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## Case Studies on Globalisation and Money Laundering

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## Observatorio de Política

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## Case Studies on Globalisation and Money Laundering\*

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### ABSTRACT

*Financial globalization has greatly improved the efficiency of capital transfers around the world, with the cost of facilitating criminal money laundering activities. Based on case studies on conditions for money laundering in the process of globalization and transformation in Europe, are discussed the challenges that a “global financial village” must confront.*

Keywords: capital mobility, fight against capital/money laundering; payment systems, cooperation for financial stability.

JEL Classification: F39.

### RESUMEN

*La globalización financiera ha incrementado substancialmente la eficiencia en la transferencia de capitales alrededor del mundo, pero con el costo de facilitar las actividades criminales de lavado de dinero. En base al estudio de casos sobre las condiciones de lavado de dinero en el proceso de globalización y transformación en Europa, se discuten los desafíos que debe confrontar una “aldea financiera global”.*

Palabras clave: movilidad de capitales, lucha contra lavado de capital y dinero, sistemas de pagos, cooperación para la estabilidad financiera.

Clasificación JEL: F39.

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\* This version is a synthesis of the more extended Working Paper “Case Studies in Globalization and Money Laundering”, presented as an invited conference in the 8th Arnoldshain Seminar- ISCES, at the University of Sao Paulo, Brazil, April 2008.

## I. INTRODUCTION

The *Single Euro Payments Area (SEPA)* process calls for the continuous improvement of payment services, by offering products that are as easy, efficient and safe as they are today at the national level. But in the context of further globalization and European enlargement we see new risks of money laundering coming<sup>1</sup>. Money laundering exists on the Cayman and the Canal islands, but also in Frankfurt. Also it is present in art auctions in London and in real estates in Miami. Money laundering at German banks switches or is comfortably at the domestic computer. Globalization and money laundering have considerably increased with innovative financial instruments (derivates, etc.) mobilizing enormous financial resources: e.g. hedge funds established in offshore centers are estimated to be around US\$ 50-100 billions (United Nations, 2007). As the global financial architecture becomes more complex, the possibilities of individuals to disrupt markets and distort the value of securities also increases.<sup>2</sup>

Activities that generate “dirty money” exploit every possibility offered for laundering capital in financial centers: Cayman Islands, Hong Kong and Liechtenstein. Money laundering allows crime to pay by permitting criminals to hide and legitimize proceeds derived from illegal activities. According to one recent estimate, worldwide money laundering activity amounts to roughly US\$ 1 trillion a year.

To provide a historical perspective, al Capone’s criminal activities as a gangster boss in Chicago cleaned illegal dollars in “Laundromats/salons”: the association with “Money Laundering” is remarkable: based on bookkeeper Meyer Lansky using a Swiss Bank, criminal money was paid in via checks, currencies, etc. on a number account. Today informants prefer to announce their knowledge and their fight without designation by the name.

In 1960s, platforms for “dirty” money in offshore tax havens and financial centers –base for the geographic expansion of Eurodollars, out of range of their central banks– were established. In 1980s funds generated by drug production increased. Narco-dollars between 1985 and 1995 paralleled the financial deregulation processes, increasing ways of ensuring capital growth, unrelated to the production of goods and services.

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1. In theory, the main function of foreign exchange markets is to expedite payment for international trade exchanges.

2. Globalization opened the doors to financial crimes such as money laundering, insider dealing, investment market fraud and financial market fraud. Reforms must be made, especially in public awareness by providing and training of relevant information. All reform must deal with the moral values concerned. See Freyer (1996c).

Chesnais (2000) points out that the volume of transactions related to drug production and sales was estimated US\$100 billion to \$500 billion a year during the first half of the 1990s<sup>3</sup> and is difficult to identify the flows of “dirty money” within this overall volume once they penetrate the world financial system.

Chesnais (2000) adds that one of the main characteristics of financial globalization is that it has put the most prestigious centers—London, Zurich, New York—in contact with offshore tax havens and financial centers used by big banks and corporations for “gray-area” operations<sup>4</sup>, and quotes the Geopolitical Drugs Observatory (GDO): “*As the wide social support enjoyed by cocaine production and sale in Colombia and Bolivia shows, these are perfectly rational activities from the viewpoint of certain social groups and several poor countries whose traditional export markets have collapsed since the 1970s*”.

