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Money Laundering in the Asia Pacific

Working Paper No. 5: Socio-economic
consequences of money laundering and related
financial crime in the Asia Pacific

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Introduction¹

Since 1988, the international community has voiced increasing concern over the impact of transnational crime and the financial activities associated with such crime. This concern, marked by a number of significant international agreements and efforts, mirrors the fact that the strategic concerns of the chief actors in world politics have turned increasingly from military to economic issues. The forces of 'globalisation' have had a profound impact on the world's leading economies, as high-tech currency trading, growth in overseas investment, lowering of tariff barriers and other integrating trends have created a world where economic autonomy for the nation-state is at best a mirage. Beyond the consequences of fluctuations in the legal economy, even greater anxieties loom in the form of new opportunities for organised crime, fraud and corruption. Crime and corruption have always been business opportunities, if illegal ones, and it is only logical that the new markets and global opportunities – trumpeted as the fruits of the end of the Cold War – present equal opportunity to criminal and corrupt economic actors.

While initial multilateral attempts at co-ordinated action took trafficking in narcotic drugs as their focus, recent efforts demonstrate an equal or greater concern with the financial structures and networks underpinning transnational criminal activities. In particular, *money laundering*, as the financial underpinning of the profitability of criminal activity, has been the subject of an intensive international legal/regulatory effort. Following the impetus and with the support of the G8, the United Nations, and the OECD, a growing institutional network with both multilateral and bilateral components has aggressively pursued an agenda of common regulatory standards, criminalisation, and institution-building, as well as co-operative investigative, prosecutorial and preventive techniques. Such is the degree of co-

¹ Methodological note

This report has been prepared with the use of four major information sources. First, an attempt has been made to draw from most major, relevant official studies and reports addressing money laundering and other financial crime – where possible with a regional focus. Second, academic research having clear policy implications has been consulted wherever possible. Third, current and archival news reports have been employed as background material where other reliable data is unavailable or in order to form a more complete picture. Finally, formal and informal interviews with officials and experts (while not directly referenced in the text) have supplemented other research materials.

ordination amongst leading international actors on this issue, that we may term these developments as the emergence of a global “regime” on action against money laundering.²

The existence of an international regime – by which is commonly understood a set of rules and principles, often articulated through international institutions, around which the expectations of state actors converge, at least partially independent of the interests of participating states – is controversial. Many observers of international law and politics are reluctant to see regime ‘outcomes’ as anything more than the direct consequence of the preferences of the most powerful state actors. From this standpoint, it might be argued that progress achieved to date on developing an international money laundering regime has depended entirely on the ability and willingness of the OECD nations to bring influence to bear on other states and jurisdictions. While there is considerable evidence to suggest that the regime has begun to have substantial independent effect on policy decisions affecting national sovereignty amongst G8, OECD, and even numerous Caribbean and Latin American states, these instances represent ‘easy cases’ in a test of the regime’s autonomy. The extent to which the regime has made inroads in these regions is not surprising when one considers the degree of ideological homogeneity and political influence of leading OECD states to be found there. Success in the Asia Pacific region, by contrast, will represent greater confirmation of the independent strength of the money-laundering regime as an autonomous institution. In that region, no single state or group of states exercises a dominant influence over decision-making and policy; in addition, there is greater political, cultural and economic heterogeneity in the Asia Pacific than in any other region of the world.

² The concept of is best introduced in Stephen D. Krasner, ed., *International Regimes*, Ithaca: Cornell University Press, 1983; subsequent debate remains divided over the question over the independent power of institutions in a world of anarchic states. See Robert O. Keohane, *After hegemony: co-operation and discord in the world political economy*, Princeton, N.J.: Princeton University Press, 1984; Mark W. Zacher, “Toward a theory of international regimes”, *Journal of International Affairs*, 44, Spring/Summer 1990, pp. 139-57; Keohane and Lisa L. Martin, “The promise of institutionalist theory”, *International Security*, 20, Summer 1995, pp. 39-5; Keohane, *International institutions and state power: essays in international relations theory*, Boulder: Westview Press, 1989; Keohane, “International institutions: can interdependence work?” *Foreign Policy*, no. 110, Spring 1998, pp. 82-96; Martin, “Interests, power, and multilateralism”, *International Organization*, 46, Autumn 1992, pp. 765-92; and for a recent refutation see John J. Mearsheimer, “The false promise of international institutions”, *International Security*, 19, Winter 1994-95, pp. 5-49. See also Susan Strange, “Cave! hic dragons: a critique of regime analysis”. *International Organization* 36, 2, Spring 1982; p. 487.

The heady optimism associated with the previously booming economies of the Asia Pacific region has given way during the recent 'Asian crisis' to concerns over economic instability and 'contagion'. Optimism concerning political reform, too, has been tempered, as moves towards democratisation in some regions have been counterbalanced by the further retrenchment of other regimes. Hopes that multilateral regional forums might act as vehicles for the liberalisation of trade and the spread of democratic, transparent institutions have suffered significant setbacks, as recent meetings and developments within APEC and ASEAN attest.³ Concern over the situation in the Asia Pacific is not limited to the areas of economic performance, human rights and diplomacy. Growing concerns over political and financial engagement in the region are often linked in turn to concerns over organised criminality, corruption and opaque financial dealing.

This study explores the social and economic impact of money laundering in the Asia Pacific. This question has both direct and indirect implications. In direct terms, money laundering is a set of practices which use the levers and institutions of the legal economy for an illegal end, which leads us to examine the degrading or corrupting effects that money laundering has in those *milieux* where it occurs. Indirectly, as money laundering is merely the manipulation of the financial end product of a broad compendium of crime, we must ask what the implications are for Asia Pacific societies, should the profit-taking activities of criminal organisations and individuals not be addressed. In the following pages, we argue that both these categories of effect are of significant concern with respect to the security and basic values of the region's population.

