

Anti- Money Laundering Policy and Containment Policy

RASHMI RAGHAV

Teacher

Abstract

The present paper deals with the Anti-Money Laundering policy. The major discussion revolves around the central argument of the essay which sustains that the containment hypothesis not necessarily be an excuse of a failed Anti –Money Laundering policy (AML). ‘Containment hypothesis is the hypothesis that, in the absence of law enforcement efforts, the illicit drug industry would be larger than at present, and that therefore its size and growth have been at least partially controlled by law enforcement’ (Windle and Farrell, 2012, p.875). The essay has tried to apply the hypothesis to the money laundering domain.

Keywords: Money Laundering, Anti-Money Laundering policy, Containment hypothesis.

INTRODUCTION

‘Containment hypothesis is the hypothesis that, in the absence of law enforcement efforts, the illicit drug industry would be larger than at present, and that therefore its size and growth have been at least partially controlled by law enforcement’ (Windle and Farrell, 2012, p.875).

The containment hypothesis narrated above has been in the backdrop of illicit drug industry. However, this paper has endeavoured to apply the same elements of containment hypothesis to the ambit of money laundering and therefore would study the containment hypothesis in the area of Anti Money Laundering (AML) policy.

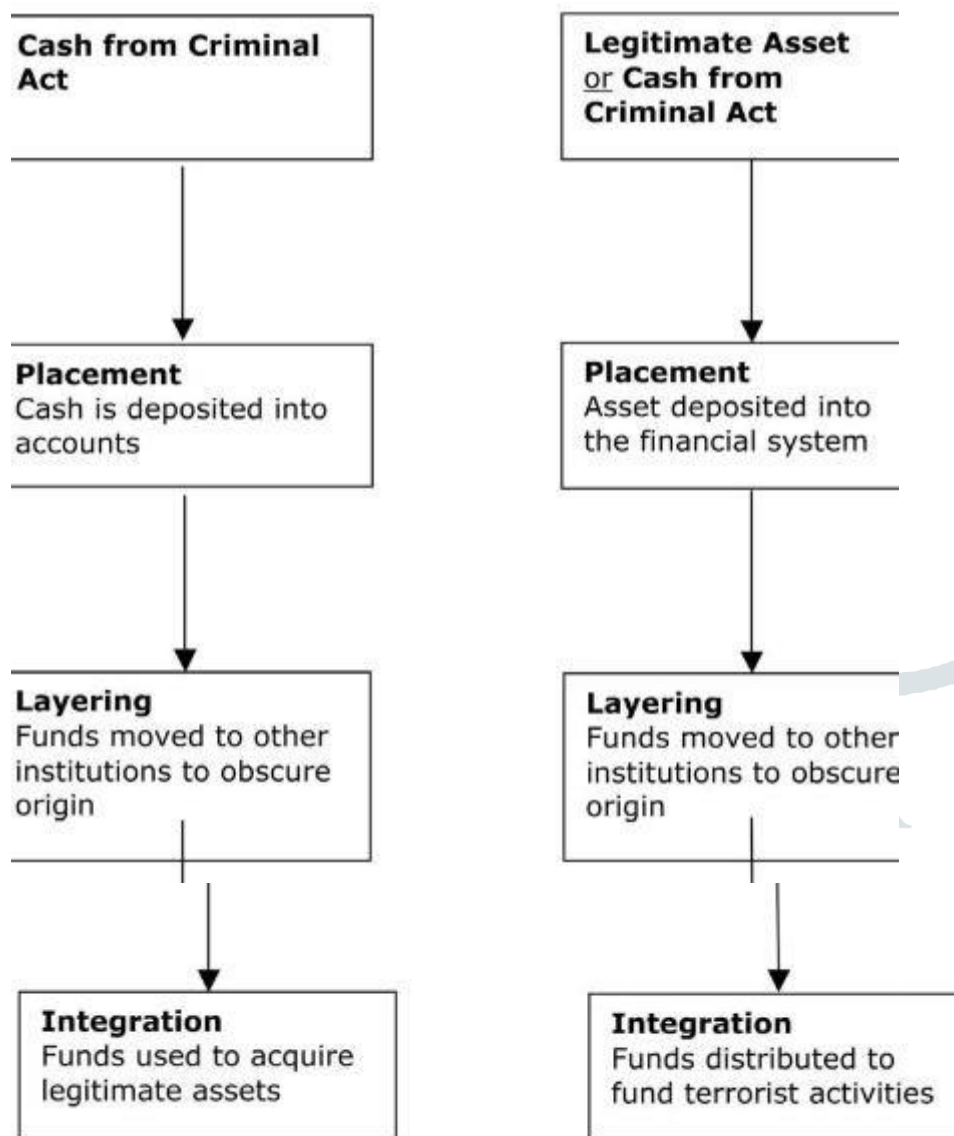
Money Laundering is the process by which the proceeds of criminal are converted into the legitimized gains so as to disguise the actual illegal origin. Money Laundering has been a major concern of the post 9/11 era. Curbing Money Laundering has a new dimension of Combating Financing of Terrorism (CFT). Various measures have been taken from time to time to fight this menace. The Anti-Money Laundering Policy like any other policies has been criticised by scholars and researchers. How effective is the policy has been of a great debate in international community. Unger (2009) stated that little is known about the effect of the policy. However, the present paper would argue that containment hypothesis not necessarily be an excuse for the failed AML policy.

