**Financial Transparency: Moving Towards Systemic Solutions**

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[**Raymond Baker**](http://www.gfintegrity.org/staff-member/raymond-baker/)

**Contributing to a Safer and More Secure World Demands That Financial Intelligence Units Work to Change the System from Within**

Keynote Address by GFI President Raymond Baker before the 22nd Plenary of the Egmont Group of Financial Intelligence Units

*As Prepared for Delivery*

**Lima, Peru**

Thank you, Sr. Espinosa. And thank you also, Murray Michelle and Kevin Stephenson, for giving me this opportunity to speak to the Egmont Group.

Good afternoon, ladies and gentlemen.

In 1997, as I was traveling the world researching for the book that I eventually wrote on illicit money, I interviewed a Swiss banker in Zurich. I gave him anonymity, as I did for others in sensitive conversations, so that he would feel free to speak his mind. He said something extraordinarily honest. He said, “As long as tax evading money is not on the same level as drug money, then we cannot curtail money laundering.” In that statement he put his finger on a key issue. As long as we hold open the shadow financial system through which tax evading money flows, we cannot curtail the use of that system through which criminal and corrupt money flows.

In our organization, we study illicit financial flows, particularly as they affect developing countries.

Our analysis shows that some $1 trillion of illicit money passes out of developing countries into tax havens and developed countries annually. Over many years, such transfers have accumulated to trillions of dollars shifted from poorer to richer countries. And our analysis shows that these flows are growing at about 18 percent a year.

Some people think that this is all about crime and corruption in “those countries over there.” In fact, in the cross-border flow of illicit money, the corrupt component—that is bribery and theft by government officials—is only about 3 to 5 percent of the global total. The criminal component is about 30 to 35 percent of the total. And the commercially tax evading component is about 60 to 65 percent of the global total.

Now, how does this money—the criminal, the commercially tax evading, and the corrupt—how does this money flow around the world? It is facilitated by a global shadow financial system which has been created by us in the richer countries precisely to handle this flow. This system comprises a number of elements:

* Tax havens. There were only four or five when I went into business at the beginning of the 1960s, and there are more than 60 today.
* Secrecy jurisdictions. Almost all tax havens provide the infrastructure of lawyers and bankers and accountants who can set up entities hiding behind nominee directors and officers, so that the real owners remain unknown.
* Disguised corporations in the millions around the world, more of them in the United States than anywhere else.
* Anonymous trust accounts.
* Fake foundations. You can establish a charitable foundation, you can donate money to this charitable foundation, and you can designate yourself as the beneficiary of the charity of this foundation, of course, avoiding taxes at every step.
* False documentation is used in all sorts of cross-border capital transactions.
* Falsified pricing in international trade, usually the over-invoicing of imports and the under-invoicing of exports, is used in a significant percentage of commercial transactions and moves more illicit money across borders than all other mechanisms combined.
* Money laundering techniques to handle specialized needs.
* Holes left in the laws of Western countries to facilitate the receipt of illicit money coming out of other countries.

The expansion of this system took off in the 1960s for two reasons.

First, to facilitate the movement of flight capital out of newly independent and other developing countries.

And second, to aid the movement of tax evading money by multinational corporations which were accelerating their expansion all over the globe.

By the late 1960s and 1970s, drug traders looked at this system and realized that it was ideally suited for their purposes. So they stepped in to use these same techniques to shift their ill-gotten-gains across borders. In the 1980s and ‘90s, other criminal groups, seeing how easy it was for the drug traders, likewise stepped into these same channels to move their illicit money. This continues to be the pattern today, with drug dealers, other criminals, tax evaders, and corrupt government officials utilizing exactly the same structures and mechanisms to shift illicit money across borders.

We have been deeply involved in the fight against drugs and crime and money laundering for more than 25 years now. We are not succeeding; we are failing. Drug trading has not been reduced. Cross-border crime has exploded over the past 25 years. Money laundering is growing, not declining.

My favorite example illustrating this failure is the Drug Enforcement Administration in the United States. Established more than 40 years ago, DEA has not succeeded in curtailing the drug problem in the United States. DEA focuses on drug busts, that is to say, it goes after the product. The United Nations Office of Drugs and Crime (UNODC) estimates that, globally, we—DEA included—succeed in interdicting some 40 percent of hard drugs—cocaine and heroin. But, more importantly, UNODC also estimates that we capture less than 1 percent of drug money. DEA has made the fundamental mistake of taking a law enforcement approach and focusing on the product. This has failed. The supply of drugs has not been lessened, and the price of drugs has not been increased. DEA has defined as success the seizure of drugs. DEA has not defined as success curtailing the drug problem. Instead of taking a law enforcement approach and focusing on the product, DEA should be taking a systemic approach and focusing on the money.