The case for the corrosive influence of money laundering is less readily apparent than that concerning the predicate criminal activities. High-profile drug cases, violent crimes associated with criminal organisations, and other sensational activities are the most tangible dangers associated with transnational criminality. However, it may prove that the greater threat to human security in the Asia Pacific lies in the indirect activities and effects associated with transnational crime, primarily in the financial realm. While attempts to date

³ 'Asian anger as reforms fail to arrive', *Electronic Telegraph*, Wednesday 9 September 1998 (<http://www.telegraph.co.uk>); Barbara J. McDougall, 'Why this APEC summit was such a bust', *The Globe and Mail*, November 27, 1998; 'Malaysian PM ridicules Chrétien on human rights', *The Globe and Mail*, November 16, 1998.

in the region addressing the issue reflect a high degree of effort and good faith, much more work is required. Money laundering leads directly to a number of negative consequences, and of course indirectly supports many others. On the other hand, there are good reasons to be optimistic about the creation of co-operative regional efforts against money laundering, despite the lack of a leading regional guarantor in the Asia Pacific. However, progress in addressing the problem in the Asia Pacific is contingent on the adoption of a strategy which recognises money laundering as embedded in a larger set of problematic national and international practices. Such progress will only be evident if matched by advances in institutional reform in the leading states of the Asia Pacific. Moreover, it will depend not simply on the actions of these states but on the commitment of capital exporting countries to support measures promoting good governance and the rule of law in the region. An Asia Pacific money laundering agenda only makes sense in the broader context of international action against financial crime and corruption.

1. Defining money laundering

Most organised crime activity is economic activity. The goal of the criminal is to use the proceeds of crime in the same manner as legal earnings, and this is possible as long as the source of the funds remains concealed. The task of the money launderer, therefore, is to make the proceeds of crime appear to be of legal origin, or of sufficiently obscure origin that any attempt to link those assets to criminal behaviour would be futile. In the context of developed states, it is generally understood that this task is accomplished through three basic steps: placement, layering and integration. The following paragraphs describe these activities, as they are currently understood.

Placement

The initial challenge for the money launderer is to place the profits from predicate criminal activity (i.e., original crimes such as drug sales or prostitution) into a bank or non-bank financial institution, in order to more easily manipulate the funds. In the familiar context of the drug trade, this will typically involve depositing or otherwise converting amounts of cash that would be unusually large by normal commercial standards. As placement of large sums of cash may trigger formal reporting mechanisms in many jurisdictions, elaborate means

may be employed at this stage to avoid detection. These may include the use of 'front' businesses such as bars, restaurants, or casinos that may reasonably claim to do business in cash. They may also involve the use of 'smurfing' techniques – numerous deposits of amounts small enough to avoid raising suspicion or triggering reporting mechanisms. Once the cash has been placed, it may then be moved with greater ease and less suspicion through the economy or if necessary offshore.

Layering

Once the money derived from criminal activity has been converted to a bank account balance or a financial instrument, the next step in laundering the funds is to 'layer' the money.⁴ The launderer seeks to insert layers of transactions between the original criminal activity and the seemingly legitimate re-emergence of the funds into the legal economy. This may be accomplished several ways, but the goal remains the same: to render the path of the funds and their ownership as opaque as possible. The most common means used here are well known. Money launderers favour jurisdictions whose financial institutions provide legally protected anonymous banking and/or who provide 'off-the-shelf' shell companies under conditions of anonymity. Other methods include the importing or exporting of non-existent products, the use of casinos or lotteries, and the purchase and resale of fixed assets or real estate. It is in this phase that the crime of laundering money becomes particularly transnational, as multiple jurisdictions are often used in further efforts to cloud the audit trail.

Integration

The goal of the placement and layering phases is to make it impossible to trace the funds to their original source. Once this condition has been achieved, the criminal assets may then be integrated into the legal economy. This may occur under the auspices of a company domiciled in the criminal's own jurisdiction, which conducts 'business' with offshore shell companies used in the layering process, or via returns on 'investments' in those companies. It may also take the form of loans with highly favourable or negligible terms of repayment, real estate investments, or other transactions, which will be unremarkable once the criminal has constructed a plausible legal commercial and business identity.

2. Regional Scope

The focus of this report is on East and Southeast Asia and the island states of the South Pacific. This grouping obviously brings together several distinct economic categories. It includes the large, heavily populated economies of East and Southeast Asia, the smaller economies of those same sub-regions, and the small states of the Pacific. Where relevant, reference will be made to the situation and/or experience of individual jurisdictions. However, as the goal of this report is to provide an overall view of problems common to a number of states or entire sub-regions, most analysis is developed in general terms.

The report excludes the distinct groupings of states in South Asia and in the territories of the former Soviet Union, as well as some states where information is either unavailable or unreliable (e.g. North Korea, Mongolia, Christmas Island). Selected developed states on the periphery of the region with an active engagement in the regional economy but with substantial extra-regional links (Australia, New Zealand, Japan, the United States and Canada) are included in the analysis where relevant, and for purposes of comparison.

Table 1: Jurisdictions covered in this report

East and Southeast Asia	Pacific Islands	Other Regional Actors
Brunei, Cambodia, PR China, Hongkong SAR, Indonesia, South Korea, Laos, Macao, Malaysia, Myanmar, Philippines, Singapore, Taiwan, Thailand, Vietnam	Cook Islands, Fiji, Kiribati Marshall Islands, Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tahiti, Tokelau Islands, Tonga, Tuvalu, Vanuatu	Australia, Canada, Japan, New Zealand, United States

⁴ A process sometimes referred to as 'structuring'.

3. Economic impact of money laundering: Asia Pacific

The scope of laundering activity

The United Nations has estimated that \$400 billion in criminal funds is laundered annually worldwide.⁵ By most accounts at least 50% of this figure comes from the drug trade. The drug trade in the Asia Pacific is a significant operation, involving the bulk of the world's heroin production, and other criminal activities such as prostitution, smuggling and corruption are also present to a significant degree in the region. However, there are few if any reliable overall statistics on money laundering for the developing states directly examined in this study. The IMF assumption of 2% of GDP is a reasonable 'rule of thumb' estimate of money laundered in any particular state, *ceteris paribus*.⁶ This estimate would suggest for 1996 that there approximately US \$500-\$600 billion was laundered annually worldwide, a figure somewhat higher than the UN estimate stated above.⁷ An estimate in an earlier study in this project, revised downwards to reflect the more conservative estimates from the United Nations – whose overall figures of money laundered globally were some 25% lower than IMF amounts – arrived at a final figure of approximately \$150 billion laundered annually in the region as the most conservative estimate possible. Of this figure perhaps one-half to two-thirds (i.e. \$75 to \$100 billion) may be associated with the drug trade, with other crimes accounting for the balance. This figure does not include sums from the 'grey areas' of criminal activity – public sector corruption, illegal activities involving the armed forces and other public agencies, and tax evasion. There is no reliable method of

⁵ See the United Nations *Crime Prevention and Criminal Justice Newsletter*, nos. 26 & 27, Vienna, November 1995.

