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Combating Illegal Economies: an assessment of EU policy-making

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Abstract: This paper examines the evolution of European Union money laundering counter-measures by applying principal agent approach to its negotiation process and thus developing some questions around the relation between member states (principals) and the European Commission (agents).

The 1991 Directive is the starting point of the discussion given its primordial role in not only marking the beginning of EU level legislation, but also acknowledging the need for coordination between the Unions' financial/internal market interests and criminal laws.

This paper establishes that, whilst money laundering legislation was initially promoted through market building concerns it is currently evolving into the realms of criminal law. Its implementation requires a substantial degree of policy coordination and competence delegation in order to warrant suitable results.

To what extent has the increasing demands coordination altered the relations between actors and their functions?

I will focus on the role and significance of the European Commission in the formulation of EU anti-money laundering legislation, its evolution pursuant the alterations in the Treaties, variations in member state preferences and international events.

[1] This paper is a draft reflecting work in progress to analyse and discuss the evolution of the anti-money laundering framework in the European Union. Please do not cite without the author's permission. For further information contact: ines.oliveira@ed.ac.uk.

1. Money laundering as a transnational threat to the common market

Globalisation of communications and of financial systems, the growth of global trade and migration have all contributed and been easily exploited by organised crime.[2] The foundation of illicit economies and their obvious interference with formal economies is much broader than commonly perceived and has spread out to the majority of world nations. Money laundering is the process through which criminals make their profits worth and as such, to a great extent, the key to stopping organised crime.

"Illicit" a well-known book written by Moisés Naím[3] highlights precisely the eclectic nature of criminal interference in states' financial interests. Anything from smuggled goods, counterfeiting, trafficking of drugs, people, weapons, clothes and others, are profit generating illegal activities that blend into official revenues and interfere with the good functioning of countries' economies, not to mention societies in general.

Fighting transnational crime is thus a common element to most states policies but unfortunately, one where "*governments are failing*"[4] and, in fact, have been from the start.

The truth is states must respect international law, jurisdiction rules and numerous cooperation mechanisms before being able to chase down criminals in foreign territories. Transnational criminals, on the other hand, are not so restricted and can take advantage of both the absence of trade borders and of new technologies to move money around the world and interfere with the international financial system.

The inequality of means is striking and effective policy-making that includes states, international organisations and the private sector becomes key to solving the problem.

Money laundering (ML) best be characterised by: its international character, its dual impact on society, at economic and criminal level, and the ease with which it mingles with the formal system through financial institutions. As a concept, it materialised and developed

[2] Phil Williams. "Transnational Crime and Corruption." *in* Brian White, Richard Little, and Michael Smith, *Issues in World Politics, Second Edition*, 2nd ed. (Palgrave Macmillan, 2001): 236.
[3] "Moisés Naím is Senior Associate in the International Economics program at the Carnegie Endowment for International Peace and Chief International Columnist for El País, Spain's largest newspaper."
http://www.moisesnaim.com/about_moises_naim
[4] Moises Naim, *Illicit: How Smugglers, Traffickers, and Copycats are Hijacking the Global Economy* (New York: Anchor, 2006): 220.

internationally over the last 40 years. As an illegal activity, it is a common threat to most countries around the world and their financial systems.

International awareness, nevertheless, dates only to the 1970's when banks in the United States of America (USA) first introduced control mechanisms aiming at the prevention of the use of the financial system for criminal profit[5]. Naturally, the USA's wide implementation of specific control measures meant that European banks operating in the USA were required to apply the same provisions both in their USA branches and in transactions deriving from the European Union (EU). This measure by American banks was one of the main triggers of anti-money laundering (AML) international policies.

ML has been, from the beginning, very much related to the protection of states' financial interests but progressively shifted its focus to a more security-oriented problem. It is doubtful, in fact, that it would have grown to be as influential a matter as it is today had it not been for its role in facilitating financing of terrorism and drug trafficking.

In reality, the United Nations Vienna Convention of 1988[6] (*hereinafter*, "the Convention") was the first international instrument aimed at combating money laundering, although mainly as a complement to the fight against drug trafficking.

The main motivator for the ML Article 3 of the Convention was, essentially, the hardening of conditions under which drug traffickers took advantage of criminal profits. Nonetheless, the Convention also recognised the transnational character of criminal activities aiming at the conversion of the proceeds of crime and the need for law enforcement to start acting accordingly.