For this purpose, the essay has been divided into three parts. In the first part a background of money laundering has been described so as to understand the nature and mechanism of the act itself. Further the paper has tried to capture the glimpse of various measures taken to curb the money laundering so as to have insight of the complexity of the AML policy. The second part of the essay deals with the notion of the effectiveness of the AML policy. It has tried to analyse the effectiveness of the policy and identified nuances of the policy itself. In an attempt to argue that containment hypothesis is not always an excuse of failed policy, elements of deflection and benefit of diffusion have been identified. In addition to this the changing face of money laundering in the globalized world has also been portrayed. In the third part of the essay the Economic Approach of Crime Theory (Becker, 1968; Ferwerda, 2009) has been studied to understand the framework of containment hypothesis in the AML Policy. The theory when applied to the arena of money laundering has able to convince that AML policy reduces crime and hence supports the larger argument i.e. containment hypothesis not necessarily be an excuse of failed AML policy.

MONEY LAUNDERING: A BACKGROUND

The process by which the nexus of the money and the original criminal activity is disguised is known as the Money Laundering (IMF, 2012). In other words this is the process by which so called 'dirty' money is turned into 'clean' money. In its Fourty Recommendations for fighting money laundering FATF particularly incorporated the technical and legal definitions of money laundering which was framed out in the Vienna and Palermo Conventions .It also identified the twenty designated categories of offences which must be integrated as predicate offences for money laundering. The act of money laundering involves three essential levels. In the initial level which is called as placement, the launderer puts his dirty or criminal proceeds into the financial market. The act could be carried out by chunking up large amounts of cash into petty sum that are then deposited straight away into a bank account. It could also be invested by purchasing assets like cheque money orders and so on. Which in turn are then collected and deposited into accounts at another location. After the assets have entered the market, the second stage of money laundering which is called layering takes place. At this level launderer gets into a series of conversions or the assets in order to keep away them from their source. The funds might be channelized through the buying and selling of investment instruments. The launderer might causally wire the assets through a series of accounts at various banks internationally. This use of largely chunked accounts for laundering is significantly prevail to those jurisdictions that do not co-operate in anti-money laundering investigations. At some point the launderer might display the transfers as payments for goods or services in order to give them a legitimate appearance. On completion of these two stages successfully launderer then gets to the third stage which is known as integration in which the funds re-enter the legitimate economy. The launderer might choose to invest the funds into real estate, luxury assets, or business ventures. (FATF, 2012)

Levi and Reuter (2006, p. 313) gave the flow chart of the mechanism of Money laundering with the element of Financing of Terrorism. Money Laundering Financing of Terrorism



United Nations has recognized four major perils of money laundering which is as bad for business, bad for development, bad for the economy, and bad for the rule of law. It was 1986 that money laundering became a criminal offence in the US by introduction of the Money Laundering Control Act 1986. It got global attention as a result of the international community's effort to counteract the illegal drugs trade in the 1980s and the establishment of the Financial Action Task Force (FATF) in 1989 (Ryder, 2008).