⁶ The figure of 2% is the low end of the range of 2-5% of global GDP being the consensus amount of money laundered globally. This suggestion appears in *Money Laundering: the Importance of International Countermeasures*, Michel Camdessus, Managing Director of the International Monetary Fund, delivered at the plenary meeting of the FATF, Paris, February 10, 1998. This paper is available on-line at (www.imf.org/external/np/speeches/1998/021098.htm)

⁷ Global GNP (a figure distinct from GDP but sufficiently close to allow generalisation) was estimated by the World Bank in 1998 at \$US 29.5 trillion (i.e. \$29,510,000,000,000). For the states listed in Figure 1, the overall GNP for 1996 was \$15.8 trillion. See *World Development Indicators 1998*, The World Bank, Washington DC, 1998, table 1.1 ('Size of the economy'). Sections of *WDI 1998* are available online at (www.cdinet.com/DEC/wdi98/wdi/wdi.htm). Table 1.1 is available at (www.cdinet.com/DEC/wdi98/wdi/pdf/tab1_1.pdf).

estimating these sums, but it is enough to suggest that the predicate problems are of such magnitude that the sums involved require action regardless of their exact amount.⁸

Compromising the legal economy

While the direct effects of crime are palpable to the lay population in most states of the region, of greater long-term damage may be the juxtaposition of crime and corruption with the worlds of finance and public administration. Money laundering and corrupt practices within governing circles have been directly and publicly linked to poor financial performance in a number of leading economies.

It is important to note that money laundering (in essence no more than a set of financial transactions) is rarely intrinsically damaging to the society in which it occurs. Many of the world's leading money laundering centres – with some notable exceptions – would also rank extremely high on any index of quality of life, economic wealth and public security. Instead, there are two indirect reasons for examining the effect of money laundering on society.

First, as mentioned above, money laundering facilitates activities which are themselves intrinsically damaging: drug trafficking, corruption, embezzlement and tax evasion are but a few of these. Second, money-laundering activity is often correlated with a general lack of transparency in financial networks (and sometimes with a broader lack of public accountability). Money laundering generally occurs as a response to a 'market opportunity' or a 'loophole' and cannot be said in most cases to *create* this lack of transparency.

However, as a profitable activity in its own right, when matched with legal activities such as asset protection trusts and international shelf companies, money laundering increases economic incentives to prolong or extend opaque economic and political provisions.

In South Korea, a recent case involving allegations of money laundering at the highest level demonstrates the extent of damage a lack of financial transparency can inflict.⁹ In the last

⁸ For a more in-depth analysis of the sources of money laundering, see Allan Castle, *Money Laundering in the Asia Pacific: Asia Pacific Money Laundering Flows and Trends*, International Centre for Criminal Law Reform and Criminal Justice Policy: Vancouver, 1999.

⁹ "South Korean court sentences head of Hanbo group", *AAP Newsfeed*, April 20, 1998; "President's son Kim Hyon-chol arrested, imprisoned", BBC Summary of World Broadcasts, May 19, 1997, Monday (from *Yonhap* news agency, Seoul, 10:10 GMT, May 17th, 1997).

three years, a major corruption scandal involving the laundering of vast sums resulted in a severe blow to the credibility of the ruling regime, and contributed in part to the financial difficulties currently being endured in that state. The case led to the jailing of the head of a major financial conglomerate for embezzling 191.1 billion won of company funds and bribing politicians and former bank heads (including a cabinet minister and four MPs) in return for loans and favours. The principal figure had previously been jailed on charges of laundering a lush fund for former president Roh Tae-Woo. The scandal led to the arrest of former president Kim Young-Sam's son, Kim Hyon-chol, who was alleged to have received a total of 6.55 billion won (\$US 7.3 million) in bribes from six companies in return for influence-peddling, and was jailed for money-laundering offences under Korea's new 'real name' banking legislation. The broader implication of these events was their contribution to the collapse of the Hanbo group, the first collapse among South Korea's giant conglomerates. The combined weight of the financial collapses, attributed in large measure to similar (if less severe) abuses, ultimately forced South Korea to appeal to the International Monetary Fund for a loan of \$US 57 billion.

Money laundering, the concealment of the origins of illegally derived assets, can be relatively simply if practised in the context of a financial system which is susceptible to corrupt practises. Such a situation negates the need for 'placement' and layering, substituting wilful blindness of officials. In Japan, as an example, the crisis in the banking system over non-performing loans can be traced in part to the penetration of the banking sector by some of that country's largest criminal organisations – precipitated in turn by opaque and unaccountable dealing between high-ranking government officials and criminal bosses in the mid 1980s.¹⁰ A recent analysis¹¹ suggests the following chronology in this case:

- The seven *jusen* (housing loan) companies which failed in 1995 had a combined total of claims amounting to 13.2 trillion yen, at least half of which was lent to *yakuza* (organized crime) related companies between from 1984 onwards.

¹⁰ "The Yakuza and the Banks", *Business Week*, January 29, 1996.

¹¹ "Ministry of Finance and Yamaguchi Gumi", *Insider* newsletter, Tokyo, March 15, 1985.