The Convention's aftermath stressed the need to intensify international cooperation on ML. So, in 1989 the Financial Action Task Force (FATF) was created by a decision of the G7 Heads of Government participating in the Paris Economic Summit. Worth noting, FATF has

[5] The Bank Secrecy Act of 1970 included reporting suspicious transactions, identifying customers and record keeping.
[6] United Nations, *Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*, 1582 UNTS p.165, Nº27627 (opened for signature 20 December 1988) (entered into force Nov. 11, 1990).
The criminalisation of money laundering was also demanded by the *UN Convention against Transnational Organised Crime*, UN Doc. A/RES/55/25, 8 January 2001.

now 34 members[7] of which 16 are European Union member states and one is the European Commission itself.

The creation of this new specialised organisation reflected "world leaders' concern at the dimension the drugs problem had attained and the speed to which drug trafficking and related money laundering were growing".[8]

In 1990, as a direct effect of international concern, two important international and regional documents on AML were released. FATF itself published the first international AML standard setting document, the 40 Recommendations[9] (revised in 1996 and 2003), and the Council of Europe agreed on the Convention '*on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime'*.[10] This was a clear sign of the general acknowledgement of ML as an international community problem.

However, only in 2001, following the attack on the Twin Towers and the subsequent efforts to stop terrorist financing did the combat of money laundering 'step up' in importance level and saw AML obligations take on a more serious tone in international fora.

After 2001, in fact, there was a general renewal of intentions and good practices to adjust AML legislation and include terrorist financing into the sought for offences. Amongst others developments of the time, FATF reviewed its standards in 2003 and, around the same time (2005) the Council of Europe reviewed its AML standards with the 'Warsaw Convention'.[11]

The detection of illicit transactions became a common concern to governments all over the world multiplying the existence of international instruments and transforming the formerly unknown ML, into a topic for discussion in international organisations e.g. the World Bank, the United Nations, the G20, the International Monetary Fund, amongst others.

[7] The 34 members of the FATF are: Argentina; Australia; Austria; Belgium; Brazil; Canada; China; Denmark; the European Commission; Finland; France; Germany; Greece; the Gulf Co-operation Council; Hong Kong; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; Russia; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States.
[8] Tom Sherman, "The Financial Action Task Force" *in* MacQueen, Hector L. *Money Laundering*. (Edinburgh University Press, 1993): 16.
[9] Financial Action Task Force (FATF), 40 Recommendations (amended June 2004) on the combat of money laundering and terrorism financing. Available at: http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF.
[10] Council of Europe, *Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime*, 8 November 1990, CETS 148. http://conventions.coe.int/Treaty/EN/Treaties/Html/141.htm
[11] Council of Europe, *Council of Europe on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism*, 16 May 2005, CETS 198. http://conventions.coe.int/Treaty/EN/Treaties/html/198.htm

In that context money laundering is:

> *"…The conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offence to evade the legal consequences of his or her action;*
>
> *(ii) The concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime;"*[12]

In light of this definition and of growing international concerns with this activity there was an effort to structure cooperation and generate a better understanding of money laundering, as an international phenomenon.

Hence, the main combat strategies agreed have been divided into three areas of action: 1) the criminalisation of the transformation of the proceeds of crime into legitimate goods; 2) the formulation of preventative measures and regulations aiming at financial[13] and non-financial institutions (including the setting up of Financial Intelligence Units); 3) and law enforcement mechanisms.

This paper will engage with selected themes of the preventative measures developed at EU level in order to provide a better overview of the problem's reach. In particular, I will try to explain how AML measures affect the private sector as well as MS internal policies.

The coordination of actions between actors will be shown as crucial to the effective development and implementation of policies at EU level.

[12] Article 6, *UN Convention against Transnational Organised Crime*, UNGA Resolution 55/25 (2000) 55th Session, 15 November 2000, UN Doc. A/RES/55/25 (Adopted 8 January 2001) (entered into force September 2003)

[13] A financial institution is "*'an undertaking other than a credit institution whose principal activity is to carry out one or more of the operations included in numbers 2 to 12 and number 14 of the list annexed to Directive 89/646/EEC, or an insurance company duly authorized in accordance with Directive 79/267/EEC (6), as last amended by Directive 90/619/EEC (7), in so far as it carries out activities covered by that Directive; this definition includes branches located in the Community of financial institutions whose head offices are outside the Community*" in Article 1, Directive 91/308/EEC *on prevention of the use of the financial system for the purpose of money laundering*, (10 June 1991), OJ L 166, 28.6.1991, p. 77.