Prior to 1986 money laundering was not considered as a crime anywhere in the world. But as of the present scenario over 170 states have criminalized the act, and most of these have set up specific agencies to fight it. Until the late 1990s, money laundering was largely the concern of the developed world. The FATF worked to diffuse AML. But a narrative that emphasized the system was only as strong as the weakest link in the chain that criminals would simply avoid countries with tough AML standard by re-routing their finances through countries that had no such laws, created pressure for change. The goal became to include every country in the coverage of AML laws. To this end, the FATF worked compiling a blacklist of countries that were regarded as facilitating money laundering through weak laws and/or enforcement. At around the same time, and with the assistance of the Bretton Woods institutions, a slew of regional bodies were created to ensure the spread of AML policies to every part of the globe. There is now one body each for the Caribbean, South America, the Middle East and North Africa, Western Europe, Eurasia, the Asia-Pacific, South and

East Africa, and West Africa. Each of these organizations, significantly known as FATF-Style Regional Bodies has the core aim of diffusing the same 40+9 Recommendation money laundering policy. (Sharman, 2008)

From then several measures have been undertaken by various institutions FATF, United Nations, IMF and World Bank to fight money laundering. Anti- Money Laundering (AML) Regime comprises of two pillars, prevention and enforcement. Prevention involves sanctions, regulation and supervision, reporting and customer due diligence while enforcement is about confiscation, prosecution and punishment and investigations. It has regional, national and global features. Thus, it is a complex combination of different policies and aspects. Ever since the policy community charged on targeting money laundering in the 1980s, official explanations of these concern have focused on political preoccupation with regards to the crimes that can ultimately direct to money laundering. Public officials have presented the AML regime as a way of combating the drugs trade, the arms trade, people trafficking and other organised crime activities, maintaining the integrity of the financial system, including taking sides good governance and transparency, fighting corruption and its economic and political after- effect, helping economic development and making sure that funds are channelled to suitable economic endeavours and allowing for ample levels of tax revenue and targeting the financing of terrorist activities. 11th September transformed the face of money laundering. It was no longer seen as just the laundering of criminal proceeds, much of which came from the illegal drug trade, but as the means by which terrorists hide their revenue generating processes and gain access to their funds Jackie Johnson (2002).

Terrorists and terrorist organizations also rely on money to sustain themselves and to carry out terrorist acts. Money for terrorists is derived from a wide variety of sources. While terrorists are not greatly concerned with disguising the origin of money, they are concerned with concealing its destination and the purpose for which it has been collected. Terrorists and terrorist organizations therefore employ techniques similar to those used by money launderers to hide their money. The techniques used to launder money are essentially the same as those used to conceal the sources of, and uses for, terrorist financing. Funds used to support terrorism may originate from legitimate sources, criminal activities, or both. Nonetheless, disguising the source of terrorist financing, regardless of whether the source is of legitimate or illicit origin, is important. If the source can be concealed, it remains available for future terrorist financing activities. Similarly it is important for terrorists to conceal the use of the funds so that the financing activity goes undetected. For these reasons, FATF has recommended that each country criminalize the financing of terrorism, terrorist acts and terrorist organizations, and designate such offenses as money laundering predicate offenses. Finally, FATF has stated that the eight *Special Recommendations* combined with *The Forty Recommendations* on money laundering constitute the basic framework for preventing, detecting and suppressing both money laundering and terrorist financing.

