S. HRG. 106–198

# THE BLACK MARKET PESO EXCHANGE: HOW U.S. COMPANIES ARE USED TO LAUNDER MONEY

## HEARING

BEFORE THE

## SENATE CAUCUS ON INTERNATIONAL NARCOTICS CONTROL

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

JUNE 21, 1999

U.S. GOVERNMENT PRINTING OFFICE

60–125 WASHINGTON : 1999

SENATE CAUCUS ON INTERNATIONAL NARCOTICS CONTROL

ONE HUNDRED SIXTH CONGRESS

CHARLES E. GRASSLEY, Iowa, *Chairman*
JOSEPH R. BIDEN, Delaware, *Co-Chair*

JEFF SESSIONS, Alabama
MIKE DEWINE, Ohio
SPENCER ABRAHAM, Michigan

BOB GRAHAM, Florida
DIANNE FEINSTEIN, California

WM. J. OLSON, *Staff Director*
SHERYL WALTER, *Minority Staff Director*

# CONTENTS

## OPENING STATEMENTS


| | Page |
|---|---|
| Sen. Charles E. Grassley | 1 |
| Sen. Jeff Sessions | 4 |


## PANEL I


| | |
|---|---|
| James E. Johnson, Under Secretary of Enforcement, U.S. Department of Treasury | 5 |
| Prepared Statement | 10 |
| Bonni Tischler, Assistant Commissioner, U.S. Customs Service | 22 |
| Prepared Statement | 26 |


## PANEL II


| | |
|---|---|
| Al James, Senior Policy Analyst, Financial Crimes and Enforcement Network | 47 |
| Prepared Statement | 50 |


## PANEL III


| | |
|---|---|
| "Carlos," A Peso Broker | 62 |
| Prepared Statement | 65 |


## PANEL IV


| | |
|---|---|
| Ms. Fanny Kertzman, Director General of Taxes and Customs, Government of Colombia | 72 |
| Prepared Statement | 75 |
| Ambassador Michael Skol, President, Skol and Associates | 95 |
| Prepared Statement | 99 |


## ADDITIONAL RESPONSES


| | |
|---|---|
| General Electric Response | 113 |

# THE BLACK MARKET PESO EXCHANGE: HOW U.S. COMPANIES ARE USED TO LAUNDER MONEY

---

**MONDAY, JUNE 21, 1999**

U.S. SENATE,
CAUCUS ON INTERNATIONAL NARCOTICS CONTROL,
*Washington, DC.*

The caucus met, pursuant to notice, at 9:05 a.m., in room SH–216, Hart Senate Office Building, Hon. Charles E. Grassley (chairman of the caucus) presiding.

Present: Senators Grassley and Sessions.

Senator GRASSLEY. I would say good morning to everybody and I want to thank you for being out so early at the beginning of a week. I hope everybody had a good weekend. I want to welcome everybody here and obviously those who have traveled long distances to be with us, some from other countries, to be here, and also those who are witnesses and for your preparation and for taking time away from your responsibilities at your particular agencies for being here.

Before I say a few things in opening, it is usually better if I would announce some administrative things so that we do not have to be repetitive. Number one, members may or may not be in and out. Sometimes Mondays it is difficult to have members be here, but even when it is convenient for members to come, they may not be here for the full period of time. So when that is the case or even for those of us who will be here for the entire period of time, we may not have time to ask all of our questions orally so we submit them for answer in writing and the extent to which we do that, we would appreciate response within two weeks, and those of you maybe not familiar with that process, the staff of the caucus I chair would be very happy to be helpful to you.

Secondly, sometimes people have longer statements than the time allotted for them for their oral presentations. All of those oral or written statements will be included in the record totally so you will not have to ask and then we ask you to summarize and your total statement will then be printed in the caucus record of this hearing. It will be available after some period of time, sometimes longer rather than shorter, for everybody to have a complete record of today's hearing. And so from that standpoint, I would appreciate everybody knowing that that can be included.