- Stock and land speculation in the 1980s, led not only to the *yakuza's* overt presence in the economy but also to its generation of close ties with political and financial elites, and bureaucrats in the Ministry of Finance.
- The dip in the land market which accompanied the Japanese recession in the early 1990s led to a willingness on the part of banks and *jusen* to lend money to virtually anyone who wished to purchase land, including *yakuza*-related organizations.
- In 1985, the Japanese ministry of finance was attempting to address a series of scandals involving mutual financing banks, based in Kanto, in central Japan. Many of these institutions had been compromised through deals with locally based *yakuza*, and had incurred massive losses in failed stock and land speculation.
- Ministry officials are alleged (though not proven) to have exploited underworld connections underground connections of former officials and requested assistance from the leader of the *yamaguchi gomi*, the largest and most powerful organised crime syndicate in Japan. The *yamaguchi gomi* were asked to remove the influence of Kanto-based *yakuza* from the Kanto mutual financing banks."
- Exploiting this situation, the *yamaguchi gomi* subsequently expanded its business relationships with the banks' management with the consent of the Ministry. Further exploitation of this influence led to suspicions of *yakuza* influence in the lending policies of many of Japan's leading financial institutions.

Japan is of course not the only state affected by the nexus of crime and corruption, though its financial woes have been of the highest profile (and global significance). In China, public sector corruption and outright fraud is – according to official reports – rampant. In the first nine months of 1998, seventy thousand incidents of public sector corruption were investigated, many in the financial sector where misappropriation of public funds is a growing danger. The bad publicity surrounding the Japanese banks would almost certainly be outstripped by stories concerning Chinese financial institutions, were adequate mechanisms for regulating and examining China's financial system actually to exist. One major investment analysis report concluded in July 1998 that China exhibited a "lack of any coherent strategy for resolving the huge insolvency of state banks, which hold over 90% of

the system's assets."¹² South Korea, as well, has had its banking system under scrutiny for serious irregularities, though it is unlikely that the system has been as badly compromised through association with corrupt actors as the Japanese banking system has been.

The prospects for successful money laundering are enhanced in the context of a financial system that lacks transparency. One recent analysis of banking in Asia suggests that an appropriate definition of financial transparency is that of "fully revealing the true financial picture of a bank or firm" and ensuring that "reported financial data reflects reality".¹³

Examples of a lack of transparency in the financial sector include:

- Delays in financial reporting or the absence of quarterly and semi-annual updates
- Lax accounting practices, especially those relating to loss and impairment definitions of financial assets
- No consolidation of the financial results of related companies, and conversely, the lack of separate corporate entity financial statements
- Complex corporate structures, lack of clear ownership interests and hidden related party lending
- Continuing accrual of interest for problem loans
- Undisclosed derivatives activity, such as forward contracts
- Lack of independent outside auditors and audit committees
- Lack of timely information about material events when they occur and/or the poor distribution of information that is made public
- Restrictions on the freedom of independent third parties to voice opinions of financial issues¹⁴

Reasons why financial institutions would resist implementing provisions requiring transparency and accountability are varied, but would include:

¹² "The worst banking system in Asia", *The Economist*, May 2, 1998; *Asiaweek* website, "Newsmap: China, 1998" (www.pathfinder.com/asiaweek/current/issue/newsmap.china.html)

¹³ *Improving Transparency in Asian Banking Systems*, Jerome S. Fons, Moody's Investors Service, 1998.

¹⁴ Adapted from Fons, *ibid*

- The restriction of management’s ability to engage in ‘self dealing’. Loans to subsidiaries, politicians, family and friends, and other activities involving a conflict of interest between depositors and shareholders on the one hand and the personal interests of bank employees on the other, may be interpreted in a harsh light when subject to international scrutiny.
- The danger of revelation of speculative activities, such as high-risk stock market or real estate purchases.
- Engagement in inefficient or corrupt business activities. In many cultures, it is expected that a loan officer would receive a “gift” for making a loan to certain borrowers.¹⁵

The report concluded that most Asian banks “have played lip service to accounting transparency. Although many banks provide negligible detail and wholly implausible “headline” financial results, many have gone through the motions... [W]hile the banks may have followed the letter of the regulations when it came to classifying problem loans, they did not fulfil the spirit of the regulations... The true extent of problem loans at many Asian banks is still not officially recognised.”¹⁶

Money laundering as a facilitator of corruption

The process of money laundering is intrinsically linked to the problem of corruption. In states where there are legal or regulatory provisions against money laundering, corruption may serve as a means of ensuring that those provisions remain ineffective. Conversely, the proceeds of official corruption require concealment and integration into the legal economy in much the same manner as other criminal proceeds. There can, in short, be no effective action against money laundering without transparency, nor can there be much optimism regarding anti-corruption measures if money can be easily laundered.

The effects of public-sector corruption are numerous, and extremely corrosive to the economic and democratic well being of a number of states in the region. A recent IMF

¹⁵ Adapted from Fons, *ibid*

¹⁶ *Ibid*

study, attempting to quantify the costs of corruption using the Transparency International corruption index,¹⁷ drew a number of important conclusions in this regard:

- The amount of corruption is negatively linked to the level of investment and economic growth – the more corruption, the less investment and the less economic growth. An improvement of one standard deviation in the corruption index yields an investment rate increase of more than 4 percentage points and an increase in the annual growth rate of per capita GDP of over a half percentage point.
- Government spending on education as a ratio to GDP is negatively and significantly correlated with corruption (the more corruption, the less spent on education). Analysis also shows that if a country moves up the corruption index by one standard deviation, government spending on education increases by around a half a percent of GDP.
- An improvement in the corruption index may be associated with an increase in current expenditure as a ratio to GDP and with a decrease in capital expenditure. This suggests a degree of support for the belief that corruption leads to high capital expenditure on unnecessary “white elephant” projects.
- Evidence is fairly robust that corruption lowers total (public and private) investment. While no clear relationship has been found between corruption and public investment, a possible explanation of this finding is that predatory behaviour by corrupt governments may help sustain the level (though perhaps not the quality) of public investment as a ratio to GDP, even as private investment declines.¹⁸

It is unnecessary to proclaim corruption to be either a negative social or an economic consequence of money laundering, as it is obviously both. What is clear is that in all but the most venal societies, corrupt practices require the laundering of funds in such a manner as to preserve the appearance of propriety. In states with a well-established democratic tradition, such as South Korea and Japan, revelations of widespread corruption and the

¹⁷ See the *Transparency International 1998 Corruption Perceptions Index*, Transparency International, 1998. The TI index is a compilation of expert impressions concerning corruption in a selection of nation-states, using an amalgam of several separate indices to arrive at an annual Index. Though indicative of general national characteristics and exhibiting results which may be intuitive to many readers, its methodology and broad scope suggest that caution be applied in interpreting the significance of the numerical rankings -- available at (www.gwdg.de/~uwwv/1998.html).

laundering of associated funds in the highest financial and political circles have been the source of acute political embarrassment for the governments of the day. Thus, paradoxically, money laundering is a necessary activity only in those societies that have established a degree of moral and legal sanction against such activity and the predicate crimes that generate the illegal funds. It is to the credit of these states that such activities necessitate a political and legal response. In other states of the region, public oversight and state accountability is sometimes insufficiently developed to render the laundering of the proceeds of crime and corruption a significant policy issue.

