



Another Fine Regulatory Mess

BY RICHARD W. RAHN

ANTI-MONEY LAUNDERING RULES HAVE UNINTENDED CONSEQUENCES

If you are in business and the government will not allow you to open a bank account, what do you do? Thirty years ago, almost anyone could walk into a bank and open a bank account with no questions asked. But now it is increasingly difficult for honest people and businesses to open bank accounts because of all the new regulations on banks, which are intended to make life more difficult for terrorists, drug dealers, child pornographers, money launderers and other assorted criminal types. Banks and other financial institutions are subject to “know your customer” regulations and are supposed to monitor the funds they receive to make sure they do not come from criminal sources.

Twenty-nine states have laws legalizing marijuana to some extent, such as for medical purposes. Eight states — Colorado, Washington, Alaska, Oregon, California, Nevada, Massachusetts and Maine, plus the District of Columbia — now have legalized marijuana for recreational use, even though marijuana is still illegal at the federal level. Federal law trumps state law — the Civil War decided that issue — but the Obama administration stated it would not try to enforce the federal anti-marijuana law in states where it had been made legal.

But banks and other financial institutions are subject to federal law, and thus cannot legally accept deposits from criminals — and those who are in the marijuana business are considered criminals by the feds but not by the states in which it is legal. The big banks fear massive fines if they have customers or customers of their customers who are engaged in an illegal activity. The feds have ultimate control over every financial institution, even ones that are purely local, because every financial institution needs a bank account with another financial institution in order to transmit and receive funds from customers outside of their own bank. Small local banks and credit unions normally have bank accounts with a bigger bank, which, in turn, has an account with one of the biggest banks that has an account with the Federal Reserve.

If the folks in Washington, D.C. don’t like some of the customers of some small bank in Denver, or in Switzerland, or even China, they have the ability to label it a “bad bank,” which is a warning to all the banks in the world that have direct or indirect corresponding bank accounts with the “bad bank” that “you are going to have trouble with us unless you drop them as customers.” Shutting down corresponding banking relationships is a major tool that the United States uses to put financial sanctions on a country like North Korea or Iran.

Many of those who are involved in the Colorado marijuana business — growers, processors and retailers — have found it impossible to get bank accounts, so they have been forced to deal in cash. As a result, armored cars go around to the various pot businesses, pick up the cash and put it in a hopefully secure warehouse. The business is growing rapidly, so literally billions of dollars of cash are being transported and hidden in Colorado alone. Once the marijuana businesses get up and running in all the states that have made it legal, there may well be more than \$100 billion in physical cash sloshing around — for this one type of business alone — making it ripe for theft, armed robbery and, of course, tax evasion.

The need to do everything in cash creates new industries, both legal and illegal. It is ironic that the anti-money laundering laws, which were in part used to discourage the use of cash because it is so hard to monitor, have been the biggest accelerant for the use of cash and attendant illegal activity. This is not only true with the domestic marijuana industry, but also with the international requirements to know your customer. Americans living abroad have been finding that they cannot open local bank accounts because foreign banks are subject to the U.S. financial reporting requirements, which often makes it too expensive for them to open bank accounts for Americans (and others). Foreign workers in the United States and other countries are finding it increasingly difficult to send remittances back home to their families (which is the best and least expensive form of foreign aid).

All sorts of clever people have been trying to figure out how to fill the need for financial services by finding ways around the government regulations, including the use of new digital monies like bitcoin and Tokken. Eventually, the clever people will develop practical U.S. dollar substitutes that are almost impossible to regulate.

The whole anti-money laundering effort is fatally flawed because it failed to anticipate how people would respond to the higher costs imposed and privacy destroyed. Yes, criminals use money, just as they use automobiles, phones and paper when committing crimes. But trying to prevent criminals from using dollars for illegal purposes — particularly when what is defined as criminal activity varies from jurisdiction to jurisdiction — imposes such huge costs on everyone else as to make the whole effort destructive to the safety, privacy and economic well-being of the citizens.

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