### **I.1. The Financial Action Task Force (FATF)**

FATF is an inter-governmental body which sets standards, and develops and promotes policies to combat money laundering and terrorist financing. It currently has 33 members: 31 countries and governments and two international organizations; and more than 20 observers, five FATF-style regional bodies and more than 15 other international organizations or bodies. The FATF 40 Special Recommendations have been recognized by the International Monetary Fund and the World Bank as the international standards for combating money laundering and the financing of terrorism.

According to the *Financial Action Task Force (FATF)*, “*The goal of a large number of criminal acts is to generate a profit for the individual or group that carries out the act. Money laundering is the processing of these criminal proceeds to disguise their illegal origin. This process is of critical importance, as it enables the criminal to enjoy these profits without jeopardizing their source. Illegal arm sales, smuggling, and the*

3. The total amount of foreign aid from the United States, other Organization of Economic Cooperation and Development (OECD) countries and the World Bank combined is about \$50 billion per year. Yet, this \$50 billion inflow to developing and transitional economies is completely offset by the \$100 billion which illegally flows back out of other pockets in those same countries with U.S. and European assistance.

4. The illegal activities of “dirty money” exploit every possibility offered for laundering and investing capital in financial centers, as Bahrain, in British and Dutch Antilles, the Bahamas, Bermuda, Cayman Islands and Hong Kong. IMF estimates 600-1500 billions US\$ per year, in Germany €30-€100 billions.

*activities of organized crime, including for example drug trafficking and prostitution rings, can generate huge sums. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to 'legitimize' the ill-gotten gains through money laundering". It also points out that "when a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention".<sup>5</sup>*

Before financial liberalization, tax havens represented the best place to deposit the profits of drugs, etc., in banks outside the country of origin. The FATF defines a "tax haven" as a country whose banking system is not sufficiently regulated and which authorizes the installation of "mailbox" companies.

It has been noted that the liberalization of currency exchange, growth in tourism and international transactions led to an increase in the number of exchange houses and the amounts involved, facilitating the laundering process, and that when dirty money has penetrated the financial system it is easy to move it on a global scale.

Fortunately, anti-money laundering campaigns are gaining support from public opinion. Before financial globalization started, money laundering appeared in the United States, as financial institutions increased the possibility of penetrate the operations.<sup>6</sup> Nowadays criminal trade is most dynamic in citadels of financial globalization, like London; and financial deregulation allowed non-banking financial institutions with lower professional ethics to increase relocation of money with fewer controls. Additionally, banking secrecy in countries such as Switzerland increases related risks.<sup>7</sup> More recently, since the tragic events of September 11, also terrorism is associated with money laundering.

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5. FATF web page, "Money Laundering FAQ". Available: [http://www.fatf-gafi.org/document/29/0,3343,en\\_32250379\\_32235720\\_33659613\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.html)

6. For instance the Bank of Credit and Commerce International (BCCI), which built its fortune on fraud and narco-dollar laundering, as well as other US banks, including First Bank of Boston, Chase Manhattan, Irving Trust, Bank of America, where employees directly involved were sentenced and banks fined, probably not enough to deter laundered money.

7. Due to space limitations we cannot concentrate here on an analysis of models on money laundering, e.g. phase model of Bernasconi, 3-Phase-model, etc.

Financing terrorism changed the way the law perceives money laundering fostering the emergence of global measures aimed at countering this criminal practice.

## II. THE ERA OF GLOBALIZATION

Ethical questions are gaining space with globalization at weight, demanding a new value system and better control structures.<sup>8</sup>

Globalization began in 19th century, stimulated by technological advances, liberal trade, remarkably free movement of people, and almost entirely free movement of capital. The world also enjoyed an unprecedented rise in prosperity: economic history shows that worldwide real GDP per head rose at a rate of 1.3 percent a year between 1870 and 1913, until two World Wars ruined the first wave of globalization. Breaking with the system of regulated financial operations and control over capital movements, existing since the crisis of 1929, the current financial globalization is dominating the majority of national systems.

Our second era of globalization involves accentuated financing aimed at greater profit from available capital, with capital gains increasingly important<sup>9</sup>. But globalization has also generated concern over increased inequality and environmental degradation. Globalization of financial markets and money laundering is a problem with new dimensions. Since transparency of financial transactions on global markets is considered insufficient, the EU and the OECD formulated in 2002 a set of proposals to fight money laundering. They include higher transparency of the capital

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8. Ethical violations in finance relate to insider trading, stakeholder interest versus stockholder interest, investment management, and campaign financing. Business in general, and financial markets in particular are replete with examples of violations of trust and loyalty in public and private dealings. See Ratzinger (2005).