¹⁸ List adapted with modifications from Paolo Mauro, *Why Worry About Corruption?* Economic Issues papers No. 6, International Monetary Fund: Washington, D.C. 1997.

4. Social impact of money laundering: Asia Pacific

Money laundering as the underpinning of transnational crime

The obvious context for action against money laundering is its relationship to criminal activities. Without some ability to conceal the proceeds of crime from the eyes of the authorities, few criminal activities would retain their economic allure. Criminal behaviour, whether of organisations, corrupt officialdom, or private citizens, is a substantial and growing public policy problem in most, if not all, of the major states of the region.

It has become a truism to state that organised crime is now of necessity transnational crime. The necessity of escaping official scrutiny in an era of increasing police and regulatory concern over organised crime has led to the routine exploitation of loopholes or insufficient oversight in foreign jurisdictions. This extra-territorial activity may be intended to facilitate a crime such as organised prostitution or paedophilia, or the resale of stolen autos, or it may be to launder the profits from criminal activities in conditions of greater anonymity. Ease of travel and communication has made these movements more possible.

But is all transnational crime organised crime? Despite the frequency with which the phrase 'transnational organised crime' is used in United Nations documentation and other fora, many criminal activities involving multiple jurisdictions are not 'organised' in a meaningful way, but are nonetheless of considerable significance. Chief amongst these is tax evasion. It is true that criminal organisations avoid taxation, primarily for the reason that the source of revenue itself is illegal. But individuals whose public profile is far less dramatic than that of a Mafia 'don' also practise tax evasion to a great degree. In the United States, an estimated 15% of personal taxable income goes unreported, and this figure is probably lower than the rates of evasion in most other OECD states.¹⁹ These funds are usually concealed through the use of offshore financial centres and other money-laundering techniques familiar to drug traffickers and other more high-profile criminals. Other individual crimes (typically, crimes of opportunity) which are nonetheless both transnational and of considerable significance when considered in aggregate include a catalogue of frauds,

¹⁹ See "Disappearing taxes: the tap runs dry", *The Economist*, May 31st 1997, pp. 21-23.

such as insider trading, credit card fraud, and various banking frauds (as highlighted spectacularly in 1995 by Nick Leeson of Barings Bank's Singapore operations).²⁰

It may in fact be a red herring to focus on organised criminal groups, who have nevertheless drawn much of the early attention in writing on this subject from an international relations perspective. Predictions of threats posed by a 'global Mafia' threaten to lead us down a road of interminable examination of 'actors' who may in fact distract us from the broader danger of systemic individual-level abuse.²¹ At present, it is sufficient to drop the 'organised', as it would seem to unreasonably narrow (and possibly misdirect) our focus.

'Negative globalisation' and societal integration with transnational crime

International criminal linkages have existed for some time. Through migration, ethnically based criminal groups from Europe, Asia and Latin America had been operating across a variety of national jurisdictions throughout the 20th century. During the period of Prohibition, US criminal organisations began to exploit variance in national legal standards, supplying their own illegal alcohol distributors with drink smuggled from Canada and Mexico. In the 1950s, the boom in Cuban gambling operations reflected the American mob's attempts to escape the rudimentary but growing scrutiny of personal finances enjoyed by the US government. Similarly, jurisdictions such as Switzerland and Monaco, whose tax haven status grew with the expansion of the welfare state in the developed world in the 1950s and 1960s, also found their secretive banking laws attracting criminal assets seeking anonymity.

Further impetus towards internationalisation came with increases in the demand for illegal drugs in the developed world, accompanied by an equivalent increase in revenue for traffickers. Combined with increasing difficulty in concealing the origins of that revenue, this series of developments placed pressure on criminal actors to exploit variance in national

²⁰ "Barings 'sent millions to finance bogus client'", *Electronic Telegraph*, March 2nd, 1995 (<http://www.telegraph.co.uk>)

²¹ See, e.g., Claire Sterling, *Thieves World* (New York, 1994). A critical review of the hyperbole found in the early literature on transnational crime can be found in R.T. Naylor, "From Cold War to Crime War: The Search for a New 'National Security Threat'", *Transnational Organized Crime*, vol. 1 no. 4, Winter 1995, pp. 37-56. Naylor argues that poorly-developed paranoid models of Russian-inspired criminal networks, a holdover from hawkish Cold War analyses of terrorism, have been warmed over by Sterling and others to "the applause of the remains of the Cold War establishment."

legislative and regulatory codes, in order to maintain a shield of secrecy over their financial operations. Earlier criminal actors had exploited Switzerland and Havana to launder their funds and escape the scrutiny of investigators. Similarly, those involved in drug trafficking in the 1970s and 1980s sought to move their money quickly from the point of sale (typically, the United States and Western Europe) to offshore locations willing to provide conditions of anonymity in financial transactions. The 'transnational' effects of these changes in the drug trade were thus not limited to the increased movement of drugs over borders, but to the increasing exploitation of international financial markets.