We are dealing with a systemic problem. We have allowed, indeed facilitated, the growth of a non-transparent, secretive global shadow financial system. We have done this under the mistaken impression that it contributes to free trade and economic growth. Not correct. I was in the private sector for 35 years, doing business all over the developing world before segueing into the think-tank community. I know that entirely satisfactory business can be done without using the global shadow financial system.

The key fallacy in our global anti-money laundering, crime fighting efforts is the idea that we can make the criminals and the corrupt government officials give up their use of this system, while we continue to use the system for our tax evasion and tax avoidance. This is not possible. The Swiss banker was right. Crime and corruption and tax evasion must be put on the same level.

The creation of financial intelligence units is a little more than 20 years old now. For some of you, your nation’s units have been formed more recently. Many of you devote a great deal of time and effort to examining Suspicious Activities Reports. And this continues to be an extremely important effort.

You are now at an inflection point—what President Obama calls an inflection point—where issues begin to shift in a different, often more fundamental, direction. You are being asked, “What are the sources of illicit money?” “What are the destinations of illicit money?” “What are the right times and means of intervening in the flow of illicit money?” Indeed, this type of responsibility has now been confirmed by the FATF, which makes it clear that FIUs are expected to conduct strategic analyses. Not just case-by-case examinations, but what is going on within your countries and across your borders.

Fortunately, progress is being made in aiding your strategic analyses and in efforts to change the reality of the global shadow financial system. These efforts center around making the financial system more transparent. I will highlight five such steps that are underway, and there are certainly more.

First, the Financial Action Task Force in Paris has recommended to participating nations that tax crimes be established as an offense under anti-money laundering standards. For many countries this is not the case. Activities of hardened criminals are the basis for a money laundering charge, but tax evasion is regarded as more benign and often not included under predicate offenses in money laundering cases.

Second, the United States is considering changes in its anti-money laundering policies. For years the United States has had two lists of predicate offenses for money laundering charges. The list covering domestic crimes is long and detailed, covering almost every crime you can think of. The list covering foreign crimes is shorter and does not cover many types of criminal money and certainly does not cover foreign tax evading money coming into the United States. Senator Charles Grassley, who incidentally endorsed the back of the book I wrote on illicit money, years ago tabled a bill that would change this situation. More recently, Congresswoman Maxine Waters has put forward a bill that would accomplish the same thing. It would get rid of the two lists and make all “specified unlawful activities” the basis for a money laundering charge, whether committed in the United States or abroad. Thus, incoming tax evading money and incoming criminal money would be treated the same. We are working hard to encourage passage of such legislation. This would be a major advancement of the AML agenda for the United States.

These steps by FATF and by the United States are essential in changing the normative behavior of many bankers and lawyers and accountants. Advice on tax evasion schemes has become normative behavior for many professionals. This will not change until we make it clear that tax evasion and the facilitation of tax evasion is in fact a criminal offense.

Third, the G20 has adopted a commitment to automatically exchange financial information across borders. The OECD is drawing up a framework by which this can be accomplished. Thus far, 47 countries have agreed to cooperate in this new global initiative, all of them developed and middle-income countries. Some commentators say that the developing countries are not ready to participate in automatic exchange. I have travelled to many countries over the last two years as a member of the UN Economic Commission for Africa’s High Level Panel on Illicit Financial Flows from Africa led by His Excellency Thabo Mbeki, former President of South Africa. We have been encouraging African countries to say “yes,” we want to be involved in automatic exchange of information, even if we have to slowly build our capacity to participate fully. Regarding tax information, from my perspective any country can deal with the first ten names on the list of account information provided. We think it is important for countries to get into this process earlier rather than later.