1.1. EU efforts to protect the common market: a battle of competences

As inferred above, international developments had a clear impact on the EU's review of its legal framework. International influence in terms of information and demand for compliance with international instruments is one of the clearest marks on the European Commission's agenda and MS' as sovereign nations.

Therefore, the EU is a unique case study on money laundering especially because of its "inter-pillar" character (internal market and criminal law) and the relationships established between all actors involved in the process. The main actors can be identified a priori as: the European Commission, Member States, the international community and the private sector (for the purpose of this research limited to private credit and financial institutions).

The first thing to be understood is that the need to combat organised crime and protect the financial system from ML and similar threats directly relates to the states' needs to protect themselves. So, when the threat of money laundering expanded, EU member states (MS) progressively, by need and international pressure, had to adjust both criminal law and economic instruments in order to preserve their own and the overall economic integrity.

At the EU level, this highlights a curious mix of competences in the sense that, if on the one hand, criminal matters, such as the criminalisation of specific offences, are completely intergovernmental (controlled by MS). On the other hand, the EU has ensured that the common market has a common protection mechanism obliging MS to implement measures that, in fact, lead to criminal law alterations.

In an attempt to satisfy all AML legislative needs, while still complying with the given competences, the European Commission guided MS in their implementation of the three main AML Directives.[14]

[14] Directive 91/308/EEC *on prevention of the use of the financial system for the purpose of money laundering*, (10 June 1991), OJ L 166, 28.6.1991, p. 77; Directive 2001/97/EC of the European Parliament and of the Council, amending Council Directive 91/308/*EEC on prevention of the use of the financial system for the purpose of money laundering*, (04 of December 2001), OJ L 344, 28.12.2001, p. 76–82; And Directive 2005/60/EC of the European Parliament and of the Council *on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing* (Text with EEA relevance), (25 of October 2005), OJ L 309, 25.11.2005 p.15-36

In this process member states, driven by the Commission, have been led to acknowledge that AML measures involve a necessary combination of coordination between institutions dealing with the internal market, including the private sector, as well as international recognition and approximation of criminal laws.

The EU's AML framework began by affecting financial institutions i.e. banks and credit institutions as a result of the first money laundering Directive[15] and the European Commission's competence limitations during the Directive's formulation process.

The Directive established the private sector as a key element in AML measures and an important instrument to identify criminals as well as have them reported to the appropriate authorities.

In this process member states, pushed by the Commission, have acknowledged that AML measures involve a necessary combination of coordination between institutions dealing with the internal market, including the private sector, as well as international recognition and approximation of criminal laws.

In fact, throughout time the Commission appears to have developed its own agenda, much influenced by international players, and began working on specific yet inter-pillar issues specifically: the legal framework and political background of measures pertaining to mutual recognition and legal assistance in criminal matters and, the application of customer due diligence requirements. It equally established: the private sector as a key to the effective implementation of criminal law; the significant influence of international instruments; and the need to coordinate policies between the Commission, member states and indirectly, the private sector.

The European Commission has become one of the most relevant actors to the EU AML framework.

[15] OJ L 166, 28.6.1991, p. 77.

2. The role of the European Commission in the adoption of the anti-money laundering framework

At the EU level, protecting the internal market and the Community's financial interests never posed any competence issues. From early on the subject of protecting financial interests was common to all member states allowing the European Commission to take on the role of administrator and agent.

On the contrary, cooperation in JHA has had steps pro and against integration. MS have always seen cooperation in justice and criminal matters as something very close to their sovereign identity and therefore showed constant reluctance in giving it up to the Community.

In reality, it was not until 1990 with a letter from Chancellor Kohl and President Mitterrand to the Italian Presidency of the Council that the 'integration process' of EU criminal law had its dawn. The letter affirmed that, "certain issues that are currently handled in an intergovernmental context could enter the scope of the union: immigration, visa policy, right of asylum, anti-drug actions and measures to fight organised crime".[16]

In 1992, in light of this change in perception, the Commission gained admission to the TREVI group, an intergovernmental mechanism to promote judicial and police cooperation in the EU albeit under protest from some MS. [17] Unlike the certain member states, the Council of Ministers was "of the view that the Community could assert the competence to compel Member States to criminalise certain forms of conduct, provided that this was necessary to achieve Community objectives".[18]