These changes in the drug economy were augmented by the same set of technological innovations that have reduced transaction costs associated with commercial activity in most industries, legal or illegal. The basic elements of 'globalisation' – improvements in speed and access factors for transportation, step-level improvements in ease of communication, the lowering of tariff barriers, removal of restrictions on the flow of currency, and other homogenising developments – have aided illegal business no more or less than legal business. The United Nations has singled out ten categories of crime for particular attention in its recent deliberations on these matters, from trafficking in drugs to alien smuggling to money laundering.²² All, it may be argued, have flourished (or even been created) by the increased ability to move people, goods, assets & ideas across boundaries and the surface of the globe at high speed. Thus the vulnerability of women and children in Thailand and the Philippines can mushroom into the market for sex tourism, due in large measure to the ease of air travel and greater communication of 'product' availability.²³

In a number of the second-rank economies of the region, corruption and criminality have an even greater hold. In Indonesia, the full ramifications and political fall-out from the corrupt practices of the Suharto regime in the allocation of contracts and the lending of

²² The full list is as follows: trafficking in narcotic drugs and psychotropic substances; trafficking in conventional arms; trafficking in nuclear materials; trafficking in women and children; smuggling of illegal aliens; large-scale car theft; trafficking in body parts; money-laundering; tax evasion; and corruption. See "Problems and Dangers Posed by Organized Transnational Crime in the Various Regions of the World", a background paper developed for the Naples Ministerial Conference of November 1994, reproduced in Phil Williams and Ernesto Savona, eds., *The United Nations and Transnational Organized Crime*, a special issue of *Transnational Organized Crime*, vol. 1, no. 3, Autumn 1995.

²³ For a web-only published account (of unusually high quality) of this trade, see Youngik Yoon, "International Sexual Slavery", at <http://www.alternatives.com/crime/PART7.HTML>.

public monies remains to be felt. Reports indicate \$100 million of public funds in that state can be proven to have been diverted to European accounts and investments over two decades by elite members. However, it is likely that between \$4 billion and \$30 billion more was laundered and presented as ostensibly legal private holdings inside the country.²⁴ On a broader societal basis, Indonesia joins Malaysia, the Philippines and Thailand in the judgement of the International Labour Organisation that in each of these countries, the sex industry accounts directly and indirectly for between 2% and 14% of GDP.²⁵

Some of these crimes occur in an obviously domestic context, while others seem to have clear transnational aspects. But all ultimately have transnational implications. For these as for other criminal acts in other parts of the world, it is necessary for those responsible to conceal the proceeds of their activities and reintroduce them in seemingly legal form for subsequent use, often in outside jurisdictions. Of equal concern to the 'predicate' crimes listed above, therefore, is the slow pace of change in regulatory and legislative governance of financial markets, given the degree of corrupt and criminal abuse at multiple levels within these political units. Where legislation covering money laundering does exist, it is often woefully inadequate for purposes of successful prosecution; nor are successful prosecutions likely in large economies with rudimentary detection mechanisms for abuse. In Thailand, one of the countries in the region most dedicated to legal reforms, efforts to introduce legislation covering money laundering only passed this year after being significantly watered down. In China, similar legislation was introduced but stands no chance of successful implementation until further measures are implemented in the development of an investigative branch of the national police force or finance ministry capable of successfully identifying the activity in question.

Further evidence of the integrating 'function' that money laundering performs in linking different areas of the global economy with criminal activity can be seen in the offshore

²⁴ See "President promises probe within days", *Deutsche Presse-Agentur*, September 15, 1998. Forbes magazine lists Suharto as the world's sixth wealthiest person, with his family fortune estimated at more than \$ 30 billion: the average annual Gross Domestic Product (GDP) of Bangladesh and more than twice that of Sri Lanka. See "Asian bank plans crack down on corruption", *Inter Press Service*, July 20, 1998 (accessed on Lexis-Nexis ALLSI, March 5 1999).

²⁵ *Asiaweek* website, "Newsmag: Indonesia, 1998" (www.pathfinder.com/asiaweek/current/issue/newsmag.indonesia.html)

sectors of East and Southeast Asia and the South Pacific. Described more fully elsewhere, offshore activity refers to the financial services sector catering to non-residents in those jurisdictions offering low taxation rates, relative ease of legal residency, and very often a higher degree of anonymity in financial transactions than is found in many developed states. The more established financial centres of East and Southeast Asia have long been utilised for laundering activities due to the sheer size and historical under-regulation of their financial markets. An additional reason for the exploitation of these centres has been their proximity to major centres of criminal activity. More recently, similar activities have emerged in a number of island states in the South Pacific, with the emergence of money laundering activities involving criminal funds originating in the former Soviet Union.²⁶

Transnational crime and money laundering: the danger of xenophobia

In the study of transnational crime and money laundering in the Asia Pacific, the danger of coming to xenophobic conclusions is all too real in a multi-ethnic, highly populous region such as the Asia Pacific. Like the legal economy, criminal economic activity linking different areas of the regional economy (for instance, Asia and North America) has grown in tandem with the opportunities presented by patterns of migration, IT innovation, and political-economic 'openings'.

While resisting characterisations of a 'crime wave', it is important to acknowledge that increasing integration across the Asia Pacific has provided most people in the region with more direct contact with all aspects of regional economic life, crime included. One unfortunate aspect of this phenomenon is the natural tendency of any particular domestic society to blame foreign actors or groups to a disproportionate extent. As an example of this, a recent official report on organised crime in Canada gives pride of place to the dangers posed by Asian criminal groups. The report notes that 'Asian signature crimes' include "home invasion robberies, gang conflicts, assault, murder, extortion, fraud, credit card scams, drug importation and trafficking, shoplifting, gaming offences, counterfeiting and smuggling offences."²⁷

²⁶ *Agence France Presse* March 02, 1999: 'Pacific republic orders tax review amid Russian mafia charges'

²⁷ *CISC Annual Report 1998*, pp. 3-7.

