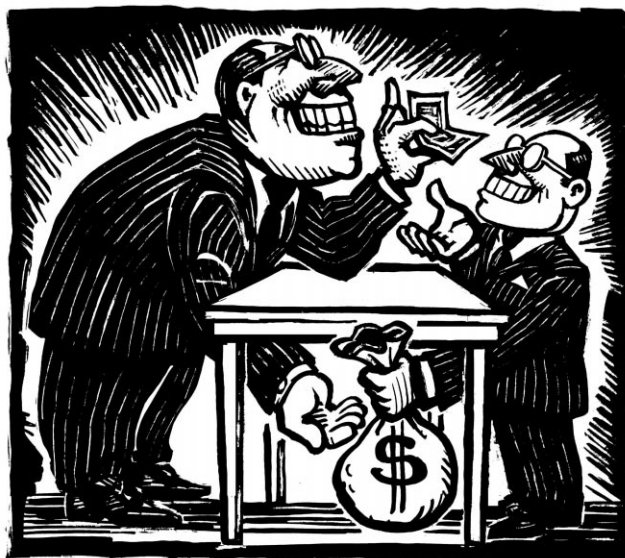
illegal purposes. And yet in the midst of the post-September 11th pursuit of terrorist funds, Osama bin Laden said that attempts to find and freeze such assets "... will not make any difference to Al Qaeda or other jihad groups. Al Qaeda is comprised of modern, educated young people who are as aware of the cracks in the western financial system as they are of the lines in their own hands. These are the very flaws in the western financial system which are be-

coming a noose for it."

Given political will, these "flaws" can be largely corrected.

Dirty Money

"Dirty money" is money that is illegally earned, illegally transferred or illegally utilized. If it breaks laws in its origin, movement or use, then it qualifies for the label.



Compliments of Matt Wuerker

□

There are three forms of dirty money that cross borders: criminal, corrupt and commercial.

Criminal

Anti-money laundering legislation in the United States identifies more than 200 classes of domestic crimes, called “predicate offenses.” If a person knowingly handles the proceeds of these crimes, then a money-laundering offense has been committed. However, only 12 to 15 of these offenses are applicable if the crime is committed outside U.S. borders, and these have to do principally with drugs, crimes of violence and bank fraud. The list does not include, for example, handling the proceeds from foreign crimes such as racketeering, securities fraud, credit fraud, forgery, embezzlement of private funds, non-violent burglary, trafficking in counterfeit and contraband goods, alien smuggling, slave trading, sexual exploitation and prostitution, among others.

Corrupt

The corrupt component of dirty money originates from bribery and theft by foreign government officials. The Foreign Corrupt Practices Act, passed in 1977, made it illegal for Americans to pay such bribes. However, that law did not specifically prohibit moving and managing bribe funds amassed by foreign government officials. Many U.S. banks aggressively pursued these stolen assets for the next quarter century. As part of the Patriot Act passed in 2001, knowingly facilitating the proceeds of foreign corruption was finally added to the list of money-laundering offenses.

Commercial

The commercial component is money which intentionally and illegally evades taxes in countries out of which it comes. There are two principal methods for accomplishing this, one piggybacking on legitimate transactions and the other an outright, fic-

titious sham. First, mispricing transactions is the most frequently used mechanism – altering the real value of exports, imports, real estate sales, securities deals, services and many other aspects of international trade. At any moment, thousands of transactions at docks and airports and passing through electronic media have false prices built into commercial invoices for the purpose of moving tax-evading money illegally out of other countries and into western coffers. The second basic mechanism is misidentified transfers from one corporate entity to another. For example, a transaction can appear to be an expense invoiced by one company to another when it is simply a blatant shift of tax-evad-

ing capital or profits offshore to an affiliated company. Such falsifications, devoid of any underlying reality, are less frequently utilized but may now transfer more money than mispricings which tag along with legal trade.