I want to, a second time now, thank you for coming. Today we will examine an issue that is of great concern to me and the Congress and specifically the work of this International Narcotics Con-

trol Caucus of the United States Senate, money laundering and how the drug cartels are using U.S. and foreign companies to launder their drug proceeds. I am concerned also not only as chairman of this caucus, but also this is a very big issue in international trade and I serve as chairman of the Subcommittee on International Trade of the Senate Committee on Finance.

The method of money laundering capitalizes on the black market peso exchange in Colombia and businesses in the United States, Japan and other countries abroad, as well. Drug cartels generate large sums of money from this illicit drug trade. Recent reports show that the drug trade generates maybe over 55 billion a year. This money obviously has to be laundered. One of the methods traffickers use is the black market peso exchange network. Drug traffickers use this exchange to help convert billions in U.S. currency obtained from the street sale of narcotics into pesos so that they can fuel the drug business at home.

Reports indicate that approximately $5 billion a year is being laundered and this figure is rapidly growing. Effective money laundering is at the root of any successful drug cartel. It allows cartels to reap the benefits of their ill-gotten gains by hiding their drug money through a series of transactions evading detection by law enforcement and banking officials. Drug traffickers no longer have the ability to deposit millions of dollars of drug money into bank accounts as a result of the increased awareness of banks, but we have only made it just a little more difficult for them to get their money converted.

We must be sure that we are taking the necessary steps to protect the citizens of our nation by preventing drug traffickers from then obtaining the profits of their illegal activities. Much has been done and much has been said about the movement of illegal drugs into the United States, but the opposite side of the business, getting the profits from drug sales and other illegal enterprises out of the United States and back into the hands of Colombia drug cartels, does not get as much publicity but is just as important.

During this hearing, we will hear the names of U.S. and foreign companies that have unwittingly helped fuel the illicit drug trade with the sales of goods that are exported and eventually sold in Colombia. These goods are being sold legitimately to export companies and businesses in Colombia. However, the problem is this merchandise, whether it be auto parts, computers, or refrigerators or a lot of other items, is being paid for with cash generated by drug sales on our streets and even in our school yards.

This happens through a middleman, the dollar peso broker. This directly translates into a safe and effective method that facilitates the ability of drug cartels to get drug proceeds back to Colombia and into their pocketbooks. Cartels have learned a new way to circumvent the safeguard that banks and the governments have put in place. Today, the black market peso exchange stands as one of the most potent, effective, and dangerous forms of money laundering techniques employed by the drug cartel. It not only makes American corporations unwittingly helping to accomplish the narcotic trafficking but perpetuates tax evasion, the growth of contraband, and ultimately the drug trade itself.

Now this process works this way: cartels collect their cash from the sale of illegal drugs in our towns and cities; the cartels then sell their drug money for pesos on the black market peso exchange. This is accomplished by a dollar/peso broker, a middleman in the transaction that makes the exchange of drug dollars and pesos happen very smoothly and very quickly. Peso brokers have bank accounts in the United States to facilitate these transactions. The peso broker assumes the risk of handling the narcotics traffic currency. For this reason, the dollars are usually sold at discount from the official Colombian dollar/peso exchange rate. The peso broker sells the dollars to business associates who deal in contraband goods. They are Colombian importers that deal in smuggling of contraband into Colombia.

This contraband consists mostly of U.S. trade goods. The smugglers need large amounts of U.S. dollars in order to pay for U.S. and foreign goods that they plan to smuggle into Colombia to evade Colombian taxes and tariffs. In exchange for pesos from these smugglers, the peso broker makes payments in U.S. currency for these goods. The currency for these transactions is now largely supplied by the drug proceeds. The bottom line: the cartel gets pesos, the Colombian smuggler gets currency to pay for the goods that he smuggles, the peso broker gets rich, and U.S. businesses, Colombian and U.S. citizens pay the cost. And here is how. Our citizens pay because drug smuggling is helped, legitimate business in Colombia is forced to close from this unfair competition, and U.S. companies find themselves facilitating money laundering.

Now, in preparing for this hearing, I and my staff learned how dangerous this process can be. Potential witnesses who initially agreed to testify anonymously later changed their mind. They declined because of the threat to them and the well-being of their families, and we understand that. These witnesses represented not only peso brokers but Colombian businessmen that can no longer compete with the price of U.S. goods smuggled into Colombia as a result of this process that I have outlined. This is despite the guarantee of anonymity that we gave them.