As a result, with the outcomes from Maastricht and Amsterdam Treaties and the creation of numerous "framework decisions", EU criminal law progressively developed a cooperation habit with other EU frameworks such as environmental law, Common Foreign Security Policy

[16] *Agence Europe*, 10-11 December 1990 *in* Ellen Ahnfelt and Johan From. "Policy on Justice and Home Affairs: From High to Low Politics" In Prof Svein Andersen e Professor Kjell A Eliassen, *Making Policy in Europe*, 2nd ed. (Sage Publications Ltd, 2001): 150.
[17] *Idem*,147.
[18] Peter J. Cullen, "The European Community Directive" *in* MacQueen, Hector L. *Money Laundering*. (Edinburgh University Press, 1993): 37.

and the internal market.[19] In principle, this should have been the trigger moment for the Commissions "progressive emancipation" in criminal law.

In reality though, already in 1986 the Commission had requested the MS to participate in the Vienna Convention negotiations of 1988 and hence opened grounds for the first EU level anti-money laundering preventive measure.[20] In this case, Commission activism proved relevant to the events that followed.

The Commission, as introduced above, was the actor responsible for gathering the available international documents and concerns, MS views and Community objectives and, naturally, for the drafting of the first AML Directive.

The first AML Directive[21] was approved in 1991 to combat money laundering in the EU. It was adopted under former 'first pillar' Articles 64 and 153a (TFEU) having direct effect on MS national legislations. The justification for choosing a directive as the selected legal instrument, however, can be justified by its pre-Maastricht enactment and the lack of option to do it under different provisions. The official reasoning, per its preamble, for the implementation of AML measures in the EU related to both the combat of drug trafficking and, simultaneously, to the protection of the EU's financial and credit institutions.

The Commission's purpose in drafting this document was to encourage and provide confidence to the construction of the internal market and its protection from the infiltration of money laundering.[22] It was, "primarily addressed to credit and financial institutions and imposes obligations on them which are designed to ensure that laundering is detected before the stage of criminal investigations is reached".[23]

The preamble stressed, however, the underlying need for coordination of different pillar policies:

> "*…in order to facilitate their criminal activities, launderers could try to take advantage of the freedom of capital movement and freedom to supply*

[19] Take into consideration the ECJ Environmental Law cases, the fight against terrorism and money laundering.
[20] COM (86) 457 final 5.8.1986
[21] OJ L166, 28.06.1991
[22] Valsamis Mitsilegas, *Money Laundering Counter-Measures in the European Union: A New Paradigm of Security Governance Versus Fundamental Legal Principles*, (1st ed. Kluwer Law International, 2003): 55.
[23] Cullen, "The European Community Directive," 35-36.

> *financial services which the integrated financial area involves, if certain coordinating measures are not adopted at Community level*."[24]

As a consequence, two of the Directive's 'products' are of particular importance and have been, as mentioned above, followed up by the Commission: the immediate increase in protection/regulation of financial transactions, including extra regulatory compliance for financial and credit institutions and the mutual recognition of some aspects of criminal law between MS (although this was an indirect effect of the directive).

How does the Commission's work concerning AML impact MS and citizens?

2.1. Money laundering and financial institutions

The first money laundering Directive was almost completely aimed at regulating the conduct of financial and credit institutions. However, unlike what may be common belief, anti-money laundering measures do not aim to restrict the activities of the internal market and, on the contrary, are "a necessary complement to rather than a contradiction of economic liberalisation."[25] The international money laundering combat strategy "is not concerned with restricting free movement of capital or fettering the efficiency of financial systems"[26] but with its protection.

Accordingly, the majority of AML measures being internationally implemented are directed precisely at financial institutions, namely: the regulations of cash movements, on payments, money transfers, identification and reporting, etc.

The first AML Directive, as the two that followed,[27] foresees the participation of financial institutions and finance professionals in the mechanisms created to combat this threat. Articles 6, 7 and 8 of the third AML Directive[28] (in line with the previous) clearly affirm the

[24] OJ L166, 28.06.1991, p.77;
[25] Sherman, "The Financial Action Task Force," 20.
[26] *Idem*, 20
[27] OJ L 344, 28.12.2001, p. 76–82; And OJ L 309, 25.11.2005 p.15-36.
[28] OJ L 309, 25.11.2005 p.15-36.

importance of credit and financial institutions as well as other elements of the private sector[29] in the combat against ML.

