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Why the War on Money Laundering Should be Aborted

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Dr. Richard W. Rahn, Chairman of Novecon Financial, was one of the contributors to [The Future of Financial Privacy: Private Choices versus Political Rules](#) (2000). He recently spoke to a conference in the Cayman Islands about many of the topics he addressed in the book. His remarks are reprinted below, with permission. Read Dr. Rahn's chapter in [The Future of Financial Privacy](#) [here](#).

Financial cryptographers are heroes, because their efforts both increase the economic well being of most of the world's peoples, and more importantly, preserve their liberty. I shall explain.

Money laundering is a terrible crime—right? Government officials and their allies in the press seem on almost a monthly basis to demand new powers to deal with the terrible menace of money laundering. Exactly what is this crime?

If you hesitate while trying to come up with a definition, you have begun to understand part of the problem. Money laundering is hard to define because it is not a crime like murder, robbery, or rape, where the evil act is clear. It is a crime of motive rather than activity. In fact, two different people can engage in the exact same set of activities, and one can be guilty of money laundering while the other is not. In fact, money laundering has only been illegal in the US since 1986, and it is not illegal in all countries.

Government efforts to combat money laundering will directly or indirectly affect the institutions for which you work. Thus, it will be important to be aware of the rules and regulations against money laundering, and the detrimental effect that they have on economic growth and personal liberty.

To observe, let alone regulate, money laundering is the financial equivalent of the Heisenberg uncertainty principle in quantum mechanics, whereby the act of observing the activity changes its nature. There are close to an infinite number of ways to “launder” money, and sophisticated money launderers know what the government rules and regulations are, and what information financial institutions are supposed to monitor and report. Thus, the behavior of money launderers instantly changes as the rules, regulations, and monitoring systems change. It is a classic no-win situation for the regulators.

Money laundering is generally understood to be the practice of taking ill gotten gains and moving them through a sequence of bank accounts so they ultimately look like the profits from legitimate activity. Institutions, individuals, and even governments who are believed to be aiding and abetting the practice of money laundering can be indicted and convicted, even though they may be completely unaware that the money being transferred with their help was of criminal origin. This makes as much sense as convicting an automobile manufacturer or dealer because someone who has purchased a car uses it in a criminal act, or charging the telephone company with a crime when someone uses a telephone to facilitate a criminal act.

Financial institutions are required to “know your customer,” which means they are required to know that their customers are not doing anything wrong—an impossible task. This is a dangerous principle because it could obviously be extended to any business from which a good or service sold is used for illegal purposes.

We are told we must stop money laundering in order to combat terrorism, drug dealing, assorted criminality, and tax evasion. However, if you look at the results of this so-called war on money laundering, you find that it has failed to produce the advertised results and, in fact, has not been cost effective, has resulted in wholesale violations of individual civil liberties (including privacy rights), has violated the rights of sovereign governments and peoples, has created new opportunities for criminal activity, and has actually lessened our ability to reduce crime.

Anti-money laundering advocates claim that strong anti-money laundering legislation and regulations are needed to prevent terrorism. Without a doubt, terrorism is a real threat, and has the potential to destroy millions of lives and severely damage our economic and social infrastructure. Chemical, biological and even nuclear weapons probably have leaked into the hands of terrorists from the former Soviet Union and former communist Eastern European states. Simply stated, the threat is real and ought not to be treated lightly. However, that said, is there evidence that the anti-money laundering activities have stopped or are likely to stop terrorist activities? The answer is no, for the following reasons. Terrorists for the most part only need modest amounts of money to ply their trade, and such relatively small sums can easily be hidden in normal looking transactions. In fact, anti-terrorism experts report that terrorists frequently use innocent sounding NGO's to fund their activities. These same experts tell us that the only effective way to destroy terrorist organizations is to infiltrate them. In addition, the NSA and CIA have long had the legal authority they need to monitor the activities (including financial) of terrorist organizations. In sum, there is no evidence that the arsenal of anti-money laundering tools employed by governments has stopped any major terrorist activity, nor is it likely to have any

impact on committed terrorists in the future. In fact, the claims made by some in the anti-money laundering war, that their activities reduce terrorism, may well be giving an erroneous and false sense of security, which only increases the risks.