We also learned that a New York fabric company in Manhattan under investigation by Customs knowingly accepted drug money as payment for its fabric sales to Colombia. Last year, five people pleaded guilty to money laundering charges in this particular case. These cases are very difficult to detect and the investigations are complex, very long-term and very manpower intensive. An example that demonstrates this is last year's culmination of one of the most successful undercover operations in the history of the Customs Service. Known as Operation Casablanca, this effort infiltrated and dismantled a group of international bankers involved in laundering drug money. The investigation revealed a top money launderer for the Cali Cartel provided instructions to make a series of deposits into accounts of cellular phones, computers and other wholesale companies in Miami. This is typical.

This morning we will hear from several panels that will discuss how the process works, what can be done about it here in the United States, but also what can be done about it in Colombia. There are many courageous people in Colombia fighting this illegal drug trade. Today we are honored to have Ms. Fanny Kertzman,

Director General of Taxes and Customs of Colombia. One of our witnesses will be anonymous and talk firsthand specifically about his work as a peso broker with drug cartels and how the cartels conduct the money laundering portions of their drug trade. He has agreed to testify despite risk and he will answer questions as fully as possible as long as his identity is not revealed.

We need to address how to deal with this problem. U.S. companies cannot allow their companies to be used, whether knowingly or not, as a way to fuel the illicit drug trade. I continue to stress the need for a comprehensive counternarcotics strategy. I urge not only the administration and U.S. law enforcement and citizens, parents, clergy, and professionals, all of the above and more, to help in this fight, but also we must involve U.S. and foreign businesses as well.

It is essential that we in Congress help build an awareness within the business community to better understand this problem and how to fight it. I am in favor of voluntary compliance rather than reporting requirements and even more so than more regulations. It is more or less an enforcement of what is on the books as complicated as that enforcement might be. We must also look to U.S. law enforcement and the difficulty that they have in detecting these process. So I hope today that this hearing helps to bring U.S. companies and others to the table to address this problem and that is an open invitation from me not only to facilitate that process but what can we do in government to be better cooperative to U.S. companies and other entities to help accomplish our goal.

Now, if the senator from Alabama would like to have an opening comment, I would turn to you at this point.

Senator SESSIONS. Thank you. Briefly, Mr. Chairman, I would like to thank you for looking into this issue. I think it is important. I have always felt as a prosecutor for a lot of years and a federal anti-drug prosecutor that has indicted quite a number of Colombians for various crimes involving drugs primarily that you follow the money. That is a key way to do it. There are some things that we can do that are effective such as forfeiting the assets of drug dealers. I strongly believe that that is a key thing and I am somewhat concerned that there is legislation afoot that would reduce the capacity of the federal government to do that. I think that would be very unwise. I am open to see what we can do with regard to this market, peso market, but I am not certain that there is a great deal that we can rightly achieve in this aspect of our efforts. But if it is, it would certainly be a good thing because if you follow the flow of the money, you can usually find where the criminality occurs. Thank you, Mr. Chairman, for your leadership.

Senator GRASSLEY. Thank you for being a consistent participant in the work of the caucus and also through our joint membership on the Judiciary Committee in which a lot of this legislation would find itself to be enacted and to consider.

Now, our first panel is already at the table. I thank them for being very prompt. So we welcome James E. Johnson, who is Under Secretary of Enforcement from the Department of Treasury, and also testifying is Bonni Tischler, the Assistant Commissioner for the Office of Investigations, U.S. Customs, and I know that Commissioner Kelly was originally supposed to testify and that he

is recovering from surgery and we all wish him a speedy recovery, but he has also been very cooperative with this caucus, not only in testifying but in working very closely with us on the issue of legislative authorization as well as our working together to try to meet the needs of Customs for more money to help them do their job better. So I thank you both for being here, and Mr. Johnson, I will start with you and please begin at this point.