9. On Nov. 14, 2001, the German Federal Cabinet passed the draft of the 4th Financial Market Promotion Act tabled by the Federal Finance Minister. *"It aims to improve investor protection by increasing market integrity and market transparency, expanding the scope and flexibility of market participants, as well as closing gaps in the system of defense against money laundering and facilitating the discovery of monies which serve to finance terrorist organizations... amendment will allow the exchanges more flexibility in organizing exchange trading and enable them to react more flexibly to market changes. In securities trading law, investor protection will be increased through the improvement of market integrity, e.g. through the revision of the ban on price and market manipulation and the transfer of responsibility for monitoring this to the federal authorities"*. Deutsche Börse Groupweb page.

Available: [http://deutscheboerse.com/dbag/dispatch/en/listcontent/gdb\\_navigation/listing/60\\_Newsboard/60\\_Top\\_Story/Content\\_Files/lc\\_art\\_ts\\_bundeskabinett\\_beschliesst\\_4\\_finanzmarktfoerderungsgesetz.htm](http://deutscheboerse.com/dbag/dispatch/en/listcontent/gdb_navigation/listing/60_Newsboard/60_Top_Story/Content_Files/lc_art_ts_bundeskabinett_beschliesst_4_finanzmarktfoerderungsgesetz.htm)



movements, the limitation of privileges by certain occupation groups (trustee, notaries etc.), and the possibilities of registration expanded. Also, sanctions against not cooperating countries and territories are suggested, since offshore centers are weaknesses of the financial system. Further, judicial and administrative collaboration must be strengthened as well as bank supervision with a limitation of cash and the regulation of activities by clearing-houses. With growing electronic money (cybermoney) and the development of derivatives, current methods of supervision are insufficient and need to be adapted to the new challenges.

To fight against money laundering banks and other financial services providers prefer voluntarily cooperation instead of issuing “black lists” of financial institutions. Cooperation of financial institutions with supervision authorities is also important.

### III. CASE STUDIES ON CAPITAL LAUNDERING

#### III.1. Russian Money Laundering

Russia suffered an impoverishment by the greatest illicit diversion of resources that has ever occurred out of any country in a short period of time; US\$150 to US\$200 billions in a decade by very conservative estimates, with figures as high as US\$500 billion being also offered.<sup>10</sup> The combination of criminal money laundering and illegal flight capital aided by western banking institutions brought this result to Yeltsin’s Russia. By the end of 1991, Gorbachev’s Perestroika shops were nearly empty, producers had begun hoarding, as had fearful consumers. Yeltsin announced in November 1991 that the government intended to free prices. Predictably, producers withheld their products from markets and rubbed their hands. Central Bank Chairman Gerashchenko protested and the IMF continued lending.

A transparent privatization delivering property widely to Russia’s hands should have preceded the freeing of prices. Producers should have enjoyed some protectionism, as did manufacture in the 19th century.<sup>11</sup> On the contrary, privatization of property in a country without property rights

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10. Anne Williamson, WorldNetDaily.com, Sep. 1, 1999.  
Available: <http://www.freerepublic.com/forum/a392764880929.htm>

11. IMF made multiple mistakes handling the Russian crisis on 1998 (Stiglitz, 2006).

resulted in an expensive, exhausting and destructive program of paper title transfers. Yeltsin oversaw that the property titles were transferred to key citizens, institutions and long-term cronies, so they would have a vested interest in sustaining him in power. On January 2, 1992, Yeltsin freed prices; the country suffered a 2500 percent inflation rate in that year. The implications were costly: in 1994, the Russian Ministry of Internal Affairs (MVD) estimated that 25% of the Russian gross national income was derived from organized criminal activities. The MVD also believed that 5600 criminal groups were involved primarily in capital/money laundering, the drug business, and extortion. Under this dismal scenario, on June 14, Yeltsin issued a Decree “*On the urgent measures to defend the population against gangsterism and other kinds of organized crime*”, it was controversial but supported by the majority of the Russian people to fight organized crime. Experts believed laws would help control the economic criminalization caused by organized criminal associations and would encourage the development of honest business.

