1. IT TAKES TWO TO TANGO: A RELATIONAL APPROACH TO MONEY LAUNDERING

The role of off-shore countries in international money laundering schemes has long attracted the attention of policy makers. Virtually all initiatives aimed at combating money laundering, both at the domestic and international level, tackle the issue.[1] Policy makers are mainly concerned with two sources of costs stemming from money laundering. Firstly, the possibility of laundering proceeds of crime affects the incentive of a potential criminal. In a world where money of illicit origins cannot be laundered the possibility of linking the capital to the crime reduces the *ex ante* incentive of the criminal to commit the crime in the first place. At the margin, more crimes will be committed if money laundering is possible. From this perspective, combating money laundering is equal, in the aggregate, to combating predicate offences. Secondly, capitals that are laundered return to the legal financial sector generating serious negative effects: Competition is distorted; the allocative efficiency of the market is undermined.[2]

Policy makers concentrate their attention on the negative effects of money laundering and on the possibility that off-shore centers might facilitate the task of criminal organizations. Concerns are raised by regulation adopted in off-shore centers, that may greatly contribute to launder money of illicit origins. The main product offered by off-shore centers to potential money launderers are, for example, a strict banking secrecy regime or rules that prevent the identification of beneficial owners of accounts. Discussions concerning these issues, however, take often as a given the existence of some countries that offer financial services to organized crime. In other words, the supply of money laundering services is treated as an exogenous variable.

This paper takes a different perspective. We will focus on features of a given country that make it more likely to enter the market for money laundering services. With this regard, our approach will argue that tax havens are structurally different from other countries. More specifically, we will argue that:

1. the utility function of countries that favor money laundering is positively correlated to the existence of criminal activities abroad;
2. the utility function of such countries is not influenced by the negative effects of criminal activity, i.e., they do not bear the negative consequences of that criminal activity.

Our approach is consistent with a previous work[3], that empirically verify the following hypotheses, that reflect the above mentioned analytical postulates:

a. tax havens do not have significant internal resources to offer on international markets. The lack of such resources pushes them to generate income through a lax supervisory regime;

b. tax havens have features that make them less attractive for criminal organizations.

The empirical results are consistent with the hypotheses. More specifically, off-shore centers tend to be small, thus being less attractive to criminal organizations; they tend to be islands, which might make control against criminal infiltrations easier; they tend to rely on income generated by money laundering, even though they are not necessarily acting in circumstances of necessity.

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[1] E.g. BANCA D'ITALIA, (1994) at 21. The document provides "operational guidelines" for financial intermediaries, aimed at facilitating compliance with the duty to report suspicious transactions' reports. Paragraph 4.2 states that financial intermediaries should pay particular attention to transactions that involve parties based in an off-shore country.
[2] On the negative impact of money laundering on the financial system see FAZIO, (1997), BIANCHI, (1997), (1998), (1999) DONATO and MASCIANDARO, (1997). (1998)
[3] MASCIANDARO and CASTELLI (1998).

We share with the work of Masciandaro and Castelli the view that there may be features of a given country that will naturally push it towards the adoption of financial regulation that may in fact facilitate money laundering. We part company in that we take a relational approach, on the assumption that it takes two to tango: We treat regulation that can affect the ease with which money of dirty origins is laundered as a product. Within this framework, we focus on the relationship that is established between a given off-shore country and its customers, i.e. criminal organizations. We are less concerned with the main product offered by off-shore to potential launderers (i.e., for example, a strict banking regime) and more concerned with the features of the off-shore that help to support the exchange between off-shore centers and criminal organizations. These features may be of various nature. Particular attention will be paid, however, to the institutional environment, loosely defined.[4] We look for features in the legal system as well as for specific rules that help to sustain the relation that off-shore and criminal organizations establish, thus determining the ultimate success of some off-shore centers over others.

Looking at the determinants of success in the competition among off-shore countries, it is hoped, will help identify which countries are actively involved in money laundering. This might in turn allow to draw a line between off-shore centers that are merely aiming at offering better quality financial services and off-shore centers that aim at attracting capitals of illicit origin, thus imposing significant costs over other countries. Grasping the factors that determine the success of some countries in the race to the bottom might also prove useful for policy makers in devising the most appropriate countermeasures.

Our attention focuses on countries that try to attract proceeds of crime through the offer of financial services to criminal organizations abroad. We leave aside the broader question of the possible role of off-shore centers in generating and facilitating international financial crises.[5]

We take an evolutionist perspective.[6] Some factors may put a given country in an advantageous position over other countries. These factors, however, need not necessarily be the result of a conscious choice by the country, whatever "conscious" means when referred to a country. They need merely prove useful, in an *ex post* perspective, in the competition with other countries. The competitive advantage of a country might also be ascribed to the accidents of history, to geographical factors, or even to sheer chance. For example, the language spoken in the country might obviously play a role in the choice made by criminal organizations. An evolutionist approach implies that while we expect a great degree of functional convergence, different countries may choose different strategies to the same end. Solutions are likely to be diverse.

At the same time, we do not exclude the possibility of a "conscious" choice by a country.[7] With this regard, the paper makes a simplifying assumption. We often consider a single off-shore center as a unitary decision agent, a black box that behaves rationally in order to maximize profits through the offer of financial money laundering services. The assumption, albeit naïve, is coherent with the goal of the paper, that is to say, an evaluation of the dynamics of competition among off-shore centers. However, we will sometimes try to shed some light on the black box, in order to look at the possible role of interest groups within the off-shore center. Further research may try to write a thorough "public choice" history of the confrontation that we expect to take place in the political arena within each off-shore country.

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[4] For example, as defined in NORTH, (1990) institutions include both formal and explicit rules and less formal rules such as norms.

[5] The latter issue has obviously attracted the attention of policy makers. This interest has also been spurred by the ever increasing integration of financial markets, which has increased the threat to financial stability posed by off-shore centers. See FAZIO, (2000b) ERRICO and MUSALEM, (1999) FINANCIAL STABILITY FORUM. (2000)

[6] As defined in ALCHIAN, (1950) and BECKER. (1962)

[7] And indeed we shall see that some "pre-committing devices" may be put in place specifically and consciously in order to support the supply of money laundering services.