The first Directive called for:

> "*Member States to prohibit money laundering and to oblige the financial sector, comprising credit institutions and a wide range of other financial institutions, to identify their customers, keep appropriate records, establish internal procedures to train staff and guard against money laundering and to report any indications of money laundering to the competent authorities*."[30]

Therefore, amongst the numerous mechanisms that make the implementation of these articles possible are the concept of 'customer due diligence' (CDD) and the obligations of the reporting system, namely to the Financial Intelligence Units (FIUs).[31]

Both CDD and obligation to report have been a central part of AML measures since the start and therefore are integral elements of the AML system. As with the Directive itself, it is the Commission who is in-charge of its implementation.

CDD is foreseen in Article 3 of the Directive where "*Member States shall ensure that credit and financial institutions require identification of their customers by means of supporting evidence when entering into business relations*". CDD is naturally followed by the obligation to report in accordance to Article 6.

It can be argued that EU law obligations are directed at member states and not the financial institutions, which whilst true in theory, is unlikely to have a significantly different effect in practice, especially when dealing with directives. Also, once the CDD provisions are implemented, the European Commission directly monitors it by contacting the financial institutions rather that MS.

Ultimately, the financial sector's inclusion in the combat against money laundering and the ways in which it interacts with MS and the EU institutions or international organisations

[29] For the purpose of this research "private sector" is restricted to the financial sector, including only financial and credit institutions as per the first ML Directive.
[30] OJ L 309 p.15-36: para. 4.
[31] FIUs were not established until much later but are still worth the reference as they were a consequence of the Directive.

provides an interesting discussion on the role of the private sector within the EU and the ways in which the private sector is heard at the international level.

The duty to implement nevertheless has been raising discussion on: the cost of compliance, the availability of information, the ways in which information flows from member state to member state, and the protection of employees post reporting.

Hence, the EU AML legal framework is still required to further develop and to predict consistency and availability of information, not to mention, include provisions on data privacy, data sharing and its compatibility with criminal procedures e.g. reporting.

Despite its controversial nature, the obligation to report and identify possible money launderers was not sufficient to stop ML from developing even more. Soon after 1991 EU member states realised that the approximation of law was the next odd yet complementary step to AML legislation.

As will be demonstrated, the development of AML outside of the community pillar, not only called for cooperation between both but, also transformed AML into something much more relevant to EU integration than would be originally expected.

2.2. Mutual recognition of EU criminal law

Mutual recognition of criminal law is another crucial element to ensure cooperation in JHA, not only because it allows for swift overcoming of national legal barriers and jurisdiction issues but also because it assists the removal of barriers of state law to police action, permitting it to act on equal ground with criminals. In the AML framework it is a necessary complement to the obligations imposed on the private sector.

As a result, much of what is done in the fields of mutual recognition and mutual legal assistance directly affects the implementation of AML legislation and, in fact, was promoted by the existence of numerous similar threats.

Specifically regarding AML, the mutual recognition of criminal laws between MS was an indirect consequence of transnational crimes but also of the internal market's own

existence. In the enacting of AML policies the assumption is that if protecting financial interests from shared threats is common, then so should the combat strategies.

Nevertheless, measures to "approximate" criminal laws and facilitate cooperation did not constitute the EU's concern until 1999 in the Tampere JHA Council. The reason it is mentioned in this paper is justified because whereas the first ML Directive focused on financial services, the outcome of its requirements and demands would have fallen in void were it not for the recognition, albeit delayed, of the need to have the criminal system accompany financial interests safeguarding measures.

"Approximation" of criminal law between MS, however, has not been straightforward.

In this instance, instead of creating common laws and standard approaches to all similar issues, effectively approximating, MS' preferred approach is 'mutual recognition' which "*entails the acceptance of judgements issued by national criminal courts, reflecting their domestic criminal justice systems*"[32] but only in matters that have been previously agreed by MS.

In other words, MS prefer to acknowledge only cooperation mechanisms that still allow them to continue preserving their national legal systems and sovereignty. MS' strategy to cooperate in relation to criminal law is clearly much more intergovernmental than that adopted to protect financial interests and was foreseen in the first ML Directive.

Somewhat puzzling then is the EU's simultaneous expansion of mutual recognition to third countries, the USA in particular. Indeed, in 2003 the first international 'third pillar' agreement, on mutual legal assistance with the USA,[33] to some extent going against the 'intergovernmental' rule that bounds the remaining legal framework. Not only did this agreement go further than MS are usually willing to go in criminal law but also, the infringements of national laws predicted concerning data protection and sharing were such that the agreement, signed in 2003, has barely been implemented yet.