Russian reforms failed as the result of a combination of three policies: a forced inflation, tariff reductions and voucher privatization. Russia needed direct investments, not speculative debt traders.

In 2000 the FATF blacklisted 15 countries including Liechtenstein, Israel, etc., and also Russia, for not cooperating on money laundering. Later, Russia launched a clampdown on illegal international transfers of dirty money by pushing new legislation quickly and implementing it. In May 2001, the Duma ratified the broad international convention on money laundering, soon signed into law by President Vladimir Putin. In 2002 Russia was taken off the list of countries failing to co-operate in the international fight against money laundering.

### **III.2. Ukraine**

Due to their weak anti-money laundering regimes, Grenada and Ukraine were added to the FATF list of non-cooperative countries and territories in 2002. Ukraine has been criticized for having deficiencies in its customer identification provisions and for providing inadequate resources to combat money laundering.

Money laundering in Ukraine during the country process to become a market economy increased the probability of legalizing illegal incomes.

This was the result of the imperfectness of laws regulating the activity of economic structures, inexperience of law enforcement bodies dealing with this problem, penetration of shady moneymakers and criminal environment into its economy.<sup>12</sup> Money laundering took place via export and import operations, cash Pooling-Accounts and compensation business, etc.. Illegally acquired funds are remitted to accounts of dummy firms, and then foreign currency is transferred abroad to pay import contracts. Then, money is transferred from one account to another until it becomes legal.

Among other well-known ways of illegal enrichment are embezzle credits (especially state ones), deceive partners, attract public funds, cause bank failures, privatize industry and trade, etc. Other practices are: (i) Make banks grow rapidly through capital accumulation, and then going bankrupt, when in reality they transferred money to foreign bank accounts and these funds were put into legal business abroad or in Ukraine. Because of imperfections in the mechanism to ease the interaction between Ukraine's National Bank and commercial banks, managers disappeared and documents were missing. (ii) Encasing foreign exchange by Ukrainian business persons through the purchase or establishment of firms abroad, the opening of representative offices or branches in Ukraine, and then transferring large sums of foreign exchange through foreign contracts. (iii) Cash money is given to foreigners to pay traveling or other expenses because they can get cash exchange on legal grounds. (iv) Very large amounts of money are put into a shady circulation through external economic activities of enterprises (price and import volume manipulations, illegal customs registration). In such cases, customs duty discharge is considerably reduced and goods illegally imported.

The combination of efforts of all governmental bodies and financial institutions can prevent money laundering in Ukraine. Ukraine's law "On preventing and struggling against the legalization of illegal incomes" and the creation of the National Agency on Financial Security will favor solving the problem of money laundering. Laundering dirty money is realized through financial institutions as bank employees which know about illegal operations, and sometimes even participating of them. State organizations are impeded of taking control of all suspicious transactions because of the large number of commercial banks in Ukraine.

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12. See Golubev and Saytarly (2003). "Typical schemes of outflow of capital and money laundering in Ukraine". Computer Crime Research Center.

Available: [http://www.crime-research.org/library/Saytarly\\_ML.html](http://www.crime-research.org/library/Saytarly_ML.html)

### III.3. Germany

#### The privatization of East German enterprises

In 1989-90, German unification formed a *caesura* in German and European history. The Treuhand agency privatized East German enterprises owned as public property. Created by the Volkskammer on June 17, 1990, it oversaw the restructuring and selling of about 8,500 firms with initially over 4 million employees. At that time it was the world's largest industrial enterprise. Critics about the unnecessary closing off of profitable businesses, misuse and waste of funds and unnecessary layoffs soon arose. In this context, money laundering emerged out of the proceeds of an illegal embargo business and part of the disappeared GDR-assets, e.g. the GDR firm empire KoKo.<sup>13</sup>

As an example we have the Leuna-Minol case, one of the most spectacular examples of the German post-war history, of which politicians and the corruptibility politics altogether was reproached. The scandal released an avalanche of proposals, initiatives and new laws and/or changes in the law to the subject of corruption. The French oil group Elf got the Leuna-works to an advantage price. Later German money laundering fight laws were concluded in 2002 after 9-11.