The most common claim of the anti-money laundering advocates is that anti-money laundering tools, such as Currency Transaction Reports, Suspicious Activity Reports, and asset forfeitures are needed to stop illegal drug trafficking. Most objective observers of the “war on drugs” acknowledge that the war is not being won and, at best, is a stalemate. For instance, the Governor of New Mexico, Gary Johnson, recently wrote in the *New York Times* (Dec. 30, 2000):

I’m neither soft on crime nor pro-drugs in any sense. Yet when I ask whether our costly, protracted war on drugs has made the world safer for our children, I must answer no. The federal anti-drug budget in 1980 was roughly \$1 billion. By 2000, that number had climbed to nearly \$20 billion, with the states spending at least that much. Yet according to the federal government’s own research, drugs are cheaper, purer and more readily available than ever before.

Governor Johnson’s skepticism is shared by many knowledgeable and thoughtful people across the political spectrum, including former Secretary of State George Shultz and Nobel Prize winning economist Milton Friedman, who believe drugs should be decriminalized.

Those who call for decriminalization are not denying that drugs destroy the lives of many people and cause great harm to society. They are merely arguing that the war on drugs, including the war on money laundering, has many more negatives than positives.

The anti-money laundering laws certainly have made life more inconvenient for drug dealers, but not so inconvenient as to get them to change their ways. Part of the reason is that fewer than 1,000 people per year have been convicted of money laundering in the US since it became illegal. The amount of money confiscated is a tiny fraction of 1% of the total amount of money the government says is laundered each year. (It is worth noting that other governments, such as the UK, have been no more successful than the US in this endeavor.) In sum, the deterrent effect is almost nil. Laundering money is a far easier task than smuggling literally thousands of tons of marijuana plus vast quantities of other illegal drugs into the US each year.

The curse of the drug culture is not going to be stopped with sporadic attacks on drug supplies or increases in anti-money laundering activities. At times, after listening to those who advocate doing more of what clearly doesn’t work, one cannot help but wonder what they might be smoking. The drug war is only going to be won by substantially reducing the demand for drugs, which is an educational task, not a police task.

Another common reason given in favor of anti-money laundering activities is to reduce various sorts of crimes such as kidnappings, smuggling and racketeering. However, the empirical evidence indicates that anti-money laundering (and anti-drug) laws have, in fact, stimulated kidnappings, smuggling and racketeering. Kidnappings are soaring in parts of Latin America, particularly Colombia, to many thousands per year, largely because of the drug war. Yet, at the same time, honest individuals are having increasing difficulties hiding their assets from potential

kidnappers, corrupt governments, and other criminals because of the anti-money laundering laws and regulations. In fact, a whole new criminal industry has grown up because of these laws and regulations—the money laundering industry. We now know that much of what we call organized crime began during Prohibition, which gave rise to the bootlegging industry. Like Prohibition, what is happening is a classic case of the police creating an increased demand for their services by inventing new crimes which, in turn, creates a new criminal industry to evade the new laws.

Former Federal Reserve Governor Lawrence Lindsey (and now President George W. Bush's chief economic advisor) has been an outspoken critic of the current war on money laundering, primarily on the grounds that it has not been cost effective and has violated basic privacy rights. Lindsey has noted:

Between 1987 and 1995, the government collected 77 million currency-transaction reports, something on the order of 62 tons of paper. Out of that, it was able to prosecute 3,000 money-laundering cases. That is roughly one case for every 25,000 forms filed. In other words, entire forests had to be felled in order to prosecute one case. But it gets worse: Of the 3,000 money-laundering cases prosecuted, the government managed to produce only 580 guilty verdicts. In other words, in excess of 100,000 reports were filed by innocent citizens in order to get one conviction. That ratio of 99,999 to one is something we normally would not tolerate as a reasonable balance between privacy and the collection of guilty verdicts.

It gets worse. Banks are required to supply the government with not only Currency Transaction Reports but also Suspicious Activity Reports. These reports impose huge regulatory costs on banks and require bank employees to operate as police officers. As a result, the total public and private sector costs greatly exceed \$10,000,000 per conviction. This whole effort not only does not make any economic sense, but is clearly incompatible with a free society. The anti-money laundering laws allow almost complete prosecutorial discretion. For instance, any potential government official who did not pay the “nanny tax” could be subject to prosecution under the anti-money laundering statutes, because it was a crime involving money. Again, Governor Lindsey noted: “we have a literally unlimited application of that law to anyone engaging in any transaction who has ever committed a crime ... [no matter how minor].”