In short, beyond their dominant position in the heroin and human smuggling trades, Asian groups are also identified in the report as linked to almost every major and minor organised criminal activity in the country. We may leave aside the question of the utility of 'Asian' as a collective descriptor (and whether 'signature crimes' such as shoplifting and murder might in fact be distributed evenly across the cultural mosaic). The message of the report concerning these actors is clear: the arrival of Asian criminal groups is a significant and negative development for social order. The remainder of the report is dominated by similar accounts of ethnically based groups with significant ties to foreign criminal organisations. Similarly, other media reports in the same jurisdiction have focused regularly on the threats to public order posed by foreign members of criminal organisations (typically Asian or Russian), reporting on the crimes noted above as well as on the problems encountered in preventing foreign criminals from gaining initial entry.²⁸

The weight of opinion subscribing to this view would seem to suggest that the threat to regional security posed by Asian organised crime is patently obvious, and that moreover it is a threat which exists on the streets of Canadian cities. However, catastrophic media predictions of a crime wave linked to transnational criminal organisations are unsupported by Canadian crime statistics, which show crime rates peaking in the early 1990s (according to three different measures). This evidence, if somewhat broad, is nonetheless compelling. Crime rates, having risen consistently over three decades, have fallen in the case of both violent and property-related offences since 1991-92. These trends have continued, with declines in the overall national rates of violent crime, property crime, and other crimes from 1996 to 1997, the most recent year for which data is available.²⁹ British Columbia, the province often suggested as being most vulnerable to the effects of Asian gang activity, in fact saw its murder rate drop to a five-year low in 1997.³⁰

²⁸ See "Canada braces for Eastern European mafia flood", *The Globe and Mail*, November 30, 1998, p A3; "Canada shuts the door on criminals: Russian mobsters and Triad members barred from country", *National Post*, November 21, 1998, p. A1; "From bikers to actors, Immigration says they're not welcome", *National Post*, November 21, 1998.

²⁹ As summarised in tabular form, "Crimes by type of offence", Statistics Canada website, www.StatCan.CA/english/Pgdb/State/Justice/legal02.htm.

³⁰ See Statistics Canada website, "Homicide offences, number and rate" (www.statcan.ca:80/english/Pgdb/State/Justice/legal12b.htm)

To avoid lapsing into depictions of a 'foreign menace', it is important to maintain perspective in two areas. First of all, the 'newsworthy' events associated with transnational criminal activity must be viewed with a degree of informed scepticism. Secondly, while transnational criminal activity and financial crime is not necessarily the exclusive preserve of criminal groups, such as the Japanese *Yakuza*, Chinese Triads, or Vietnamese gangs, the existence of these actors represents a simple explanation of criminal activity for public consumption. More often than not, these actors can be portrayed as negative influences operating from a foreign jurisdiction or alien immigrant culture. The reality, which may involve the actions of individual citizens, government officials, financial institutions with ostensibly good reputations, and the 'grey areas' of state, military or private sector corruption, is often less easy to package. This is the case for experts and lay observers alike.

5. Conclusion

The opaque environment: tackling money laundering in the Asia Pacific

The growth of the Asia Pacific economies, spurred by globalisation and matched by the growth of corrupt and criminal economic practices, has left vital regulatory capacity trailing. The scarce or non-existent capacity of the leading regimes in the Asia Pacific to identify, confront, and regulate against crime and corruption, in society generally but most specifically in financial markets, is as much of a threat as the activities of criminal groups themselves.

The recurring themes of the implication of state officials in corrupt schemes, of the penetration of key areas of the economy by criminal actors, and of the uneven ability of the authorities in a number of jurisdictions to adequately address criminal activities, suggest that optimism regarding the democratisation of the region may indeed be misplaced. At a minimum, these developments suggest that economic revival must be accompanied by transparency and accountability in financial markets and in government – which in turn requires concerted institution-building – if long-term security from these ills is to be achieved.

To fail in this regard, as these states and those foreign actors engaged in the region are now failing, is to raise the spectre of instability and the possibility of increasingly authoritarian solutions to domestic crises. To date, those states attracting most attention due to attacks on the rule of law by criminal actors have been from outside the Asia Pacific – notably, Colombia and the states of the former Soviet Union. However, these are not the only jurisdictions where progress towards liberalisation may be threatened by criminality and corruption. The Asia Pacific is in chronic need of efforts to increase transparency and accountability in the regional economy, measures central to the continuance of democratisation, the expansion of the rule of law, and the spread of social and economic justice in the region.

The analysis presented so far points to several ingredients needed to advance the entrenchment of the international anti-money laundering regime in the Asia Pacific. These are to enlist the support of operational-level personnel in the jurisdictions affected, to have the governments of those jurisdictions accept the need for greater transparency and oversight of their economies, and to acknowledge at the international level that crime and corruption are intrinsically questions of development. Each of these factors rests on a foundation of political will, without which their realisation would be impossible.

The first problem will be in creating operational-level support for participation in the anti-money laundering regime. Investigating officers, prosecutors, judges, bankers, banking regulators and others involved in a nation's international affairs must see it in their interests to be part of this international mechanism. Winning the support of these personnel, who are most often working at the mid-level of their institutions, can be essential to the momentum of a regime's entrenchment. In fact, this kind of operational support might push other and higher-level support in situations where there are conflicting national interests at stake (as is usually the case in this area, and always the case where corruption and the attraction of flight-capital are in play). There may be a natural impetus in this direction in states that are undergoing a process of transformation in the direction of a market economy, to the extent that the self-interest of regulators ideally becomes somewhat autonomous vis-à-vis the financial and political elite. Nonetheless, part of the commitment that has to be shown by development banks, aid programmes and intergovernmental

organisations is in this area. Technical assistance can be crucial in building international allegiances in national personnel. Training programmes, awareness raising as to international standards, assistance in implementing co-operative procedures and, importantly, provision of the infrastructure necessary co-ordinate internationally, all have significant long-term potential in this regard. The FATF has expressed a willingness to co-ordinate and in some cases provide training, and various agencies of the United States government have been doing so recently.³¹

Acceptance of transparency in the police, in government and particularly in the economy is the second important factor determining the success of the anti-money laundering regime in the Asia Pacific. This includes curtailing bank secrecy, but means also much more than this. It means enforcing the 'know your customer', recording and reporting requirements across the full range of institutions and technologies, as recommended by the FATF. It means, significantly, moving over time towards the sort of supervision of financial institutions (including second-tier institutions) that has been the subject of ongoing Basle Committee regulation.³² The sort of transparency needed is that which consists of an institutional system of checks and balances safeguarding prudential standards and consumer interests, without being subject to overwhelming criminal influences. Such transparency and supervision seek to ensure that markets are not distorted to the detriment of society as a whole by corrupt practices, incompetent management or similar phenomena. International approaches to dealing with corruption take into account the need for such supervision.³³ More importantly, recent statements by the G8 and by international lending institutions in

³¹ See FATF factsheet, "Anti-money laundering efforts in the Asia/Pacific region"; INCSR 1997.