#### III.3.2 German tax evaders and Money laundering

A secret dossier of the Bundes Nachrichten Diensts<sup>14</sup> (BND) called Liechtenstein a "Hort der internationalen Geldwäsche" (repository of international money laundering). Based on its law (anonymous foundations, number accounts, banking secrecy, tax rates) Liechtenstein (and Switzerland) want to participate in the global growing offshore-business (Bernasconi, 1999). The requirement that financial internet transactions must be anonymous and safe, and the need for disclosures concerning alleged widespread tax evasion by German citizens through Liechtenstein, highlights a much broader challenge to successfully deal with tax evasion

13. Also the transmission of the relatively generous West German social system and its institutions connected powerful transfer achievements and conditions in politics and economy. The crisis of the German welfare state until today has no answer on globalization, the indebtedness of the country and the demographic change, see Roland Eisen (2007).

14. In January 24, 2006, the BND (Federal Information Service) received an email through its regular Internet address. The sender claimed to have secret data from Liechtenstein that he was prepared to offer the BND. The material, he wrote, was related to financial investments worth €3.5 billion (\$5.2 billion). He added that he was not reporting the information in return for payment, but because it struck him as deeply unfair that multimillionaires could continue to amass their fortunes without paying taxes. Focus Online (28/07/2005). Available: [http://www.focus.de/finanzen/news/geldwaesche/das-bnd-dossier\\_aid\\_15744.html](http://www.focus.de/finanzen/news/geldwaesche/das-bnd-dossier_aid_15744.html)

by German citizens: how to respond to countries/territories that seek to profit from tax dodging by residents of other jurisdictions.

In our increasingly interdependent world, OECD countries and a number of co-operative financial centres have been working together for a number of years to address the problems posed by anti-competitive tax practices, both in OECD countries and offshore, by developing standards of transparency and exchange of information in tax matters that balance the interests of financial privacy with the need for countries to effectively enforce their own tax laws. In 2002, OECD published a list of un-cooperative tax havens, initially including seven countries. Several have now made commitments to work with OECD to improve transparency; remaining Andorra, Monaco and Liechtenstein. *“As long as these financial centres refuse to co-operate in bilateral tax information exchange and fail to meet international transparency standards, residents in other countries will continue to be tempted to continue to evade their tax obligations”*.<sup>15</sup>

An economic scandal in Germany involved as many as 900 wealthy Germans and almost up to 4 billion euros in taxes. At stake are billions of euros in tax revenues lost to the German government. A total of up to 20 bank employees, members of foundation boards and account managers in Liechtenstein and Germany are under investigation for their alleged roles in developing tax savings models. The debate on welfare reforms and excessively high executive compensations has drawn the attention to the ever-widening gap between rich and poor.<sup>16,17</sup> On February 27, 2008, belatedly transferring EU-guidelines, the German Federal government decided on stricter rules against money laundering.<sup>18</sup>

15. OECD web page (19/02/2008), “Tax disclosures in Germany part of a broader challenge, says OECD Secretary-General”. Available: [http://www.oecd.org/document/34/0,3343,en\\_2649\\_201185\\_40114018\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/34/0,3343,en_2649_201185_40114018_1_1_1_1,00.html)

16. While life at the bottom of society is characterized by inadequacy and uncertainty, those at the top are accused of living in excess and eroding the cherished German principle of social solidarity. Spiegel Online, (02/25/2008), “Liechtenstein's Shadowy Informant: Tax Whistleblower Sold Data to the US”. Available: <http://www.spiegel.de/international/business/0,1518,537640-4,00.html>

17. Annually hundred of billions US\$ disappear out of the balances of payments in high tax countries, and circulate in the global financial system. The Caymans are the fifth largest finance place of the world: six hundred commercial banks are registered, without physical presence; forty-seven of the leading large banks are registered in the country, twenty of the largest American banks. An investigation commission of the US-senate concludes that leading American banks, Chase Manhattan, Citigroup, etc. are insufficient against offshore money laundering.

18. See Reuters (27/2/ 2008), “Deutschland Kabinett beschließt Gesetz zur wirksameren Geldwäsche-Bekämpfung Mittwoch”. Available: <http://de.reuters.com/article/domesticNews/idDEBUC74446120080227>.