The Western Role

Both the western and non-western worlds have cooperated for a century in creating and perfecting mechanisms for moving corrupt and commercially tax-evading money out of countries where it is generated and into countries where it is secreted. Western corporations and banks have taken the lead in developing techniques for mispricing, false documentation, fake corporations, shell banks, tax havens, bank secrecy jurisdictions, numbered accounts, payable-through accounts, concentration accounts and more. Drug dealers stepped into these same channels in the 1960s and 70s to move their profits from one country to another. Admiring the success of drug cartels, other criminal syndicates began utilizing these same channels in the 1980s and 90s to move their money into western accounts. And in the 1990s and the current decade, terrorists have taken advantage of these same mechanisms to move major parts of their money. As a consequence, U.S. Treasury Department officials estimated that 99.9 percent of the foreign criminal and terrorist money presented for deposit in the

“What we have sown in the business of moving corrupt and commercial dirty money, we now reap in the inflow of criminal and terrorist money.”

United States gets into secure accounts. Key European officials made similar estimates for their countries. To put the same point in the opposite way, our anti-money laundering efforts fail 99.9 percent of the time.

The prevalent view that drug dealers invented money laundering in the 1960s is misinformed. Basic arrangements for laundering were, in fact, devised and honed years earlier. Thus, in countries that loudly tout the rule of law, statute and tradition have long maintained the stream of illegal money arriving from abroad. What we have sown in the business of moving corrupt and commercial dirty money we now reap in the inflow of criminal and terrorist money.

The linkage, the synergy, the similarity between all three forms of dirty money is not widely understood in western business and government circles. It is clearly understood by every drug kingpin, criminal syndicate head and terrorist mastermind.

The idea at the core of U.S. and European anti-money laundering efforts is flawed. The idea that we can successfully protect ourselves from a narrow range of dirty money we do not want, while at the same time cultivating the receipt of a much broader range of dirty money we do want, is fundamentally unworkable.

Magnitudes

How much money are we talking about? The International Monetary Fund estimates global money laundering at \$600 billion to \$1.5 trillion a year. A rough, working figure would be on the order of a trillion dollars a year. Breaking it into its component parts reasonably produces a picture as follows: some \$500 billion a year in the criminal component, \$20 to \$40 billion in the cross-border movement of corrupt money, and another \$500 billion or so in the tax-evading component.

Furthermore, it is likely that half of the total, \$500 billion, comes out of developing and transitional economies, countries with often unstable governments, weak legal systems and 80 percent of the world's population. This is largely a perma-

nent outflow. Little of it, perhaps less than ten percent, returns to such countries as foreign direct investment, masquerading under an acquired foreign identity. The streams of money from poorer countries parked in western accounts have now accumulated to trillions of dollars.

Of the \$500 billion estimated to pass annually out of developing and transitional economies, perhaps half, \$250 billion a year, is eventually lodged in U.S. accounts or dollar-denominated assets elsewhere.

The estimate of \$500 billion a year exiting illegally from developing and transitional economies, possibly half placed in dollar assets, could conceivably vary by an order of magnitude. Wherever the most accurate figure lies, the margin of error is not great enough to affect the analysis that logically follows from such numbers. Dirty money constitutes the biggest loophole in the free-market system.

“For every \$1 that is generously handed out in assistance across the top of the table, some \$10 is taken back under the table.”

Impact on U.S. Interests

The unchecked diversion of trillions of dollars out of other countries

not only constitutes a gaping loophole in the free-market system, it is also the most damaging economic condition impoverishing the poor in developing and transitional countries. It drains hard-currency reserves, heightens inflation, reduces tax collection, worsens income gaps, cancels investment, hurts competition, undermines free trade and saps growth. It leads to shortened lives for millions of people and deprived existences for billions more.

Compare the \$500 billion a year estimated to be moving illegally out of developing and transitional economies to the \$50 billion a year in western aid given to these same economies. In other words, for every \$1 that is generously handed out in assistance across the top of the table, some \$10 in dirty money is taken back under the table.

Widespread lawlessness in the global financial system facilitates drug trafficking, contributes to terrorism, cripples important domestic and foreign interests of the United States and subverts progress for the global poor.

□

Traditional Explanations

The underlying reasons why such illegalities are so pervasive are often misunderstood.

For wealthy citizens in foreign countries who illegally move their money abroad, the typical rationales offered have to do with evasion of taxes, circumvention of exchange controls and protection against inflation and confiscation. Although these points have an element of truth, they do not identify the primary intent. The predominant motivation is the hidden accumulation of wealth. A survey conducted in the 1990s of 550 business owners and managers in 11 countries produced this, among other startling conclusions. The essential drive is about getting rich secretly, hiding such money at a distance and avoiding pressures for distributions to employees and relatives locally.

