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Another Fine Mess

by Richard W. Rahn

HOW MONEY LAUNDERING, TERRORIST FINANCING PUT THE EU AND U.S. AT ODDS

All too rarely do government leaders fully think through the effects of their actions — extraterritorial application of law being a prime example.

If a U.S. citizen engages in bank fraud in Germany, clearly the Germans have a right to prosecute him. But does the U.S. government also have the right to prosecute that individual? If a U.S. citizen violates U.S. tax law by not reporting income made in Canada, the United States has the right to charge him. But does Canada also have a right to charge him even if he had reported the income to the Canadians?

The above cases are simple compared to the growing complexity of dealing with a variety of international financial situations where laws differ among jurisdictions and more than one country claims the right to bring charges against individuals and institutions (who may not be their own citizens) for crimes not committed in the country.

Noted legal scholar Bruce Zagaris, who specializes in international financial crime, has written a new paper for the Center for Freedom and Prosperity Foundation that is being released this week. Mr. Zagaris writes: "On one hand, the U.S. has proactively used unilateral extraterritorial law enforcement avenues, as well as its superpower status, to prosecute money laundering and terrorist financing violators and forge multilateral alliances. On the other hand, the U.S.'s unilateralism in the financial enforcement arena has alienated smaller jurisdictions and led to substantial increases in costs for cross-border transactions."

The U.S. courts have ruled that the U.S. has jurisdiction over extraterritorial conduct or when a non-citizen engages in the conduct at least partly in the United States. In addition, the United States has proactively asserted it "has the right to regulate criminal acts by non-U.S. citizens occurring outside the U.S., as long as they produce effects in the U.S." As can easily be seen, such a definition is a never-ending slippery-slope, which is causing great conflicts among governments. As a result of the increasingly expansive view of U.S. courts to take cases and enforce judgments extraterritorially, courts and legislatures in other countries are also asserting extraterritorial enforcement authority.

Large countries are usually able to defend themselves when other countries try to extend and enforce their laws to the territory of the large jurisdiction, but small jurisdictions are often left in a position where they are unable to defend themselves and their citizens. The major countries have established informal intergovernmental bodies, such as FATF (Financial Action Task Force), which exclude certain jurisdictions from the global financial enforcement regime. Small regimes are merely informed of new "global standards" that they are expected to follow no matter how much damage they may do their economies. Failure to follow the new rules can land them on "black lists" that further isolate them from the world's financial system. Many of these countries are relatively poor, so we have a situation where the big rich guys make the poorer smaller guys suffer even more.

The global anti-money laundering and anti-terrorist financing regulations have rarely been subject to independent and professional cost-benefit analyses, which again makes it very easy for big states to beat up on small states, without any solid justification. Large states with partially independent, smaller states within their jurisdictions, now find themselves in conflict with other large states. The European Commission blacklisted 23 jurisdictions "for their weak regulation" of the anti-money laundering/anti-terrorist finance policies in February 2019. The list included four U.S. territories — Puerto Rico, Guam, American Samoa and the Virgin Islands. The U.S. Treasury Department immediately condemned the blacklist and said that it did not expect U.S. financial firms to heed it. At this moment, there is a stalemate between the Americans and Europeans — which places an uncertainty tax among all of those involved, reducing investment and growth.

It is difficult enough for businesses and individuals in any one jurisdiction to understand all the laws and regulations that apply to them, but once governments begin to extend their laws and regulations to foreign jurisdictions, the global financial and legal system begins to melt down. Laws and regulations are often in conflict, so those who are engaged in multiple legal jurisdictions are increasingly at risk — which causes them to rationally de-risk by withdrawing investment from those entities least able to defend themselves. The result is slower world growth and job creation.

Now that several U.S. territories have been blacklisted, the Trump administration may well be in the best position to lead a fundamental reform effort. Clear global rules need to be established as to when extraterritorial application of laws is justified and not justified. Issues like dual criminality in tax, anti-money laundering and terrorist finance need to be addressed to bring some rationality and fairness to the system. And finally, procedures need to be established so that any jurisdiction can challenge a rule that does not meet a reasonable cost-benefit test.

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