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Useless Anti-Money Laundering Laws

By Richard W. Rahn

INVASIVE FINANCIAL RULES ONLY DETER THE LAW-ABIDING

Governments occasionally pass laws with good intent but which backfire because they were poorly thought out and created perverse incentives, making the situation far worse.

The current effort to stop money laundering has turned into a disaster for the global poor, who can no longer get bank accounts or easily and legally transfer money (remittances) to their relatives in poor countries. The anti-money laundering laws and regulations have made international trade and investment more expensive, thus perpetuating poverty. They have destroyed much legitimate financial privacy, and they have undermined the rule of law by destroying due process. Serious drug dealers, criminals, tax evaders and terrorists can find plenty of legal and illegal ways to launder money.

In 1919, the 18th Amendment to the Constitution was passed, prohibiting "the manufacture, sale, or transportation of intoxicating liquors." It was a disaster. A large portion of the population refused to go along with it and found ways to acquire and consume booze despite the law. Prohibition provided huge profits for bootleggers and gave rise to organized crime. The situation became so bad that in 1933 the 18th Amendment was repealed.

More recently, the so-called Affordable Care Act (Obamacare) was passed with the intent of providing health insurance to all Americans, while enabling them to keep their own doctors and reducing medical costs. The system has not worked, because it was predicated on the false idea that young, healthy people would be willing to buy high-cost insurance to subsidize the elderly and the ill. This has not happened. People have lost choice in health care providers, while the costs to the taxpayer have soared. Out of necessity, it is in the process of being repealed before it leads to bankruptcies for more insurance companies and even government.

Money laundering is normally defined as transforming the profits of crime into apparently legitimate assets. In the United States before 1986, it was not a separate crime and hence, there was no criminal specialty in money laundering. With the increasing concern about the expansion of the drug trade, the first anti-money laundering bills were passed in the 1980s as well as the increasing legalization of asset forfeiture. After the 2001 terror attacks, the rationale for the anti-money laundering effort increasingly became to prohibit terrorist finance; and over the past decade, the rationale has increasingly become to prevent tax avoidance and evasion.

Money laundering fits under the definition of vague law because, unlike murder or robbery, it is not a crime of an act but one of "intent." Two different people can engage in the same physical transactions, but if one intends to hide the source of the proceeds of funds and another does not, they can be treated very differently. This leads to many problems and substantial prosecutorial abuse. It is not only banks and financial institutions that are supposed to know the source of their clients' funds, but also such diverse people as car dealers, pawnbrokers, real estate agents, and on and on. Often, it is not considered good enough to know the source of a customer's funds (often a near-impossibility), but the source of the funds of the customer's customer.

The result is that banks and other financial institutions increasingly refuse to open accounts for low-income people, who are then forced to deal in cash or with those in the financial underground. There is a very high fixed cost for banks and others to do "due diligence" on their customers — the costs being roughly the same for a $5,000 deposit, a $500,000 deposit or a $5,000,000 deposit. Given the massive penalties banks and other financial institutions are subject to for making even an unintentional mistake, their safest course of action is to drop small customers.

The ever-increasing compliance costs on financial institutions have resulted in much less consumer choice, as small banks and others are forced into mergers because of these costs. Americans living abroad find it increasingly difficult to open bank accounts regardless of their income or wealth status, as growing U.S. financial imperialism (using the anti-money laundering campaign as an excuse) causes foreign banks to refuse to deal with U.S. persons. Recent academic and think tank studies show the situation only getting worse — all cost and no gain.

There are infinite ways to launder money, and a friend who is an expert in finding proceeds of crime just sent me a list of a number of ways he has seen that are almost undetectable and unprovable. (I refrain from printing them here in order to avoid being accused of aiding the criminal class.) The point is that the smart and rich can find plenty of ways to launder money, but the poor, including poor countries, and the honest pay a huge price for all of the additional compliance costs, which reduces productive global capital formation and real incomes.

The beneficiaries of these laws and regulations are all of the international bureaucrats at the Organization for Economic Co-operation and Development, Financial Action Task Force, United Nations and International Monetary Fund, who formulate and enforce the rules, while enjoying tax-free salaries and, of course, the liberty-hating political class who has gained more power over others' lives. Anti-money laundering laws and regulations can neither be cost-effective nor can they avoid destroying basic liberties — and thus need to go the way of Prohibition.

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