#### IV. EUROPEAN INTEGRATION

A free movement of capital and payments within the EU, and between the EU and third countries, is an essential component for establishing the internal market in financial services. A complex EU framework for combating money laundering must not be overseen especially in new member states.<sup>19</sup> On January 1, 2007, the EU was enlarged through the accession of two new Member States, namely Bulgaria and Romania. The European Central Bank and the European Commission will prepare convergence reports every two years. These reports provide the basis for the EU Council's decision on whether the new Member States fulfill the necessary conditions for the adoption of the euro. On 1 January, 2008, the euro was introduced in Cyprus and Malta (Freyer, 1998c; Jovanovic, 2005). Six years after the introduction of the euro banknotes and coins in the 12 "first-wave" countries and one year after the adoption of the euro by Slovenia, this is the third successful euro cash changeover.<sup>20</sup>

##### IV.1 Single European Payments Area-SEPA

To Facilitate the full potential of the European economy via the *Single European Payments Area (SEPA)* calls for the continuous improvement of payment services, by offering pan-European products that are as easy, efficient and safe as they are today at the national level. The European Payments Council (EPC) is focusing on the development of three pan-European payment instruments: SEPA credit transfers, direct debits and card payments. These three payment instruments will dominate cashless payments in virtually all EU countries. The SEPA is an initiative of the European banking industry.

By anticipating modern payment systems and a continuous improvement of service levels, the SEPA is enabling the realization of new technological opportunities and can provide major benefits.<sup>21</sup> In an important departure from the previous system in use, the SEPA makes no distinction between national and cross-border payments. Under SEPA,

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19. See Franco (1996), Eckhard (1998c) and Eckhard (2004a).

20. See European Central Bank, Press Release, (3/1/2008), "The euro cash changeover in Cyprus and Malta. Available: <http://www.ecb.int/press/pr/date/2008/html/pr080103.en.html>.

21. See European Central Bank, Press Release (4/5/2006), "Single Euro Payments Area Joint statement from the European Commission and the European Central Bank". Available: [http://www.ecb.int/press/pr/date/2006/html/pr060504\\_1.en.html](http://www.ecb.int/press/pr/date/2006/html/pr060504_1.en.html)

users of payment services will be able to make cashless payments in euro from a single bank account using a single set of payment instruments (SEPA credit transfers, SEPA direct debits and SEPA card payments) as easily, smoothly and safely as they can with national payment instruments today. Commencing January 1, 2008, the SEPA affects each and every credit institution, commercial enterprise and consumer, first in the 13 euro-area countries. Other European nations which are not part of the €-area are free to participate by making use of the relevant rules, procedures and standards. Each working day, 187 million cashless payment transactions are initiated in the euro area, over 85% of which are credit transfers, direct debits and card payments.

Payment fraud is an important threat to the European economy, and in particular for the health of an efficient Single Payment Area in Europe. It also undermines user's confidence in payment systems, in particular in relation to new payment technologies. Prevention of (and combating) payment fraud needs to be improved. This can be achieved through the active cooperation of all the stakeholders involved in the payment chain. Indeed, the effectiveness of the prevention measures is enhanced when they are designed and implemented in partnership with all the parties concerned.<sup>22</sup> Preventive measures against fraud in non-cash means of payment is of great importance for the creation of an EU Single Payment Area with efficient and secure payment means and systems, and confidence of users in the payment systems. At the European level, further improvements in efficiency in the area of payment settlement have allowed economies of scale which will benefit the European economy as a whole. The harmonization of payment instruments presents banks with a strategic challenge. This takes the form of offering new products and services, developing new business models and replacing antiquated systems as well as optimizing settlement options. SEPA lays the foundations for increased competition. SEPA project makes a major contribution to the Lisbon agenda which inter alia aims to boost the dynamism of the European economy.<sup>23</sup>

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22. The EU launched in October 2004 a new Action Plan (2004-2007) to prevent fraud on non-cash means of payment Available:

[http://ec.europa.eu/internal\\_market/payments/fraud/index\\_en.htm](http://ec.europa.eu/internal_market/payments/fraud/index_en.htm) Summary minutes of the 13th meeting of the committee on the prevention of money laundering and terrorist financing held in Brussels (11/12/2007). Available: [http://ec.europa.eu/internal\\_market/company/docs/financial-crime/meetings/20071211-summary\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/financial-crime/meetings/20071211-summary_en.pdf)

23. Transparent accounts to trace dirty money or funds connected with terrorist financing may undermine data protection and the citizens' trust in their governments respect for their privacy. See Bremen Research Center on Money Laundering (available: [http://www.bfog.uni-bremen.de/cms\\_en/](http://www.bfog.uni-bremen.de/cms_en/)) and European Parliament legislative resolution on the proposal for a directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering, including terrorist financing (COM(2004)0448-C6-0143/2004- 2004/0137(COD)).