It is clear that former Vice President Al Gore and many of his staff could have been charged with violating the anti-money laundering statutes because of the Buddhist temple fundraising scam, if he did not have such a sympathetic prosecutor in Attorney General Janet Reno. Newspaper reports give the impression that there are many money laundering violations in political fundraising by all parties. However, virtually no one is prosecuted since such prosecutions would not be popular with the political class.

However, a corporate leader (particularly one who had not made large contributions to the appropriate politician) probably would have been subject to both civil and criminal liabilities for the same “studied ignorance” of activities performed by underlings that were ignored in Al Gore's case.

Thomas Jefferson said: “When the government fears the people, there is liberty. When the people fear the government, there is tyranny.” The anti-money laundering statutes are a clear attempt to get the people to fear the government. For those of you who doubt that government officials use such statutes to routinely violate fundamental privacy rights and prosecutorial discretion, I suggest that you read an excellent new book by the very distinguished economist and former Assistant Secretary of the US Treasury, Dr. Paul Craig Roberts, entitled, *The Tyranny of Good Intentions*, as well as my own book, *The End of Money and the Struggle for Financial Privacy*. Former judge John Yoder, who was the first head of the Asset Forfeiture Office of the US Department of Justice, wrote:

When I set up the Asset Forfeiture Office, I thought I could use my position to help protect citizens’ rights, and tried to ensure that the US Department of Justice went after big drug dealers and other big time criminals, rather than minor offenders and innocent property owners. Today, overzealous government agents and prosecutors will not think twice about seizing a yacht or car if they find two marijuana cigarettes in it, regardless of where they came from. I am now ashamed of, and scared of, the monster I helped create.

There is a certain irony in the fact that many of those who are the biggest advocates of giving the government more power to control money laundering in the name of crime reduction are in fact impairing our ability to reduce crime. Perhaps the most common criminal act is for one person to try to steal another person’s money. This is most often paper currency. There were approximately 18,000 murders in the US last year, and tens of millions of robberies and burglaries. Many of these crimes were, probably, in pursuit of paper currency. An easy way to reduce the amount of crime is to greatly reduce the amount of paper currency by going to various forms of electronic currency. The technology now exists—transfers from computer to computer, or to and from wireless devices and smart cards. A major barrier in the widespread adoption of such devices is the desire of the citizens to have the same degree of anonymity with such devices that they have with paper currency. Yet government officials have tried to restrict the use of the necessary encryption (those of you who are financial cryptographers well understand how absurd such restrictions are) and limit the amounts of money that can be transferred with such devices, unless there is an audit trail that enables government agents to spy on everyone’s financial transactions. Those who advocate such restrictions have no understanding of costs and benefits and little appreciation of liberty and financial privacy.

The most dubious reason often given by the advocates of anti-money laundering laws and regulations is that of trying to stop tax evasion. First, such advocates seem to have problems differentiating between tax evasion and tax avoidance—which is not only legal but also a right. Second, such advocates seem to be unable to differentiate between evading reasonable taxes imposed by honest democratic governments and unreasonable taxes imposed by dishonest and corrupt governments.

Recently, the Organization for Economic Cooperation and Development (OECD), the club of 29 rich nations, has denounced and is threatening 35 mainly smaller and poorer nations for engaging in “unfair tax competition.” What the leaders of the OECD are upset about is the fact that many of their citizens are moving financial assets to these non-OECD jurisdictions with less punitive

tax laws. These smaller countries have found that it is good business to build financial sectors based on reasonable tax rates and financial privacy. Some arrogant bullies in the OECD are now trying to use international money laundering treaties, and more odious forms of coercion, to try to force these small countries to raise tax rates and abolish financial privacy. To do so would force many of these countries to go back to relying almost totally on tourism and sugar cane for economic sustenance. No nation has the right to tell another sovereign entity what its tax rates and financial privacy policies ought to be. To do so is nothing more than financial imperialism.