Various measures have been taken from time to time to fight the menace of money laundering. Tsingou (2005, pp.18-20) has summarized the various dimensions of AML policies taken from global to private world.

YEAR	GLOBAL	US	EUROPE	PRIVATE
1970	Bank Secrecy Act			
1980	Offshore Group of Banking Supervisors		Council of Europe: Measures Against the Transfer and Safekeeping of Funds of Criminal Origin	
1986		Money Laundering Control Act	UK: Drug Trafficking Offences Act	
1988	UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances			
1989	Financial Action Task Force – FATF			

1990	FATF Recommendations; Caribbean FATF			
1991			European Commission: First Money Laundering Directive	
1995	Egmont Group of Financial Intelligence Units		Europol	
1996	Revised FATF Recommendations			
1997	OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions			
1998	OECD Report on Harmful Tax Practices			
1999	Eastern and Southern Africa Anti-Money Laundering Group			

2000	FATF: List of Non-Cooperative Countries and Territories; OECD List of Tax Havens with Harmful Tax Practices; Regional Anti-Money Laundering Task Force, Latin America; UN Convention Against			Wolfsberg Principles
	Transnational Organised Crime			
2001	FATF Special Recommendations on Combating the Financing of Terrorism; Basel Committee: Customer Due Diligence	US Patriot Act, Title III: International Money Laundering Abatement and Anti-Terrorist Financing Act	European Commission: Second Money Laundering Directive	
2002	FATF/IMF/World Bank Agreement on Anti-Money Laundering Pilot Project		Europol mandate expanded; UK: Proceeds of Crime Act	Wolfsberg Principles on Combating Terrorist Financing

2003	Revised FATF Recommendations; UN Convention Against Corruption			
2004	IMF/World Bank include FATF standards to their Financial Sector Assessment Programmes; Eurasia Group; North Africa and Middle East Group			
2005	UN Security Council Resolution 16 17		European Commission: Third Money Laundering Directive	
2006		Patriot Act renewed		International Association of Money Transfer Networks

This manifests that various measures work at different levels to combat Money Laundering. The AML regime is developing on two fronts, prevention and enforcement, and at three levels: national, regional and international (global). Prevention is mostly about sanctions, regulation and supervision, reporting and customer due diligence while enforcement is about confiscation, prosecution and punishment and investigations. In essence, however, despite the criminalisation of money laundering and the recent prominent and public role of enforcement agencies in the AML regime, the process appears to be mostly a regulatory one. The global regime to control money laundering involves three dimensions as Reuter and

Truman(2004) put in national and international building blocks, a firm legal and enforcement foundation, and close interaction between the public and private sectors . They explained the arms of AML Regime as

PREVENTION	ENFORCEMENT
Sanctions	Confiscation
Regulation and Supervision	Prosecution and Punishment
Reporting	Investigation
Customer due diligence	Predicate Crimes

Post 9/11, it became apparent that the war on terrorist finance was to dwell in a essential place in the war on terror. The Terrorist Financing Executive Order enacted by George W. Bush on September 24, 2001, made it lawfully possible call financial supporters of terrorism as terrorists. The Executive Order significantly extended the U.S. government's powers to accuse those providing funds and infrastructural support to suspected terrorists. Also to freeze and block assets. The order also published a blacklist of terrorist organizations and individuals whose assets were to be frozen internationally. The order was heralded as the first hit on the global terror system., President Bush said in the press release that to make starve the terrorists of funding, turn them against each other, defeat them out of their safe hiding places, and bring them to justice. In the fight against profit-oriented crime and money laundering a large number of actors are involved, working on the prevention and detection of money launderers, based on a system in which public and private institutions on a national and international level cooperate. Prevention, detection and reporting are carried out by private partners, while the public partners have an analytic and repressive task.

Post 9/11 anti money laundering measures were raised to a more stern dimension.

