



## How Money Laundering and Corruption Impact the World Economy

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### Introduction

Teddy Roosevelt once stated “Unless a man is honest, we have no right to keep him in public life, it matters not how brilliant his capacity, it hardly matters how great his power of good service on certain lines may be...No man who is corrupt, no man who condones corruption in others can possibly do his duty by the community” Roosevelt made that statement around 1900. It is every bit as meaningful in 2013 as it was in 1900. Unlike 1900, today we live in a much more complex world, comprised of much more complex challenges. Corruption, illicit financial flows and money laundering combine to make a corrosive combination that presents a complex global challenge. To deal with this problem, we must understand the nexus between corruption, illicit financial flows and money laundering.

What is corruption? Corruption is an abuse of public trust. It is the abuse of power or position for personal gain. What are illicit financial flows? Illicit financial flows represent the flow of funds away from legitimate commerce and economies. It is funding originated for illicit purposes and diverted to bad actors. Illicit financial flows are impacted directly and indirectly by corruption. Corrupt public officials, around the world, directly divert the proceeds of their corruption away from legitimate funding flows to support their personal illicit lifestyle. Such diversions are in the billions of dollars. Corrupt public officials indirectly influence illicit financial flows of other criminals by enabling the criminal conduct thorough their corrupt support of the criminal activity. How does money laundering relate to corruption and illicit financial flows? Individuals and entities engaged in corruption and illicit financial flows must move ill-gotten gains in a manner to avoid detection. Money must be available to the criminals on a continuous basis. These demands require the ability to launder the illicit funds.

Corruption exists at every level and segment of society. No country is immune from corruption. Every country experiences corruption to some degree. Transparency International publishes the Corruptions Perceptions list which ranks countries for their propensity for corruption. Corruption occurs in both the public and private sectors. Public corruption involves elected officials, government and municipal officials and employees ranging from the most senior to the most junior levels. Private sector corruption includes corporations, businesses, unions and non-government agencies.

What are the consequences of corruption? Corruption has a corrosive effect on the rule of law, economic development and democratic principles. Corruption poses a threat to national security. It undermines public trust in government. Corruption poses a threat to public safety. It weakens the infrastructure. An example of a weakened infrastructure was demonstrated in Mexico in September 2013. Two tropical storms converged on coastal areas causing serious flooding. In the aftermath of the storms, the Mexican government was criticized for a lack of preparedness. In addition, corruption was blamed for a weak infrastructure that could not deal with the flooding conditions, putting public safety at risk. Corruption poses a threat to the economy. Corruption undermines legitimate financial flows. Corruption often leads to flight capital pouring out of a country seriously eroding the economy. An example of this is Afghanistan. Afghanistan is one of the most corrupt countries in the world. Corrupt officials and other criminals have taken their ill-gotten gains out of Afghanistan and taken them to Dubai.

Corruption, transnational crime and terrorism present a dangerous trifecta. Transnational criminal organizations and terrorist groups acting in concert with each other, or unilaterally, rely on corrupt officials to protect their illicit activity. Corruption serves as an enabler for criminal and terrorist organizations. This poses a significant threat to national security and the economy.

The prominent theme of corruption is that it is the abuse of power and trust. Methods of corruption include the following criminal activity:

- Bribery
- Embezzlement
- Theft
- Fraud
- Extortion and blackmail
- Nepotism or cronyism
- Improper political contributions
- Conflict of interest
- Other

Global Financial Integrity published a report in December 2012, entitled Illicit Financial Flows From Developing Countries 2001-2010. The report stated that crime, corruption and tax evasion cost the developing world \$858.8 billion in 2010. Illicit financial flows include proceeds from:

- Drug trafficking
- Human trafficking
- Wildlife trafficking
- Weapons trafficking
- Illegal logging
- Counterfeit consumer goods
- Corruption
- Money laundering
- Other illicit enterprises



Money laundering is essential to illicit financial flows. Money laundering methods include money laundering through the financial system; bulk cash smuggling; and trade based money laundering. Bulk cash smuggling has been a long standing problem. As the financial services industry improves its anti-money laundering monitoring capability, and more free trade zones are created, trade based money laundering becomes a more significant problem. Illicit trade poses a barrier to economic growth. Mis-invoicing is the mechanism used most frequently to facilitate illicit trade.

## **Public Corruption**

Public corruption poses a fundamental threat to national security and our way of life. It impacts everything from border security, to neighborhood safety, to verdicts handed down in courts, to the quality of roads, schools and government services. Corruption takes a significant toll on our pocket books. Public corruption ranges from high and low impact government employee corruption, to political corruption, to judicial corruption. Public corruption can be systemic or one-off corruption.