A broader definition of fraud in non-cash means of payment<sup>24</sup> can help for a better understanding of the growing involvement of trans-national organised crime in payment fraud and how in most cases is able to circumvent countermeasures. Estimates in relation to card fraud in the EU are between €500 and €1000 millions, and more worryingly, payment fraud is increasingly taking a trans-national nature. At the beginning of the 21st century organized crime became a topic in public debate and on political agendas throughout Europe. To control organized crime, far-reaching legal and institutional reforms have been implemented.

#### IV.2 Financial Transparency and Money Laundering

The aim of the EU is to reduce the risk of financial malpractice covering also taxation and law enforcement. Four lines against corporate malpractice are considered: (i) internal control in a company, (ii) independent third parties, (iii) supervision and (iv) enforcement.<sup>25</sup>

Based on these challenges the European Commission launched strategies to prevent financial and corporate malpractice.<sup>26</sup> *The “Parmalat affair showed how some companies use complex structures to reduce the transparency of their activities to investor”* (Frits Bolkestein, Internal Market Commissioner). Risks of such financial scandals must be reduced, with policies needing to be tightened up in certain areas since these scandals damage financial markets and confidence declines. Artificially Raised Values<sup>27</sup> as fraud schemes are an explanation for offering inflated

24. Transparent accounts to trace dirty money or funds connected with terrorist financing may undermine data protection and the citizens’ trust in their governments respect for their privacy. See Bremen Research Center on Money Laundering (available: [http://www.bfog.uni-bremen.de/cms\\_en/](http://www.bfog.uni-bremen.de/cms_en/)) and European Parliament legislative resolution on the proposal for a directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering, including terrorist financing (COM(2004)0448-C6-0143/2004- 2004/0137(COD)).

25. See Summaries of EU legislation, Corporate and financial malpractice (2004). Available: [http://europa.eu/legislation\\_summaries/justice\\_freedom\\_security/fight\\_against\\_organised\\_crime/133224\\_en.htm](http://europa.eu/legislation_summaries/justice_freedom_security/fight_against_organised_crime/133224_en.htm)

26. The European Commission has adopted a strategy for co-ordinated action in the financial services, company law, accounting, tax, supervision and enforcement areas, to reduce the risk of financial malpractice. The Commission’s Communication recommends timely and effective implementation of the Financial Services Action Plan (Action Plan for Company Law and Corporate Governance), an effective EU framework for dealing with most of the financial issues raised by the recent scandals, as well as strict control of the application of legislation. The Commission suggests new policy initiatives in tax and law enforcement. The key elements are: enhanced transparency, improved traceability and better co-ordinated enforcement.

27. The Federal Bureau of Investigation has opened criminal inquiries into 14 companies as part of an investigation of the subprime-mortgage crisis. FBI officials said the probe is focusing on accounting fraud, securitization of loans and insider trading, among other areas.



values in exchange for fees of millions US dollars. Still, fraud remains a problem for companies around the world: e.g. the € 5 billion losses announced by Société Générale.<sup>28</sup>

Also, as no oversight of hedge funds exists and more frauds can come, government must take a greater role to control banks and funds better. *“In fact, the current subprime crisis is a typical product of the financial globalization and liberalization championed by the United States (US). Globalization and liberalization of economic activities should take place on a level playing field. But the globalization and liberalization of finance led by the US is based on power politics. Other countries, including Japan, have no choice but accept the “open market theory” as wielded by the US, “the financial cowboy” of the world. The US format emphasizes market opening and liberalization of financial products and trading without a “common system” based on equality, fairness and negotiations to keep things in order. From accounting rules, market assessment systems, risk control procedures, to financial policies and even market terminology, everything is decided by the US. In order to guarantee US capital a smooth ride anywhere in the world, the federal authorities have ignored conventional practices in market evaluation and “played dirty” to whitewash the real risks of such low-credit products as subprime mortgages. In the financial market painting over real risks inevitably leads to investment bubbles. Once it becomes a crisis, even sound assets could go down the drain. Such is the seriousness of the current subprime crisis. The Fed seems to have been fooled by watered-down market assessments. The subprime crisis may end up bringing the US out of its wild fantasy and back into the real world, where it has to pursue “financial globalization” with other nations fairly, openly, and on a level playing field.”*<sup>29</sup> *With Globalization of economic activities/markets (services, capital and information as well as labour) interdependence is quickly increasing, especially cross-border mobility.*