For the United States, and also Europe, the justification for encouraging and facilitating the inflow of tainted money from abroad has been straightforward. We have been guided for many years by an implicit cost-benefit analysis suggesting that the receipt of such money is good for America, good for Europe. It shows the strength of our economies. People in foreign countries want to bring their money here and invest where they know it will be safe and can grow. Succeeding administrations have encouraged this view. U.S. Treasury Department officials have indicated several times in recent years that it is U.S. policy to support the deposit of money from other countries. When asked if a distinction is made between the legal and illegal components of such transfers, the answers typically revert back to our very narrow definition of the few classes of illicit proceeds which we consider to be criminally laundered money. Other forms of criminal and commercial dirty money are regarded as acceptable.

Policy Implications

With broad, though not total, international cooperation after September 11th, Al Qaeda's traceable resources were, to a large extent, pushed out of the global financial system, confirming what can be accomplished given the necessary political will. However, the ability of Al Qaeda or other terrorist

groups to recreate and employ similar financial networks of dummy corporations, disguised bank accounts and falsified transactions for future use has hardly been altered. Furthermore, the negative impact of dirty money on developing and transitional economies is severe, often catastrophic, as the case studies below illustrate.

Today it is appropriate to ask two very fundamental questions. First, can the case be made that the inflow of dirty money is good for America? Our consideration of this question has so far focused only on one side of the equation, the arrival of hundreds of billions of dollars, perhaps \$250 billion annually, from offshore, serving, it seems, to bolster the U.S. economy. But the damage done to the fabric of our society resulting from our appetite for dirty money is staggering. Domestically, it shields and thereby facilitates the passage of drug, criminal and terrorists' money into U.S. investments and holdings. And internationally, it undermines key foreign policy objectives of the United States in poorer countries in Africa, Latin America and Asia and in the transitional economies of the former Soviet Union and Eastern Europe.

Consider the commercially tax-evading component, which some people suggest is the more benign part of the dirty-money problem. The argument is often made that it is not our responsibility to enforce other countries' tax laws. While this is true, it is not the right question. The important question is, is it in our interest to break the tax laws of other countries? When we do, we promote lawlessness in international trade and finance. This adds our hands to the mechanisms that move dirty money around the world. And, disturbing as it may be, this adds our hands to the mechanisms that enable terrorists to fly planes into the World Trade Center and the Pentagon and into the ground in Pennsylvania. The hundreds of billions of dollars escaping illegally every year out of weaker countries, amassing to trillions of dollars permanently lodged in the most advanced nations' repositories, arrive at a punishing cost.

If the case cannot be made that the inflow of dirty money or any part of it is good for America and other western democracies, then our perception of this issue must change from an assumption of its benefits to a recognition that the price tag

attached to these felonious funds is altogether unacceptable.

The second question is whether or not it is possible to attack the global dirty-money problem more aggressively without impeding the legitimate free-market system. Here, it is important to understand that the proper goal is not to stop all suspect transfers but rather to curtail — substantially curtail — dirty money and our facilitation of its safe receipt. Stopping dirty money would require draconian procedures. Significantly curtailing dirty money can be accomplished without throwing sand in the gears of legal trade and investment and is entirely a matter of political will.

Several steps can move this effort well forward of our current position, as enacted in earlier regulations and amplified in the Patriot Act:

- Anti-money laundering legislation should be extended to bar knowingly handling all three forms of illicit proceeds. We cannot expect to have honest government and reputable commerce in developing and transitional economies, functioning in a global financial framework that facilitates illegal transfers of many forms of criminal money and virtually all forms of tax-evading money. Incremental legislation reluctantly pushing the anti-money laundering agenda a few notches ahead every few years is an inadequate approach to an urgent issue.

- Access to all western clearing house systems and correspondent bank relationships, with the United States taking the lead, should be promptly denied to offshore secrecy jurisdictions, laundering centers and shell banks. The Financial Action Task Force in Paris has recently diluted the strength of its “name and shame” approach to foreign money-laundering centers, an effort that must be reinvigorated. And offshore tax havens, often complicitous in channeling all forms of dirty money, are finding increased use by U.S. companies. Barring access to western financial systems is an underutilized instrument in the struggle against dirty money and warrants application in a much more purposeful manner.