³² The Committee released its *Core Principles for Effective Banking Supervision* in September 1997, inviting non-member countries to endorse them by October 1998. The Principles were elaborated in close collaboration with supervisory authorities in 15 non-member emerging market economies, and in consultation with a number of other non-member states. See Duncan E. Alford, "Basle Committee minimum standards: International regulatory response to the failure of BCCI" *George Washington Journal of International Law & Economics*, v. 26 p. 241, 1992. The Committee has been increasing its international influence by involving non-member nations and international organisations in its work, and the G7 Heads of Government has welcomed these efforts. As such, the Committee appears set to play a role complementary to that of the FATF in establishing conditions within which money laundering becomes increasingly difficult.

³³ The General Assembly resolution on 'International co-operation against corruption and bribery in international commercial transactions' refers to the need for "transparent and accountable government": GA Res. 52/87 (2 February 1998), ¶3. Similarly statements are made in the *United Nations Declaration Against Corruption and Bribery in International Commercial Transactions*, Annex to GA Res. 51/191 (21 February 1997), preambular ¶1 ("stable and transparent environment ") and GA Res. 51/59 (28 January 1997), ¶7 ("transparency and integrity of financial systems").

the wake of the Asian economic crisis have made a link between corrupt and distorting practices and that crisis.³⁴ The result has been commitment by Asia-Pacific governments to move in the direction of increased accountability in their economies.³⁵ If the commitment to scrutiny and balance is a sustained one, we might expect the emergence of an institutional culture that will make the entrenchment of counter-money laundering measures, and then the detection of laundering itself, increasingly possible. After all, the institutional climate in a culture of endemic corruption has to be characterised by opacity and resistance to accountability. Change one, and the other can follow, provided the political will and the resources are made available. The resources, in this case, include those provided by donor governments and international institutions for infrastructure, training and other technical assistance.

This latter point directs us to the third factor and final factor, that of the need for acknowledging crime and corruption as *developmental* and not just compliance or 'law and order' issues. This question is the broadest, and takes us well beyond what criminal or even regulatory law can deal with. It is obvious that questions of criminal economies (in particular, drugs) and official corruption are ultimately questions of development in the sense that they involve questions of the macro-management of the economic and political system to reduce the incentives that create these phenomena.³⁶ On an economic level, participants in illegal economies must be given adequate incentives to switch to other, licit activities.³⁷ Threat of criminal sanction is only one factor, and it will never be the most important. As British criminologist Michael Levi remarks, "to catch some offenders – even

³⁴ "G8 Birmingham Summit: Final Communiqué", on-line at www.birmingham.g8summit.gov.uk/docs/final.pdf.

³⁵ The *Joint Press Statement* of the Second ASEAN Finance Ministers Meeting of February, 1998 makes a commitment to proceed immediately with an ASEAN Surveillance Mechanism and the establishment of a Surveillance Secretariat. It also endorses the Basle Committee Core Principles: *Joint Ministerial Statement*, APEC Finance Ministers Meeting (Kananaskis, Alberta, Canada, May 23-24, 1998), ¶6.

³⁶ The developmental question is also one quite apart from those asking whether and which drugs should be dealt with by the criminal law, and which by other forms of regulation.

³⁷ This point was recently made by Pino Arlacchi, Executive Director of the UN Office for Drug Control and Crime Prevention, in a statement to the Commission for Social Development. He pointed out that such incentives come from the active support of donor countries for alternative development programs: "Economic alternatives to illicit drug cultivation, trafficking must be created, head of UN Drug Control Office tells Social Development Commission", UN Doc. SOC/4440, 18 February 1998. The point needs to be made, as such programs are declining: José Bengoa (Special Rapporteur), *The relationship between the enjoyment of human rights, in particular economic, social and cultural rights, and income distribution* (Final Report), UN Doc. E/CN.4/Sub.2/1997/9, 30 June 1997, ¶¶49-53.

major ones – is not necessarily to reduce crime and vice: the latter depend on the organisation of the criminal markets and upon the willingness and capacity of new or existing offenders to enter them.”³⁸

It can confidently be said that to convict or deter drug traffickers is not necessarily to reduce drug trafficking to the same extent. Nor will the imposition of regulations on financial institutions necessarily stem the flow of illicit funds (given the likely ability of new technologies and human ingenuity to keep ahead of the regulators). We are dealing with structural phenomena, depending on the existence of markets that provide attractive alternatives to whatever a given country calls licit economic activity. This is more than a question of directing more resources to finding viable alternative crops for Golden Triangle farmers (who are often also members of marginalised indigenous groups) or increasing opportunities for the underclass in Western societies to live fulfilled lives without pharmaceutical supplementation. It is a question of providing incentives to officials in Asia Pacific jurisdictions to keep out of illegal profit-making sidelines, to immersing them in a legal culture that rewards professionalism and protects whistle-blowers.

These are not easily achieved goals. The low-level corruption that everywhere greases the wheels of the drug economy is partly the product of an underpaid civil service. This in itself is but one sign of the inability of much of the world to direct adequate resources towards developing its own society, owing in part to contemporary economic relations and to historical influences, including those of colonialism. Hemming officials in with a web of laws will not be enough. Rather, the systemic factors supporting corruption must be addressed. Thus, the ability of an anti-money laundering regime in the Asia Pacific to rise to some level of adequacy in relation to the phenomena it addresses will ultimately only occur against a backdrop of development towards increasingly ‘good governance’. Movement towards political and regulatory forms to match increasing economic freedom must be supported on a long-term and substantial basis. Whether such support will be forthcoming, either on the part of the governments of the jurisdictions in question or on that of donor or investor countries, remains to be seen.

³⁸ M. Levi, “Regulating money laundering: the death of bank secrecy in the UK” (1991) 31 *British Journal of Criminology* 109 at 123.

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