## V. MONEY LAUNDERING AND MORAL<sup>30</sup>

The aim of law is to control limit the burden that drugs, criminality and corruption put on society. Then, fiscal measures, the widespread of

28. Clear segregation of back- and front-office activities was one of the clearest lessons to emerge from the rogue-trading scandal at Barings Bank in 1995. See Economist.com (Jan 29th 2008), "Société Générale and the rogue trader". Available: [http://www.economist.com/daily/news/displaystory.cfm?story\\_id=10598231&top\\_story=1](http://www.economist.com/daily/news/displaystory.cfm?story_id=10598231&top_story=1)

29. Researcher -China Institute of International Relations: China Daily (01/29/2008) [online]. Available: [www.chinadaily.com.cn](http://www.chinadaily.com.cn).

30. Cfr. Dobson (1993) and Bhagwati (2004).

democracy, social control of corporate behaviour, etc. gains importance. Economic globalization continues to outpace both the political structures and the moral sensitivity required to ensure a just and sustainable world. To achieve these aims requires that all nations commit themselves to realize that goal (Stiglitz, 2006).<sup>31</sup> A broader definition on ethical purposes and responsibility and sustainable investments can help to overcome existing limits, e.g. the project “Ethical-Ecological Rating” based on ecological and social criteria (Boatright, 2007).<sup>32</sup> Other creative projects, e.g. Grameen Bank, have also proved having positive effects in this context.<sup>33</sup>

The actual discussion in Germany on money laundering and moral leadership should remember policy makers the establishment of the Deutsche Bank Foundation: can charities be grounded in the best of values? To expect moral leadership from the nonprofit and philanthropic sector, particularly in times when other public and private institutions fail, etc..<sup>34</sup> Can charities become money-launderers, accepting stolen goods?<sup>35</sup>

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31. *“Bankers/rating agencies believed in financial alchemy. They thought that financial innovations could somehow turn bad mortgages into good securities, meriting AAA ratings. A lesson of modern finance theory is that repackaging risks not make much difference. There might be some money in repackaging, but not the billions that banks made by slicing and dicing sub-prime mortgages into packages whose value was much greater than their contents. The only thing we got wrong was how bad banks’ lending practices were, how non-transparent banks really were, and how inadequate their risk management systems were. It was interesting to see the different cultural attitudes to the crisis on display. In Japan, the CEO of a major bank would have apologized to his employees and his country, and would have refused his pension and bonus so that those who suffered as a result of corporate failures could share the money. He would have resigned. In America, the only questions are whether a board will force a CEO to leave and how big his severance package will be. This is the third US crisis in the past 20 years, after the Savings & Loan crisis of 1989 and the Enron/WorldCom crisis in 2002. Deregulation has not worked. Markets may do not lead, as if by an invisible hand, to societal well-being. Achieving a better balance between markets and government is essential”. Joseph E. Stiglitz, (2008), “Alpine Schadenfreude”, Project Syndicate. Available: <http://www.project-syndicate.org/commentary/stiglitz96/English>*

32. See also Dow Jones Sustainability Index (Available: <http://www.sustainability-index.com>), Sustainability Yearbook 2008.

33. M. Yunus pioneered microcredit, the innovative banking program that provides poor people with small loans they use to launch businesses and lift their families out of poverty. In the past thirty years, microcredit has spread to every continent and benefited over 100 million families. See Yunus and Weber (2007); Dowla and Barua (2006).

34. See Ekir Landessynode (2008) "Vorlage der Kirchenleitung an die Landessynode Wirtschaften für das Leben. Stellungnahme zur Wirtschaftlichen Globalisierung und ihren Herausforderungen für die Kirchen. Available: [www.enodo.de/downloads/DarmstaedterErklaerung.pdf](http://www.enodo.de/downloads/DarmstaedterErklaerung.pdf)

35. Stanford Social Innovation Review, (January 31, 2006), Mark Rosenman, Blog : Money Laundering & Moral Leadership. Available: [http://www.ssireview.org/site/printer/money\\_laundering\\_moral\\_leadership](http://www.ssireview.org/site/printer/money_laundering_moral_leadership)

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