- Without being excessively burdensome, financial institutions and multinational corporations need to put in place enhanced measures to ascertain the legitimate origin of deposits and resources in cross-border transactions. The United States has had repeated instances — Bank of New York, Citibank, IBM, Bell Helicopter, just to name a few — where failures to exercise due diligence brought dirty money to U.S. shores, to the detriment of the broader society. What remains to be instilled is a culture which asks rather than avoids the right questions. And this culture cannot be instilled as long as an implicit assumption prevails that the inward transfer of dirty money is basically good for the United States.

We have a choice to make as a society. Which is more important to us: to fight crime and terrorism with all reasonable and legal means at our disposal, and to fight poverty which contributes to failed states and fosters crime and terrorism, or to continue to cultivate the hundreds of billions of dollars that flow into the United States illegally from other countries? If not post-9/11, post-campaign finance reform and post-Enron, then when?

The Center for International Policy has recently conducted extensive research on three examples of the impact of dirty money on selected countries. These case studies illustrate some of the pitfalls for the United States and other nations arising from facilitation of illicit proceeds.

Russia



Russia has suffered what appears to be the greatest theft of resources that has ever occurred in a short period of time, estimated at \$200 billion to \$500 billion during the 1990s. Active cooperation or benign neglect emanating from western corporations and financial institutions facilitated virtually the whole of this lawless transfer.

In the late 1980s and early 1990s, as the assets of the Russian state were being taken over by entrepreneurs, the richest among them later

□

called “oligarchs,” exports of oil, gas, gold, diamonds, aluminum, pulp, timber and more were being made out of Russia, primarily to buyers based in Europe. Kickbacks in the billions of dollars passed into corporate and personal accounts of the Russian exporters, in Switzerland, Germany, France, England, Spain, Cyprus and elsewhere.

As ownership of Russian assets continued to gravitate to the private sector in the mid 1990s, many Russian exporters established their own offices in other countries to buy and sell resources and products coming from or going to their country. Hundreds of such entities sprang up in Europe and the United States. Exports were sold to these companies at very cheap prices and then resold to foreign buyers at world market prices. For example, some oligarchs purchased oil domestically for \$10 a metric ton, resold it to their own dummy corporations abroad for about the same price, and then resold it again to foreign buyers at \$120 a metric ton. In many cases, 100 percent of the revenues from such exports remained in foreign bank accounts, and nothing was remitted to Russia.

In 1996, the Russian central bank required Russian banks to advise exporters that they must bring back 50 percent of export proceeds within a specified period. This regulation was almost totally ignored. Two years later a revised regulation required a higher percentage of export revenues to be remitted according to a strict schedule. Exporters reacted to this somewhat toughened statute by underpricing their exports on outgoing commercial invoices, thus reducing the documented revenues to be returned. The underpricing was compensated for by normal pricing when the exporters’ own overseas companies resold to foreign buyers, once again retaining the marked-up revenues offshore.

Russian exporters also found it useful to establish their own banks. From the mid 1980s to the mid 1990s, the number of banks in Russia grew from three to some 2,500, as companies established their own institutions, particularly to facilitate han-

dling their own trade documents. While many of these banks were limited to domestic, ruble accounts, hundreds had correspondent banking relationships overseas and dealt in foreign exchange, further lubricating the transfer of money abroad.

Lack of due diligence in overseeing correspondent relationships produced the Bank of New York fiasco. Utilizing home computers and dummy corporations, Lucy Edwards, a bank senior vice president, and her husband, Peter Berlin, managed to siphon some \$7 billion out of Russia from 1995 to 1999.

“Was there a point at which western governments and international financial institutions should have pushed to curtail resource shifts out of Russia?”

As early as 1993, even the Russian central bank set up an offshore company, FIMACO, on the British isle of Jersey, apparently as a repository for IMF funds in-

tended to reinvigorate the Russian economy and stabilize its currency. Some of the IMF funds were alleged to have been invested in Russian high-yield government bonds, known as GKO, with the earnings allegedly pocketed by private individuals and government officials. Attempting to probe the affair, a PricewaterhouseCoopers audit reported that, “We have not been provided access to Ost West Handelsbank,” which was the recipient of a large part of a \$4.8 billion IMF tranche. In March 1999, then-Treasury secretary Robert Rubin stated before a congressional panel that IMF funds sent to Russia “may have been siphoned off improperly.”