The facts are that most of the OECD countries now have at least some tax rates higher than the revenue maximizing rate and, to the extent these rates are on labor and capital, they diminish both economic growth and the social welfare of their citizens. Many of the taxes on capital are in essence expropriation. Such rates are both economically destructive and immoral. To remove one's capital from such mistreatment is rational and to be expected. Tax competition is very desirable because it forces governments to be both more cost effective and less coercive.

Given that not all the world's people can live in Switzerland, they at least ought to have the basic human right to opt out of financially repressive regimes. No one would argue that it was immoral for a citizen of Nazi Germany to avoid paying taxes that would be used to support the death camps and the war machine. There may not be regimes still left that are as criminal as Hitler's or Stalin's but, unfortunately, there are still many criminal and corrupt governments around the globe. Some of the shrillest voices in the anti-money laundering crowd are often very naïve about the nature of many of the criminal and corrupt governments that still inhabit our planet. The OECD nations quite simply have no moral right to prevent people from hiding taxes and other financial assets from such governments—and, in fact, the demands to end all bank secrecy and increase tax rates would do precisely that.

Those governments and politicians who are unhappy about “tax havens” might do well to look in the mirror and ask themselves why so many of their own citizens are moving assets and income elsewhere. Even in the relatively free democratic countries, it is hard to find governmental units where there is not considerable waste of the taxpayer monies. If a business delivered equally poor service for what many governments charge, it would either go out of business or its owners would be fined and perhaps sent to jail for misrepresentation. Given that governmental units are almost always monopolies and also control the police and justice functions, an abused taxpayer often only has the options of revolution or moving his or her assets. Capital flight is a peaceful signal to government authorities to “get your house in order.” To cut off this alternative under the guise of fighting money laundering is likely to lead to far worse consequences.

As a result of easily usable and almost unbreakable public key encryption, the Internet, and rapidly developing digital money products, the ability of governments to detect and control the movement of money and other financial assets will be almost impossible without governments knowing everything about everyone's financial affairs. History teaches us that governments abuse the information they have about their citizens. Both the US Constitution and the UN Declaration of Human Rights recognize and guarantee basic privacy rights, including financial privacy.

The new technologies are developing so rapidly that government will not be able to keep up with the innovations. As Ronald Reagan once said, “The best minds are not in government. If any were, business would hire them right away.” President Reagan’s quip was not intended to disparage the many very hard-working, intelligent, and dedicated government employees, but only to illustrate that government is seldom on the cutting edge of new technologies. The serious money launderers will always be a couple of steps ahead of government. That does not mean that the money laundering police will not be able to catch a few people each year, but they will be primarily the slow, the careless, the small fish, and the politically targeted. The big, serious money launderers will be less likely to be caught in the future than they are now, which means it will be a relatively safe occupation.

We are always told by those who advocate giving government more information about us that it will be kept confidential and our trust and confidence will not be betrayed. Yet we are always betrayed. IRS and FBI files, again and again, are not kept secret. The government was even unable to keep our most sensitive nuclear weapons files secret, yet we are told to trust. Do you really think it was just a coincidence that many of the conservative public policy organizations that were critics of the Clinton Administration were audited, while none of liberal ones were?

Benjamin Franklin said it best: “They that can give up essential liberty to obtain a little temporary safety deserve neither safety nor liberty.”

As I noted in the beginning of this talk, those of you in the financial cryptography business are heroes in that your work is critical in guaranteeing that people will still be able to enjoy a reasonable degree of liberty in the information age. Even those of you who are not motivated by belief, but by a desire for more wealth are nevertheless heroes, because as the great economist and philosopher Adam Smith noted 225 years ago, the invisible hand of your own self-interested efforts are benefiting all mankind. Keep it up!

I expect that most of those who advocate anti-money laundering laws and regulations are not mean-spirited, but decent folks who just have not thought through the consequences of what they are promoting and doing. I also realize that during the last two decades a sizable anti-money laundering industry has emerged with many billions of dollars to spend, and that those whose jobs depend on such an industry—law enforcement officials, equipment purveyors, and assorted bureaucrats, etc.—are not going to take kindly to my comments, even if they cannot refute my arguments.

But if you truly want less crime, more prosperity and opportunity, and more freedom, you will “just say no” to the anti-money laundering laws and regulations.

<https://cei.org/outreach-regulatory-comments-and-testimony/why-war-money-laundering-should-be-aborted>

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