[32] Valsamis Mitsilegas. *EU Criminal Law*. (Hart Publishing, 2009): 101
[33] European Council Decision 2003/516/EC of 6 June 2003 *concerning the signature of the Agreements between the European Union and the United States of America on extradition and mutual legal assistance in criminal matters*, OJ L 181 of 19 June 2003, p. 25

Mutual recognition then seems to combine intergovernmental and Community preferences while simultaneously open panoply of debates over delegation of powers within the EU and in specific topics. It is trapped between the acknowledgement that some threats require concerted action and the simultaneous desire to maintain sovereignty.

For this reason, the adopted documents[34] in this area are good examples of the ambiguity surrounding delegation of competences in areas with an inter-pillar character. The AML framework has greatly benefited from the developments surrounding mutual recognition. However, the role of the Commission in this process and its significance to European integration merits further analysis.

3. Why has the Commission become such an important actor in what concerns AML?

As Pollack affirmed, the functions of supranational institutions sometimes say more about the institutions own preferences than those of its principals, the MS.[35]

In the case of the EU AML framework, principal-agent and theories of delegation can assist in clarifying the relationship that has developed between the member-states, as principals, and the Commission, as agent.

The 'principal-agent approach' (*hereinafter*, PA):

> *"draws from rational-choice theories of domestic and international politics, arguing that instrumentally rational actors (voters or legislators at the domestic level, states at the international level) delegate powers to executive*

[34] European Council Framework Decision 2006/783/JHA on the application of the principle of mutual recognition of confiscation orders, OJL 328 of 24 November 2006; European Council Decision 2003/516/EC of 6 June 2003 concerning the signature of the Agreements between the European Union and the United States of America on extradition and mutual legal assistance in criminal matters, OJ L 181 of 19 June 2003, p. 25; European Council Framework Decision of 13 June 2002 on the European arrest warrant and the surrender procedures between Member States - Statements made by certain Member States on the adoption of the Framework Decision, OJ L 190 of 18 July 2002, p. 1 – 20; And European Council Act of 29 May 2000 establishing in accordance with Article 34 of the Treaty on European Union the Convention on Mutual Assistance in Criminal Matters between the Member States of the European Union, OJ No. C326/1 of 21 November 2001

[35] Mark A. Pollack. "Delegation, Agency, and Agenda Setting in the European Community." *International Organization* 51, no. 1 (1997): 107.

and judicial agents systematically in order to lower the transaction costs of policy-making".[36]

Henceforth and for the purpose of this paper MS will be viewed as 'principals', with autonomy of decision and sovereignty, whereas EU institutions are for the most part 'agents' to which principals delegate powers to.

Delegation in AML policy-making has two identifiable main reasons: Firstly, as an international threat, ML problems are similar and shared as is the solution; Secondly, at the international level, EU included, MS tend to defend preferences that either have already been discussed at national parliaments, or that have been discussed at the intergovernmental level with partner states.

Delegation is, ultimately, a simplifying mechanism to EU member state relations. It is through it that "the principals hope to manage externalities, facilitate collective decision making, resolve disputes, enhance credibility, and/or lock-in commitments."[37]

The drafting of the first AML Directive and some of the events that followed is a rich example of how delegation can occur in one occasion and end up influencing a whole different area of work. Interesting questions arise from this delegation process namely: what the role of each actor is? What are the consequences of agent dissent?

For example, during the negotiations of the draft proposal, MS and the Commission were faced with the debate on the inclusion of 'criminalising' (as per Commission proposal) or 'prohibiting' (as per MS' preference). In this instance, the Commission drew its proposal recognising, following its meetings with FATF, that the ML offences needed to be criminalised. However, MS did not recognise the Commission's competence to do so and altered the term to 'prohibit'.[38]

Nonetheless, criminalisation was still included at the end of the text where it can be read MS should "*undertake to take all necessary steps by 31 December 1992 at the latest to enact*

[36] Mark A. Pollack, "Principal-Agent Analysis and International Delegation: Red Herrings, Theoretical Clarifications and Empirical Disputes." *Bruges Political Research Papers*, no. 2 (February 2007): 3. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1011324.
[37] David Howarth, "At the Vanguard of Globalization: The OECD and Capital Liberalization", *Review of International Political Economy*, (with Tal Sadeh) (*forthcoming*) 2011: 5.
[38] See, Mitsilegas. *Money Laundering Counter-Measures in the European Union: A New Paradigm of Security Governance Versus Fundamental Legal Principles*

criminal legislation enabling them to comply with their obligations under the aforementioned instruments".[39]

Ultimately, the obstacles noted during the negotiation process at the Council seem to have been, in reality, an issue of principle rather than true difference. Furthermore, although the Commission "lost" that specific battle, 20 years later we see how the development of the framework actually took place much more in line with Commission preference than with MS.