One of Russia’s premier entities, Gazprom, set up an affiliate, Itera, in Jacksonville, Florida, in 1992. In a series of asset-stripping transactions, Gazprom shifted resources to Itera, producing losses for Gazprom and disproportionate benefits for its U.S. affiliate. In one set of transactions, Gazprom sold gas to Itera at \$2 to \$4 per thousand cubic meters, which Itera then resold at \$30 to \$90 per thousand cubic meters. Today, Itera Group N.V., registered in the Netherlands Antilles, comprises some 130 companies with stakes in metal, construction, chemical and other industries.

Two questions arise from this case study. First, was there a point at which western governments and international financial institutions should

have pushed to curtail resource shifts out of Russia? In the early 1990s, many Americans, Europeans and Russians themselves believed that the only way to prevent communism from returning to Russia was by getting capital and property out of the control of the state. This was largely accomplished by 1994 or 1995. But then the bleeding of wealth from Russia into western coffers continued unabated in the second half of the 1990s, long after the ability of communism to resurrect itself had passed, in the opinions of most observers. Indeed the bleeding continues today. Even if one subscribes to the political argument that communism had to lose the opportunity to recapitalize and reconstruct itself, the question remains, should the West have maintained its facilitative role in the further deterioration of the Russian economy beyond the mid 1990s?

Second, could the West have done anything to curtail the deterioration of Russia's economy from, say, 1995 or 1996? A centuries-old instrument is readily available to assure that export proceeds are remitted – the confirmed, irrevocable letter of credit. Issued by a foreign bank, it requires that export proceeds be paid to the foreign bank, and that bank is then obligated to send the proceeds back to the exporting country. Who should have insisted on adoption of such commercial norms by Russian exporters? Certainly the IMF, in its loan negotiations with the Russian government, had the power to do so.

Russian business executives and bankers did not invent any new ways of stealing from their state. They simply stepped into well-established channels. At the same time, equally well-established instruments could have sharply curtailed the long-term damage done to the Russian economy, damage that may take a generation or more to recoup.

The greed of Russian entrepreneurs and the willingness of the United States and Europe to cooperate in criminal activity deeply scarred the Russian economy and set back for years the development of democratic capitalism in the country.

Congo



Corruption and dirty money in the Democratic Republic of the Congo, formerly Zaire, led to state collapse. Since independence, the nation has twice been wracked by civil wars. The most recent outbreak began in 1998 after rebel forces toppled the Mobutu regime the preceding year. Since then, fighting over territory and mineral resources has involved Rwanda, Burundi, Uganda, Zimbabwe and Angola and has caused two to three million deaths.

Congo's rich mineral resources, possibly exceeding South Africa's, include diamonds, copper, zinc, uranium, germanium and coltan, used in producing cell phones and satellites. King Leopold II, the only individual ever to own a colony, pursued the plunder of his fiefdom across the turn of the last century, extracting rubber, ivory, timber and produce, until western – particularly American – pressure forced him to relinquish his title to the Belgian government. Official policy then continued the “strategy of attrition” for another half century.



Mobutu Sese Seko governed the Congo for over thirty years.

Joseph Mobutu styled himself as Mobutu Sese Seko Kuku Ngbendu waza Banga, which means “the all-powerful warrior who, because of his endurance and inflexible will to win, will go from conquest to conquest leaving fire in his wake.” At least the last part of his self-anointment proved accurate. He came to power in

1965, after the first prime minister, Patrice Lumumba, was assassinated in a plot condoned by the CIA, with the knowledge of Belgium and France. As one of the world's best known kleptocrats, he amassed a fortune estimated at more than \$500 million, held mostly in European property investments and Swiss bank accounts. Bilateral aid, as well as World Bank and IMF funding, were regularly diverted to his own pockets.

Mobutu is sometimes credited with inventing banking from home. He would often pick up the telephone and order transfers from central bank

□

reserves into his own overseas accounts or delivery of sacks of foreign currencies to his places of residence. Maintaining a large family and a coterie of sycophants costs real money.