Fourth, there is a global move afoot to require the natural persons owning corporations and financial accounts to be known, preferably publically but at least to government authorities. This is huge. Ending ownership secrecy is the single most important step we can take to curtailing the abuses of the shadow financial system. And accomplishing this is a matter of political will. Let me illustrate. After 9/11 in the United States we passed a strengthened anti-money laundering law. Among its targets were shell banks, banks where the ownership was not known. The new law said that it is illegal for any U.S. financial institution to receive money from a foreign shell bank. Furthermore, it is illegal for any other financial institution anywhere in the world to send money to the United States that it has received from a shell bank. Furthermore, this prohibition includes wire transfers that might touch a New York City correspondent bank account for a fleeting moment before speeding off somewhere else. Guess what? Just like that, shell banks were reduced from thousands around the world to just a handful, with a few still operating today in Europe and Asia being extremely careful to assure that their transfers never go through New York. In other words, with an act of political will and the stroke of a pen, shell banks were almost eliminated from the global shadow financial system. The same thing needs to be done and can be done with shell corporations. Get rid of them.

My fifth point will take a few moments to relate. The U.S. Supreme Court made a ground-breaking ruling in 2005, which is just beginning to be comprehended by U.S. corporations. The case was entitled *U.S. vs. Pasquantino*. In this case, Pasquantino and his collaborators were smuggling liquor from the United States into Canada to avoid Canadian customs duties. The Supreme Court ruled that this was a scheme to defraud. Now, interestingly, it did not matter in their ruling who was defrauded—in this case the Government of Canada, or of what they were defrauded—in this case customs duties. It only mattered that a scheme to defraud had been perpetrated from the United States, and it was upheld that they had committed a felony offense.

Multinational corporations make similar decisions every day about manipulating customs duties and VAT taxes and income taxes through the pricing of imports and exports in international trade. By these actions these corporations may very well be committing felony offenses

I frequently speak at law schools. One of the things I do is bring three or four MBA students into the law school classroom to consider a transfer pricing decision for a multinational corporation in a cross-border transaction. I tell them that their job is to maximize profits for the corporation. The MBA students invariably decide on a price that manipulates VAT taxes, customs duties, and income taxes. I then turn to the law school students who have read *U.S. vs. Pasquantino*. I pass out to the law school students a letter supposedly from one of the people making the pricing decision which says:

“I’m vaguely aware of anti-money laundering laws and prohibitions against mail and wire fraud, and I’m turning to you for advice. Regarding my participation in this transfer pricing decision, would you please give me a one sentence letter stating that the chance that I have committed a felony offense is zero, or that there is a chance that I have committed a felony offense.”

The last time I did this, 19 out of 23 students said that there is a chance you have committed a felony offense. Similar laws against mail fraud, wire fraud, and schemes to defraud exist in the laws of many countries.

Now, this has been a rather long story to make a very fundamental point. Think of the implications of this. By asking corporate executives and managers to manipulate taxes in cross-border transactions, we may be creating felons within our corporate ranks, hundreds of thousands of people who are committing criminal offenses. What does this say about our ideas of ethics and corporate responsibility? And how much does this complicate your lives trying to curtail the flow of illicit money into and out of your countries? Many law firms in the United States and Europe are now advising their corporate clients of the risks of trade misinvoicing.

Tax crimes, drug trading, human trafficking, and corruption all use the same mechanisms available in the global shadow financial system to shift proceeds across borders. We are finally recognizing that all of these are related issues that must be addressed in similar ways.

Ladies and gentlemen, I recognize that many, if not most, of you are in intelligence gathering and some of you are also in law enforcement. Your jobs are to enforce the laws that are on the books or to provide intelligence that enables others to enforce the laws. This is what you do. What I am suggesting to you is that if the laws are so porous, so full of holes, as to accommodate so much illicit money, then you cannot succeed in your larger task—contributing to a safer and more secure world. A law enforcement approach within a porous financial system that thrives in the shadows cannot work.

I am asking you, the world’s financial intelligence units, to contribute to changing the system. I don’t want you to spend 40 years like DEA has done in the United States, failing to solve the problems you are addressing. Together with your law enforcement activities, I want you to spend an equal amount of time changing the system, advising your governments and parliamentarians and also your civil society organizations that we have to get rid of the global shadow financial system if we are going to solve the problems we are together facing. Change the system. End the shadows; make it transparent.

My colleague at Global Financial Integrity, Tom Cardamone, said something spontaneously recently that was quite profound. He said, “The world is what it is. We can fight it, or we can fix it.”

You are primarily in the business of fighting it. I’m asking you to get equally into the business of fixing it.

You are the smartest people on the planet dealing with these issues. Fix it, ladies and gentlemen, fix it.

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[*Raymond Baker*](http://www.gfintegrity.org/staff-member/raymond-baker/)*is president of*[*Global Financial Integrity*](http://www.gfintegrity.org/)*, a Washington, DC-based research and advocacy organization.*