Member states have, since 1991, progressively abdicated some of their authority to supranational bodies,[40] regional and international. Despite the numerous EU laws, competence constraints and installed control mechanisms, MS show some inclination in favour of more efficient policy-making regarding the protection of the internal market and the threat posed by money laundering.

While doing so, nonetheless, MS continue to have preferences on how matters should develop exerting them through their participation e.g. in the Committee on the Prevention of Money Laundering and Terrorist Financing. Said preference to delegate powers is, as I have tried to suggest in this article, influenced by a significant number of factors ranging from: threats to internal market and the need to protect it (reflected in the development of EU criminal law); the influence of international norms/information (e.g. from the United Nations, the Financial Action Task Force and the World Bank) and; the progressive involvement of the private sector.

This can mean that, at times, the outcome of policies or the type of coordination established may actually depend neither on the Commission's preferences, nor on MS preferences, but on international influence.

Regarding the AML framework the Commission holds, in theory, a level of informational advantage over most MS that effectively influenced EU policy-making since 1991. Moreover, its preferences can, in the remaining cases, be justified as aiming to accomplishing EU's

[39] OJ L166, 28.06.1991, p.77.
[40] Mark A. Pollack, "Delegation, Agency, and Agenda Setting in the European Community," *International Organization* 51, no. 01 (1997): 99-134.

objectives, naturally providing the moral upper ground and a more collectivist notion than that held by MS.

The Commission's preference was, at this point, influenced by international elements, not necessarily with self-interest. And, perhaps attesting to that MS did criminalise the offence through an attached declaration[41] creating a good example for principal-agent analysis and its understanding of the importance of information flows.

PA, in fact, predicts the possibility that agents may go beyond or against MS' preferences through the exploitation of the degree of information it holds. It identifies the tactic created to avoid these types of MS reaction, that is, the possibility of member states to establish several kinds of control mechanisms over its agents (ex-ante and ex-post) and thus monitor the work of the agent.[42]

In what this paper is concerned, one of the last relevant control measures enacted by principals towards the Commission took place during the making of the Maastricht Treaty, where Commission powers were "heavily curtailed in the fields of foreign and security policy and justice and home affairs".[43] It looked as if after 1991 MS realised that, more and more globalisation and the spreading of transnational criminality would lead to policies requiring coordination and mutual recognition of criminal and other laws, implying advanced delegation to the Commission.

It was the Maastricht Treaty that determined screening and selection mechanism regarding the nomination of commissioners and the president; monitoring and reporting requirements.

Member states, moreover, created three oversight mechanisms e.g.: 'fire alarms', institutional checks (Ombudsman, court of auditors and the ECJ) and 'police patrols'. Also,

[41] Mitsilegas, *Money Laundering Counter-Measures in the European Union: A New Paradigm of Security Governance Versus Fundamental Legal Principles*, 65.
[42] Jonas Tallberg, "Supranational influence in EU - enforcement: the ECJ - and the principle of state liability", *Journal of European Public Policy* 7, n. 1 (2000): 111.
[43] Fabio Franchino, "Control of the Commission's Executive Functions," *European Union Politics* 1, n. 1 (February 1, 2000): 67.

the famous 'comitology' system is a good example of MS efforts to limit the Commission's preference in the implementation of certain "ideal policies".[44]

Control mechanisms, following PA assumptions, were created to prevent agency losses, or what is known as 'shirking' and/or 'slippage'. These happen when: a) the Commission preferences differ from MS (shirking) or; b) the Commission uses its right of initiative to pursue its preferences (slippage).[45]

Regardless, within the first AML Directive the division of roles and delegation structure was quite simple, given its focus on the financial interests and the internal market on the one hand, and by the lack of option in choosing a 'lesser instrument'. Furthermore, at that stage, AML strategies were not so developed as to allow for implementation concerns or to contemplate cooperation in criminal law.

The European Commission had an undeniably significant role in the writing up of the first Directive (before Maastricht) and continued to do so in the subsequent development of related legislation in what concerns its scope, definitions, implementation, etc.