The war on drugs which was the main focus before taken by the War on Terror .This became a basis to apply far-reaching measures on anti-money laundering as terrorist financing is added to the AML Legislation. Earlier than 9/11 governments had tried to put into operation client-profiles and 'know your customer' regulation. But this was blocked by the lobby of the banks and privacy lobbyists. The Patriot Act which was implemented in the consequences of 9/11, override these objections and introduced the opportunity for information exchange between banks, but also imposed a larger access to that bank information for police and judicial services. Levi states that it would have been very doubtful that process as intrusive as customer due diligence would have been accepted this silently without the attacks on 9/11. Furthermore, not only were more comprehensive regulations introduced, the War on Terror also increased budgets for police and judicial services and expanded their competencies .Banks chose to strengthen their checks and procedures, as any alliance with terrorism financing could have devastating effects. The FATF developed specific guidelines for financial institutions to facilitate them to detect terrorist funding and the emphasis now shifted from drug related crime to all serious forms of organised crime and terrorism (Verhage , 2008).

ANTI –MONEY LAUNDERING (AML) POLICY: AN ANALYSIS

To understand the containment hypothesis, it is important to analyse the policy itself. Policy per se has various nuances and before arriving to any conclusion it is important to have glimpses of the dimensions of AML policy. How effective is the AML Policy has been of a great debate among the researchers and the Scholars. AML Policy is itself a complex in nature. For researchers like Unger (2009) very few results are known about the effectiveness of the policy. This could be because of the very nature of money laundering or the complexity of policy itself. Levi and Reuter (2006) put that the real hit for policy is not the money laundering but the predicate crime. So the basic idea behind is what exactly are being targeted by the policy. And when this is not clear, it is inane to say that policy is a failure. Chong and Silanes (2007) stated that whether the AML policy really mattered, and if it did, the wrong area has been covered because money laundering is a symptom and not a cause in itself.

Naylor (2003 in Beare, 2003) identified four premises on which the Proceed of Crime Approach to the Crime Control Policy works. Firstly discouraging the motive by lowering the criminal profit. Secondly, when the motive is deterred criminals would not corrupt the legitimate economy. Thirdly, it would prevent the future crimes and fourthly the general deterrence overall. AML policy is thus works on this deterrence theory. So the ambit of AML Policy is broad. And to know the effectiveness of this policy it is essential to know about the criminal wealth and legal income. This would mean that a demarcation is essential to measure the policy effect. The deterrence theory over here is very simple and has been criticised about its feasibility. However targeting financial activities related to crime may sometime prove to be effective in detecting and disrupting the underlying crimes (Cue'llar, 2003).

To know the effectiveness of policy itself, one must look for the basic goal of the policy. It may be perceived that the ultimate goal of the AML policy is to curb the money laundering itself. Before the FATF came in it was not a subject of criminalization, and now when it has become a crime in itself, AML is designed to control this crime. Reuter and Truman (2004) identified three goals of AML Regime, they are crime reduction, the safeguarding the financial system and controlling terrorism, corruption and failed states. They further stated that to know the effectiveness of AML regime, assessment should be done on the individual cases. A single approach would not be sufficient to study these three goals of the AML Policy.

The other dimension of the AML policy is that it acts at various levels and different actors are involved in the implementation of the policy. Sharman (2008) stated that the diffusion of AML Policy in the developing countries has been of coercive in nature which actually shows in the low rate of compliance with AML/CFT (IMF, 2011). These could be the structural constraints of the Regime for example the problem of the Jurisdiction regarding confiscation and of predicate crimes (Stressons, 2000).

Tsingou (2005) argued that AML Regime has evolved as focussed and consistent in its aims and a global in its approach. If it has been accused of being inefficient, it is not because of its nature which is developing but

due the fact that its underlying premises are questionable. Bachus (2004) in his study found that the anti - drug money laundering efforts got results after the 9/11. It was the result of a shift from drug to terrorism. Putnam(1988) argued that efficiency of an international AML/CFT regime mostly depends on the efficacy of its constituents and vice versa. Most of the studies suggest that the bottomline of money laundering as a problem is nothing but the attitude of government towards the money laundering itself. Borgers (2009) stated that the socio-economic backgrounds of informal banking system has been not taken into account by the international community.