The cases of Robert Hanssen and Hector Rodriguez offer the contrast between high and low impact Government Employee Corruption. The case of Robert Hanssen represents high impact government employee corruption. Hanssen was a corrupt FBI agent. He was a Russian spy who provided classified information to the Russians. Hanssen was responsible for the deaths of spies in Russia working for the United States (U.S.). Consequences of the Hanssen case included a threat to national security and a loss of trust in the FBI. The case of Hector Rodriguez is an example of low impact Government Employee Corruption. Rodriguez was a corrupt Customs and Boarder Protection Officer. He accepted bribes to allow illegal immigrants to pass into the U.S. from Mexico through his inspection lane at the San Ysidro Port of Entry. The consequences of the Rodriguez case were threats to national security and the economy.

The case studies of the Knapp Commission and Jonathan Callahan demonstrate the difference between systemic and one-off Police Corruption. The Knapp Commission was appointed in 1971 to assess the level of corruption in the New York City Police Department (NYPD). The Commission uncovered widespread systemic corruption in the NYPD. This corruption was portrayed in the movie *Serpico*, about Police officer Frank Serpico, who reported the corruption. Consequences of this case included widespread loss of public trust in the NYPD and a threat to public safety. Jonathan Callahan was a Police Officer in Clayton County, Georgia. Callahan's case exemplifies one-off Police Corruption. Callahan used his position as a Police Officer to provide protection to drug dealers. In addition, he stole two firearms from a motorist he stopped. Consequences of the Callahan case were a loss in trust of the Clayton county Police Department, a threat to the economy and to public safety.

The cases of Operation Greylord and Abel Corral Limas illustrate the difference between systemic and one-off Judicial Corruption. Operation Greylord was the FBI investigation into widespread systemic Judicial Corruption in the Cook County, Illinois court system. As a result of the investigation, 92 people were indicted. Most pled guilty. Individuals indicted included 17 judges, 48 lawyers, 10 deputy sheriffs, eight policemen, eight court officers and one state legislator. Consequences of the investigation included loss of trust in the Cook County



government and a threat to public safety. Abel Corral Limas was a Judge in Brownsville, Texas. Judge Limas accepted bribes from criminal defendants and intermediaries in return for favorable rulings in criminal cases. This was a one-off Judicial Corruption case. Consequences of the case were a loss in trust to the Brownsville court system and a threat to public safety.

The Abscam and Senator William Jefferson cases represent highly visible systemic and one-off Public Corruption cases. Abscam was an FBI undercover operation conducted in the 1970s and 1980s. It focused on systemic corruption in the U.S. Congress. One Senator and six Members of the House of Representatives were convicted for accepting bribes. Consequences included loss of trust in the U.S. Congress and a potential threat to the economy. The case of Senator William Jefferson was a one-off Public Corruption case. Senator Jefferson was convicted of accepting bribes. During the execution of a search warrant, the FBI found \$90,000 in cash hidden in Jefferson's freezer. Senator Jefferson was sentenced to 13 years in jail. Consequences included loss of trust in the U.S. Congress and a threat to the economy.

### **Politically Exposed Persons**

A Politically Exposed Person (PEP) is defined by the Financial Action Task Force (FATF) as an individual who is, or has been, entrusted with a prominent public function. A PEP can be either domestic or foreign. A PEP presents a high risk for causing illicit financial flows from their countries, especially in developing countries. A PEP poses a high risk for money laundering. A PEP tends to use shell companies as a facilitation tool. Senior foreign officials engaged in large scale corruption can have a disproportionate impact on a country, a region, even a generation of citizens victimized by a corrupt society.

Definitions regarding PEPs include:

- Foreign PEPs are individuals who are, or have been, entrusted with prominent public functions by a foreign country.
- Domestic PEPs are individuals who are, or have been, entrusted domestically with prominent public functions.
- International Organization PEPs are individuals who are, or have been, entrusted with a prominent function by an international organization.
- Family members are individuals who are related to a PEP either directly or through marriage or similar forms of partnership.
- Close associates are individuals who are closely connected to a PEP, either socially or professionally.

Typical examples of how foreign PEPS operate and cause the illicit flow of funds from their countries through their illegal activity can be gleaned from the case studies of Omar Bongo and Vladimero Montesinos. Omar Bongo was the President of Gabon for 41 years until his death in 2009. He used offshore shell companies to move over \$100 million in suspected funds through private bank accounts. Bongo provided large amounts of cash to family members that were intended for his personal benefit. Three decades of autocratic and corrupt rule made Bongo one of the world's richest men. Vladimero Montesinos was the longtime head of Peru's intelligence service. He made extensive use of shell companies to launder \$400 million



globally, \$80 million of which was laundered through the U.S. Montesinos was at the center of a vast web of illegal activities to include embezzlement, gun running, drug trafficking and money laundering. Montesinos fled Peru and received safe harbor in Venezuela. He was ultimately arrested, extradited to Peru and convicted.