In 1982 a retired German central banker, Erwin Blumenthal, who had earlier been seconded by the IMF to Zaire's central bank, reported that "... the corruptive system in Zaire, with all its wicked and ugly manifestations, will destroy all endeavors . . . towards recovery and rehabilitation of Zaire's economy." He went on to add that there is "... no (repeat no) prospect for Zaire's creditors to get their money back in any foreseeable future." Despite such warnings, multilateral loans to Zaire totaling some \$2 billion continued for the next decade. Congo's foreign indebtedness remains over \$10 billion today, a sum that can never be repaid.

A recent UN report released in October 2002 entitled in part, "Illegal Exploitation of Natural Resources and Other Forms of Wealth," documents continued pillage of Congo's resources. The report implicates 85 multinational corporation interns based in the United States, Canada, the U.K., Belgium, Germany, Netherlands, Switzerland, Finland, South Africa, Ghana, Zimbabwe, Thailand, China and elsewhere, all considered to be in violation of OECD Guidelines for Multinational Enterprises.

Financing supplied by such companies exacerbates the ongoing conflict, provides funding to rebel authorities operating in the country and drains the government's meager foreign exchange reserves. External involvement in the Congo ranges from occupying forces of Ugandan, Rwandan and Zimbabwean troops, western businesses, arms traffickers and groups with ties to terrorist networks such as Amal and Hezbollah. In some cases, in return for mineral resources, weapons and munitions are given directly to warring factions.

The UN report declares that illicit proceeds are generated through "... organized systems of embezzlement, tax fraud, extortion, the use of stock options as kickbacks and diversion of state funds conducted by groups that closely resemble criminal organizations." In pursuit of all three forms of dirty money – criminal, corrupt and commercially tax evading – the study identifies five principal strategies:

- Asset stripping
- Control of procurement and accounting
- Organized theft
- Using corporate facades as covers for criminal activities
- Purchase of military equipment

The free-for-all currently characterizing Congo's economic affairs is illustrated in the linkage of conflict diamonds and outside powers. Minerals Business Company is identified as handling Zimbabwe's interest in the diamond trade:

The Minerals Business Company uses Zimbabwe's military and political influence to evade the legal requirements of the Democratic Republic of the Congo and to avoid paying the costly licensing fees. The refusal of MBC to honour its obligations to the public treasury has prompted official complaints from the Ministry of Mines demanding that MBC comply with the law. MBC officials have asserted that Zimbabwean entities are not obliged to adhere to the laws of the Democratic Republic of the Congo. (p. 13).

Among companies named in the UN report are First Quantum Minerals, Anglo American, De Beers, Group George Forrest, Cabot Corporation, Orion Mining, Oryx Natural Resources, Tremalt and Eagle Wings Resources. Eagle Wings, for example, a subsidiary of Trinitech International, Inc. based in Ohio, reportedly maintains close ties to the Rwandan regime. According to the UN report:

Eagle Wings operates in the Democratic Republic of the Congo as a Rwanda-controlled comptoir with all the privileges derived from this connection. Eagle Wings is not obliged to

fulfill its full responsibilities to the public treasury managed by the RCD-Goma [Rassemblement Congolais pour la Démocratie] administration. Like other Rwanda-controlled coltan comptoirs, Eagle Wings collaborates with RPA [Rwandan Patriotic Army] to receive privileged access to coltan sites and captive labor. (p. 16).

“Captive labor?” In the quest for questionable profits, is a U.S. company now repeating the worst excesses of the last century?

Argentina



Argentina is an excellent example of how habitual and pervasive illicit transactions and dirty money can deeply damage the political and economic underpinnings of a nation.

Recall that Argentina dollarized its economy in 1991, making it legal for anyone to take pesos to a bank and exchange them for dollars, no questions asked. Many experts were certain this would have multiple benefits for the economy, including cleaning up the outflow of illicit proceeds. After all, why would anyone exchange pesos for dollars, and vice versa, illegally when they can do the same thing legally at a bank? The avoidance of transparency lies at the heart of most schemes for moving ill-gotten gains. Three Argentine examples help illustrate the point.