‘Money laundering is one of those problems that is very hard to get a grip on.’ (Yeandle *et.al*, 2005 cited in Nicolas Ryder, 2008, p.635). When talking about the very nature of money laundering it is one of the most challenging area to understand the AML Policy and its effectiveness , the very nature of money laundering and its changing facets in globalisation have to be taken into account. Policy effectiveness could not be concluded without knowing the complexity of the problem itself. Bachus (2004) identified three main difficulties in detecting the cases of money laundering- various ways of money laundering, once the process is known the launderer switches to another mode and since the AML Regime is global , various countries and government have responded to it differently. He (2010) identified various ways through which money was laundered it involved cash smuggling, banks, insurance shell companies, real estate, international trade, off shore companies. And in the computer world the facility of electronic money and disguised identity made things easier for the launderers. Simsor (2013) explored typologies, trends and threats of money laundering in today’s changing world. Cash and fraud are very much the features of money launderers. His paper also considered number of emerging systems: new payment technologies, prepaid access cards, electronic money, and person-to-person (P2P) loans. This shows the complexity of the money laundering itself. Blum *et. al* (1998) identified three area which has changed the context of money laundering , namely dollarization of black markets, the general trend towards financial deregulation, the progress of the Euro market and the proliferation of financial secrecy havens. And they made difficult in detection of crime. Though the idea of money-laundering has not changed over the centuries, the circumstance and perspective in which it occurs has been subject to extensive advancement. In particular there have been a number of developments in the global monetary system during recent decades that have made the finding, freezing and forfeiting of criminally derived income and assets all the more difficult. These are dollarization of parallel markets, the general tendency towards financial deregulation, the advancement of the Euro market and the proliferation.

The shift to what is sometimes considered as a tentative global economy has been carried out by new technologies that allow exceptional speed in the progress of money. Foreign exchange merge with contract payments and debt settlements in a vast combination of movements and transactions that is fast and complex. Indeed. The globalization of financial services has become one of the most vital dimensions of the by and large globalization process. Fuelled by developments in know-how and communication, the financial infrastructure has developed into a system that links countries, banks and other financial institutions such as brokerage houses and stock markets, currencies and investment portfolios in a global exchange mechanism that engages in operation 24 hours a day. At the same time, the development of megabyte money i.e. money

in the form of symbols on computer screens made the system more complex. The advanced economy is still characterized by the feature of cash.

Any crime control policy often faces with the challenge of displacement of crime. Unger and Hertog (2012) shown in their study the shifting or displacement of money laundering from traditional banking sector to areas where the regulation is minimum like buying of gold via internet. However, Barr and Pease (1990) what they termed as deflection which they said is the replacement of more serious crime to less serious crime, often is the attribute of crime control policy. It may be argued that AML policy if not curb the money laundering, it could displace the proceeds of crime from more serious crime like terrorism to less serious crime like tax evasion. Within this framework it would be useful to understand Clarke and

Weisburd (1994) the Diffusion of deterrence and discouragement. When HSBC were to pay Penalties for money laundering (BBC, 2012) the other Bank would have been more cautious and alert regarding the implementation of policy itself.

ECONOMIC THEORY OF CRIME

The true measure of crimes is the harm done to society. Beccaria (1764).