It played, and continues to play, a significant role in translating the subsequent Directives into the *acquis* for adoption by new MS, drafting reports on the implementation process and ensuring the updating of policies when necessary.

The role of the Commission became significant early on, already at the time when the Commission took the "necessary steps to ensure that the majority of EFTA countries implement the terms of the Directive in their national law following ratification of the Agreement for a European Economic Space".[46] Furthermore, it "has insisted on progress in the area of money laundering in its various negotiations with the states of Central and Eastern Europe,"[47] thus ensuring that new MS had these measures included in their *acquis* from the start and that the internal market is not disturbed by eastern criminal networks.

It was the European Commission that, from the moment the first Directive was adopted became the body responsible for the monitoring of its implementation, update and review.

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[44] *Idem*, 65.
[45] *Ibidem*, 67.
[46] Bill Gilmore "Money Laundering: The International Aspect" *in* MacQueen, Hector L. *Money Laundering*. (Edinburgh University Press, 1993): 9
[47] *Idem*, 9

The second and third AML Directives[48] were as well and in their own right achieved through the Commission's work liaising with FATF, the requirements of the new struggle against terrorism and progressive advances in the technological and strategic capacity of criminals.

The Commission, in spite of the control mechanisms and attempts to curtail its powers, has managed to maintain a significant role in shaping policies and significant space to enrol in what can be described as "slippage" by the principal-agent defendants.

The truth is that whilst lacking accountability and competence in some of the AML developments that that took place post 1991, the Commission has implied that its 'preferences' are more based on the available information originating either from other EU specialised bodies or international organisations. Thus it acquired a certain degree of 'impartiality' and inevitability that may justify MS acceptance of its role.

How then does PA explain the role of the European Commission in the coordination of AML legislation and policy-making?

PA would depict it through the processes of delegation and the assumption that MS are principals and the Commission as agent, may or may not defy them by provoking agency losses. However, principal agent is not critical of reality. In other words, whilst it explains preferences and reality in general it does not question its future or past in light of principles. Regarding the anti-money laundering measures, whereas Commission's competences increase is favourable to the internal market and the functioning of criminal law, therefore making perfect sense. On the other hand, that competence will not have any democratic character without further alteration to the Treaties. PA does not really discuss integration as much as it explains it. In order to further explore the AML topic, a more critical tone should be added to PA.

Within the Lisbon Treaty, actually, there have been some developments of control mechanisms targeting the Commission, which are parallel to its increase in competences within JHA. It is also an excellent tool to guide a discussion on the effects of integration.

[48] OJ L 344, 28.12.2001, p. 76–82; And, OJ L 309, 25.11.2005 p.15-36.

In future research, it would also be interesting to debate the reasons behind the increase of intergovernmental oversight over Commission activities. Especially, one should reflect on the work and relevance of the Committee on the Prevention of Money Laundering and Terrorist Financing and how it relates to the expansion of the co-decision procedure in light of the Lisbon Treaty.

4. Combating Illegal Economies: a common strategy in the making

Policy-making behind AML measures in the EU has not always received adequate attention from all actors involved that either view it as a criminal law problem alone or a market deficiency. As such, one of the main objectives of this paper was to demonstrate how the two are actually much related and must continue to develop through a mechanism of close cooperation between all actors. A common efficient strategy is required.

In this rather exploratory paper I aimed to demonstrate that whilst the first AML Directive was mainly directed at financial institutions and served to regulate its operations mechanisms, the instruments that followed predict the increasing EU integration and relative supranational governance. By highlighting the first money laundering Directive's consequences in the private financial sector and EU criminal law I also intended to establish its heterogeneous character and the policy-making problems that stem from it.

This paper illustrates how regardless of the progressive delegation that followed the first AML Directive, MS have not fully given up their authority over criminal law neither do they seem inclined to do so. Mutual recognition was the preferred approach. As a result, different implementation levels of AML legislation exist in each member state lead to confusion on the financial sector's side (itself a transnational business) and complaints over lack of coordination in policy implementation.

The European Commission, consequently, appears to be the possible solution to the policy coordination issues through the use of its administrative and well-informed nature. However, the extent to which its role can go beyond current settings within the AML realm is

still to be determined and can instigate important debates on accountability and the role of the supranational.

In reality, a lot more can be said about the topics I have presented for discussion. The objective of this paper, however, was to augment the questioning and debate on a complicated yet current issue that whilst being much broader than European Union and its internal actors still deeply affects the European internal structure.

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