First, trading patterns were for a decade badly skewed in Argentina, as importers sought to use open convertibility to minimize value-added taxes. In cooperation with foreign suppliers, imports were often and significantly underinvoiced in order to reduce VAT charges on goods arriving at the docks, airports and borders. Importers paid the indicated amount on commercial invoices, leaving the underpriced amounts remaining to be paid by other means. Many Argentine businesspeople became experts at keeping an entirely separate set of books, even separate entities, to sell part of their imports or goods produced from such imports. Revenues from these unregistered and unrecorded

transactions were then taken to a bank, with instructions to transfer capital abroad. These funds, shifted offshore, settled the balance on underpriced commercial invoices. Thus, in the absence of adequate customs inspections and controls, free currency convertibility contributed to substantially reduced collection of VAT taxes.

A second example demonstrates how IBM found itself caught up in scandal. In an arrangement called Proyecto Centenario, IBM entered into contract with Banco Nación to install computers valued at \$250 million throughout the bank’s 525 branch offices. Judge Aldo Bagnasco accused IBM of paying bribes, referred to in Buenos Aires as “a little happiness,” to get the contract. IBM Argentina reportedly funneled these payments through two local companies, Consad and its subsidiary CCR, which were supposedly functioning as subcontractors to IBM. Payments of \$37 million went to CCR, a firm with one employee and one telephone.

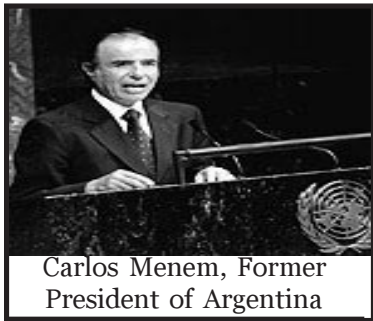
CCR redistributed millions which ended up in bank accounts in New York, Switzerland, Luxembourg and Uruguay. Upon request from Judge Bagnasco, Swiss authorities revealed that beneficiaries of such accounts included directors or ex-directors of Banco Nación. At least two recipients admitted that they received millions and confirmed that the payments were a gift from IBM.

Juan Carlos Cattaneo, former assistant to the secretary general of the presidency, funded Consad, one of the companies fronting for bribes. His brother, Marcello Cattaneo, apparently the bag man in the transactions, was found hanged from a radio antenna in 1998, under suspicious circumstances. The IBM-Banco Nación contract was cancelled in 1997. Swiss banks turned over \$4.5 million in frozen assets to the Argentine government in 2002.

At a minimum, it appears that IBM’s U.S.-based corporate office failed to exercise sufficient oversight of its Argentine subsidiary. In 2002, the Justice Department was reportedly conducting 65 or 70 investigations of various U.S. companies suspected of violating the Foreign Corrupt Practices Act in many countries.

Scandal has also reached into the administration of former president Carlos Menem.

Fabricaciones Militares (FM), a weapons manufacturer, was accused in 1998 of exporting 6,500 tons of arms to Bosnian Muslims via Croatia in 1991



Carlos Menem, Former President of Argentina

and 1993, in violation of a UN arms embargo. The U.S. government was reportedly well aware of the transactions.

Menem was briefly placed under house arrest in June 2001, after being accused by Judge Jorge Urso of forging documents that facilitated the trades. Also indicted at the time were three other former officials – an army chief of staff and ministers of defense and foreign affairs. Originally valued at \$35 million, with Panama indicated as the false destination, the arms went through several intermediaries of Argentine, Chilean, South African, French and Austrian nationality before final delivery by a Croatia Line vessel at \$70 million.

The Balkans deals apparently emboldened FM and the Menem government. In 1995, 8,000 rifles were reportedly dispatched to Guayaquil, at a time when Ecuador was in a border conflict with Peru, and Argentina was offering to function as a peace broker.

These kinds of incidents, involving the business community, a major U.S. company and a discredited past administration, contributed to and now underlie the political and economic breakdown of Argentina and suggest that a very long road stretches ahead in the rebuilding task facing one of America's most important neighbors.

Burying the Relic

For more than a hundred years, North America and Europe solicited, transferred and managed illicit proceeds seeking exit from other countries and residence in western accounts. In recent years, no nation received more such criminal, corrupt and commercial dirty money than the United States. Our reasons are straightforward: we like the arriving billions of dollars and assume the inflows are good for our economy. And it is this equation that now demands searching reevaluation.

America cannot wage a successful war against drugs, crime, terrorism, global poverty and state collapse, while simultaneously seeking and harboring ill-gotten gains from across our borders. To think we can is folly.