This paper has tried to study the effectiveness of AML policy through the economic theory of crime. The Economic Approach takes its starting point from the Classical School of criminology, Jeremy Bentham and the idea of Utilitarianism. It says human behaviour is based on maximising pleasure and minimising pain. Man is in his action a rational actor. In the arena of criminology, crimes can be categorized as economically driven crimes and noneconomically driven crimes. Economically driven crimes (or *economic crime* for short) are primarily driven by financial gains and presumably follow the utilitarian concept, i.e., it is guarded by manipulating their pains (punishments) and gains (rewards). Generally if there are victims left by a crime it is called a predatory crime. In the human society, crime is a complex phenomenon. The first study of crime, by means of modern economic analysis, is the seminal work by Gary Becker. Most of the current works by economists still follow genuine Beckerian or mix it with other methods, such as game theory and information processing, All of them aim to minimize the social cost of crime based on economic principles. That theory holds that rational criminals compare the benefits of crime and the expected punishment. One of the most interesting features of recent economic theories of crime is that they explain both criminal behaviour and law enforcement activity. Indeed, the most influential of these theories, for example, Becker (1968) assume that crime and law enforcement are simultaneously determined, so that it is not possible to analyse one without also taking the other into account. Loftin and McDowall (1982).

Becker (1968) applied the same idea and applied his theory of economics to study crime and crime control. He developed a model to study the effectiveness of Public Policy which according to him is for the discouraging the public from doing offenses. Becker (1990) stated that the criminals are as equal as the non-criminals who are rational in their effort. Some people because of moral and ethical reasons resist themselves

to involve in committing crime even if the act is rewarding and less likely to be caught. It would mean that there would be no validity of police and prison in society. However, this attitude does not always prevail. Rationality implied that some individuals become criminals because of the financial and other rewards from crime compared to legal work, taking account of the likelihood of apprehension and conviction, and the severity of punishment. Now the amount of crime depends upon the environment created by public policies. He said there's an optimal amount of crime in the society at all times. It is because it would be too costly to curb crime completely. Hence, theory of economics should be applied to crime which focuses on balancing the marginal advantages of reducing crime by one unit verses the cost to society of doing that. Becker (2012).

Fender (1998) has applied the same theory and presented a model of crime and punishment where the decision to become a criminal is rational, in the sense that it is based on a comparison of the benefits and costs of crime with those of its alternative. The equilibrium is studied by various factors including policy variables on the level of crime. Similarly Winoto (2005) explained in the context of criminology, crimes can be grouped as economically driven crimes and non-economically driven crimes. Economically driven crimes are primarily driven by financial gains and presumably follow the utilitarian concept, i.e., it is controlled by manipulating their pains (punishments) and gains (rewards).

Ferwerda (2009) constructed a theoretical model on the grounds of Becker theory. He tried to find out whether anti-money laundering policies reduce crime. In his model the chance of being trapped for money laundering, the punishment for money laundering, the chance of being convicted for the predicate crime and the operational costs of money laundering are negatively related to the quantity of crime. If all of these factors are certainly influenced by a stricter policy, then anti-money laundering policy deters probable criminals from illegitimate behaviour and therefore lowers the crime rate. He developed an indicator to test his hypothesis for anti-money laundering policy from the reports on money laundering of the FATF, IMF and World Bank. His research therefore showed to some extent the AML Policy was able to reduce crime.

Therefore, the Economic model in its analysis establishes two main elements of AML policy. At one end it has tried to explain what the crime policy in general should or must aim at. And at the other end it has able to prove that AML policy is not inefficient as generally perceived, but has ability to influence crime negatively.

CONCLUSION

The present essay has studied the containment hypothesis in the backdrop of Anti-Money Laundering (AML) Policy. In the first part a general idea and background of money laundering and anti-money laundering policies has been presented which manifested the complex nature of the policy itself. In the second part the various nuances of effectiveness of AML policy have been identified. These nuances in turn argued that AML policy would not necessarily be a failed policy. In the same context the challenging facets of money laundering have been understood and elements of deflection and diffusion have been realized. Finally the

AML Policy has been looked through prism of Economic Approach Of Crime. The study of Ferwerda (2009) which used the same model came out with the findings that AML Policy reduces crime rate.

Therefore, it may argued that the containment hypothesis not necessarily be an excuse of a failed policy.

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