### **Private Sector Corruption**

Private sector corruption is a significant problem that usually involves accounting statement fraud. Private sector corruption includes corporate and business corruption, union corruption and non-government organization (NGO) corruption. Corporation and business corruption can be domestic or international. Corporate wrongdoing has come to be seen as a routine occurrence. It was magnified by the financial crisis. Corporate and business corruption is a threat to the economy. Union corruption has had a propensity to involve organized crime. Traditional organized crime, particularly La Cosa Nostra, has been a corrupting influence on unions. Union corruption is a threat to the economy. NGOs are often reluctant to talk about corruption. Because NGOs operate globally and in many regions at high risk for corruption, they are susceptible to bribes and extortion. NGO corruption poses a threat to public assistance and in some instances, a threat to national security.

### **Foreign Corrupt Practices Act**

The Foreign Corrupt practices Act (FCPA) prohibits offering to pay, paying, promising to pay, or authorizing the payment of money or anything of value to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity, or to secure any other improper advantage in order to obtain or retain business. Opportunities abound for companies to operate in the international arena. In doing so, it is essential that such companies recognize risk and be knowledgeable of corruption laws.

Common corruption risks include:

- Payments of consulting fees or commissions
- Transactions with state-owned entities
- Payments to Customs officials

An effective company compliance program includes:

- Commitment from senior management
- Code of conduct
- Policies and procedures
- Oversight, autonomy and resources
- Risk assessment
- Incentives and disciplinary measures
- Third party due diligence
- Confidential reporting and investigation
- Continuous improvement



FCPA due diligence requires knowing the local environment. This requires conducting thorough due diligence on key partners in the region. In addition, you must ensure the appropriate level of monitoring of company activities, development of effective internal controls over cash and tracking all instances of corrupt behavior.

FCPA cases to learn from include Walmart and Chiquita Brands International. Walmart bribed officials in Mexico to change and/or expedite requirements to build stores. They used middlemen to facilitate the bribes. An internal investigation was thwarted by Walmart business executives. They succeeded in turning the internal investigation over to the Walmart business leader in Mexico who was responsible for paying the bribes. The business leader swept the internal investigation under the rug. This case illustrated a lack of tone at the top and the lack of an autonomous investigative process. The consequences of this case were damage to Walmart's reputation and the disruption to a tourist attraction in Mexico. Chiquita Brands International owned banana plantations in Colombia. Chiquita made illegal payments to the paramilitary group United Self Defense Forces of Colombia (AVC). The AVC is a foreign terrorist group. Chiquita claimed they were extorted by the AVC. As a result of this case, Chiquita paid \$25 million in fines and is the subject of civil law suits. The consequence of the Chiquita case was a threat to the national security of Colombia.

### **Understanding Risk**

Prevention begins with understanding. We have to understand the variations of corruption, the risk factors that lead to corruption and best practices to prevent corruption. We have to understand illicit financial flows and how corrupt officials rely on flight capital to move their ill-gotten gains out of their country to safe havens. We have to understand money laundering methods that corrupt officials rely on to include trade based money laundering, bulk cash smuggling and money laundering through financial institutions. We have to understand the conduits and/or intermediaries corrupt officials rely on to include the use of shell companies and individuals. An important element in understanding conduits and intermediaries is to identify beneficial ownership.

Understanding the risk of corruption also requires understanding the risks posed by geography, cultural vulnerabilities and business activity. In considering geographic risk, we must assess country specific risk, regional risk and global risk. We must also assess the cultural vulnerabilities presented by geographic risk. What is the propensity for bribery and corruption? Is bribery an accepted business practice? What is the regulatory and law enforcement capacity and will in a given country? What is the level of the criminal and/or terrorist threat in a country or region? We must understand the types of business activity that take place in given countries and regions. How is business impacted by the cultural vulnerabilities associated with a country or region? What are reasonable business practices? Do you know the red flags for corruption and illicit financial flows?

Corruption, like many other criminal activities, begins with opportunity. Given the opportunity to grow, corruption will mature, cause greater risk, and become more difficult to overcome. We must challenge opportunity through preventive measures. Meaningful preventative measures



can only be developed through identifying and understanding risk. The first step is to limit opportunity.

## **Conclusion**

Regardless of whether criminal activity involves public corruption, PEPs, FCPA, and/or illicit financial flows, the activity will require money laundering and the use of financial institutions. If you work in a financial institution, is your institution positioned to identify corrupt activity and the illicit flow of funds? Can you assess reasonableness? Do you have adequate due diligence and enhanced due diligence mechanisms in place? Can you disrupt corruption and illicit financial flows?

Corruption is a global problem. It exists at every level and segment of society. Corruption is the abuse of trust and power. The combination of corruption, illicit financial flows, and money laundering is corrosive. This corrosive combination presents threats to national security, public safety and the economy. Corruption can be high or low impact. Corruption can be systemic or one-off. To fight corruption, we must understand and mitigate the risk of corruption. Corruption is a global problem that requires the implementation and sustainability of global anti-corruption measures.