Those who favor the status quo – facilitating the inflow of all or some of the dirty money still legal – must make the argument that the benefits outweigh the costs to our society. In the absence of such a credible argument, logic dictates an alternative conclusion: We don't want it.

The remaining question is then narrowed and simplified: How do we curtail the billions of illegal, unwanted dollars arriving at our doorstep? The answer begins with a willingness to put all three forms of dirty money – criminal, corrupt and commercial – squarely on the political-economy table for determined action.

The notion that we can build the kind of orderly, globalizing world we want while feeding our appetite for dirty money is unsustainable. This process, a relic of an earlier age, needs to be promptly changed. America will be stronger, not weaker, as a result. Political will is the missing ingredient.

Raymond W. Baker, with a career in international business concentrated primarily in developing countries, is a Senior Fellow for the Center for International Policy.

IPR Dirty Money

00000

1755 00 00

550

00 020036

(202) 23203317

0 (202) 23203440

0000

000

NON-PROFIT
ORGANIZATION
U.S. POSTAGE
PAID
PERMIT NO. 1503
WASHINGTON, DC



0000000000

© COPYRIGHT 2003 by the Center for International Policy. All rights reserved. Any material herein may be quoted without permission, with credit to the Center for International Policy.

MISSION STATEMENT: The Center is a nonprofit educational and research organization whose mission is to promote a U.S. foreign policy based on international cooperation, demilitarization and respect for basic human rights.

PLEASE SEND ME MORE INFORMATION ABOUT THE CENTER FOR INTERNATIONAL POLICY

I'D LIKE ___ ADDITIONAL COPIES OF THIS REPORT (SINGLE COPY \$2.50; 20 OR MORE \$1.00 EACH)

I'D LIKE TO MAKE A CONTRIBUTION OF _____ TO SUPPORT THE CENTER'S WORK.

NAME _____

ADDRESS _____

STAFF:

ROBERT E. WHITE, *president*
WILLIAM GOODFELLOW, *executive director*
RAYMOND BAKER, *senior fellow*
NICOLE BALL, *senior fellow*
FRICK CURRY, *senior associate*
LANDRUM BOLLING, *senior fellow*
PARKER BORG, *senior fellow*
MELVIN A. GOODMAN, *senior fellow*
ADAM ISACSON, *senior associate*
ANYA LANDAU, *associate*
NITA MANITZAS, *associate*
PAUL OLWENY, *associate*
MIRANNA SMITH, *director of operations*
WAYNE S. SMITH, *senior fellow*
SARAH STEPHENS, *associate*
INGRID VAICIUS, *associate*
ALISON WHELAN, *finance and development*
BRIONNE DAWSON, *research associate*
MELIS ALGUADIS, *intern*
CAROLINE DE COURREGES, *intern*
ALIAKBAR ESFAHANI, *intern*
JULIE HARBOUR, *intern*
LIZZETTE HAMILTON, *intern*
SARAH LARMAN, *intern*
MONICA LUKASZEWICZ, *intern*
ERIK SONNE, *intern*
TARA TEMPLIN, *intern*
ROBERT WROBEL, *intern*

BOARD OF DIRECTORS:

CHAIR:

CYNTHIA MCCLINTOCK, *professor, George Washington University*
MARIO BAEZA, *investment banker, NYC*
LOWELL BLANKFORD, *newspaper publisher, San Diego*
WILLIAM J. BUTLER, *chairman, executive committee, International Commission of Jurists*
THOMAS COOPER, *president, Gulfstream International Airlines*
JOAN DASSIN, *Ford Foundation*
ADRIAN W. DEWIND, *attorney, New York*
SAMUEL ELLSWORTH, *partner, Ellsworth-Howell Alexandria, Virginia*
GERALD F. GILMORE, *Episcopal minister*
SUSAN W. HOROWITZ, *social worker, New Mexico*
ROBERT G. KERRIGAN, *attorney*
SALLY LILIENTHAL, *president, Ploughshares Fund*
CONRAD MARTIN, *Fund for Constitutional Government*
STEWART R. MOTT, *board of trustees, Fund for Constitutional Government*
PAUL SACK, *businessman, San Francisco*
DONALD SOLDINI, *International Preferred Enterprises, Inc.*
EDIE WILKIE, *president, Peace Through Law Education Fund*
DESSIMA WILLIAMS, *professor, Brandeis University*