**STATEMENT OF JAMES E. JOHNSON, UNDER SECRETARY OF ENFORCEMENT, U.S. DEPARTMENT OF THE TREASURY**

Mr. JOHNSON. Thank you. Mr. Chairman, Senator Sessions, good morning. It is a privilege for me to be able to appear before this, the Caucus on International Narcotics Control, to speak about a very important issue, and I am happy to be joined by Assistant Commissioner Bonni Tischler. I have submitted a rather lengthy statement for the record and with your permission, Mr. Chairman, I would like to summarize.

As this caucus is aware, international crime constitutes a national security threat. It also is a threat brought home to us directly on our streets, in our schools, within our communities. Such crime, particularly as it relates to drugs, is the work of international criminal enterprises. I am here to talk today about one of the systems that these international criminal enterprises uses which is the Colombian black market peso exchange system. This system is perhaps the most dangerous and damaging form of money laundering that we have ever encountered.

Today I wish to share with you how the Department of the Treasury in concert with other law enforcement agencies, regulators and private sector representatives, is working to disrupt and dismantle this money laundering system. Mr. Chairman, I would like to thank this caucus for its leadership and its efforts on this very important matter. Since the House hearing in 1997, the federal government has maintained its focus on the black market peso exchange as a major component of its anti-money laundering strategy.

We have taken several steps designed to enhance our efforts in this fight. We have worked to design and implement smart and tough law enforcement initiatives that are focused on the choke points of the black market peso exchange system. The successes resulting from these initiatives have built upon a foundation of close cooperation with our international partners in this effort including and most importantly the government of Colombia.

Here I must acknowledge the outstanding efforts of Ms. Fanny Kertzman, Colombia's Director of Revenue and Customs Service. Ms. Kertzman has worked closely with us, sharing information that has enabled us to not only understand but to effectively begin to move against the black market peso exchange. In order to place these initiatives in their proper context, I would like to take just a few moments to briefly summarize the operations of this system. A more detailed account of the workings of the exchange system will be provided by Alvin C. James, who is a senior policy adviser for Money Laundering Enforcement at the Financial Crimes Network. He is also an IRS special agent.

The Colombian black market peso exchange system is primarily an exchange of currencies, the selling and buying of U.S. dollars. The two major customers of this system are drug traffickers who amass millions of U.S. dollars which they are unable to use unless they are converted to pesos and Colombian importers who need U.S. dollars in order to pay for illegal imports. Basically we have a Colombian drug cartel with U.S. dollars in the United States who need pesos and, on the other hand, you have Colombian importers with pesos in Colombia who want to very often smuggle goods into Colombia in contravention of Colombian laws, and they are looking for United States dollars to pay for those goods. Enter the peso broker. The Colombian importer or smuggler pays for the dollars by providing pesos to the broker in Colombia.

For purposes of this example, and I would just give you a quick example, let us assume that this peso broker is a small-time operator. He gives the importer an IOU in exchange for the pesos. The IOU will be payable in dollars. The broker then sells the pesos to the drug trafficker who pays for them by effecting the transfer of United States dollars to an operative of the broker working in the United States. Now the peso broker has dollars to pay the Colombian importer for the pesos. But instead of having the peso dealer deliver the dollars in Colombia and exchanging them for the IOU, the importer instructs the peso broker to use the dollars that have been deposited often in a United States financial institution to pay a U.S. merchant or a U.S. exporter for goods that he has ordered and that will be smuggled into Colombia.

That completes the transaction and at the end the drug trafficker has laundered his illegal profits and gets clean pesos in exchange for dirty drug money. The Colombian importer is paid for merchandise in U.S. dollars purchased on the black market, which allows him to circumvent Colombian laws, and the peso broker has collected a handsome commission from both the drug trafficker and the importer.

Now with that as a backdrop, what I would like to do is with the remainder of my time is focus on what we have done, what we are doing and what we intend to do to combat this intricate and complex form of money laundering. As I said earlier, in putting together, in assembling and formulating our response to the black market peso exchange, we have worked to design and implement smart and tough law enforcement initiatives that are focused on the choke points of the exchange system. Through these initiatives, we have ensured our ability and have continued to make solid cases hitting the black market peso exchange at every choke point. In fact, Mr. Chairman, you identified one, just one example of Customs very successful approaches in dealing with this problem.

But to pull together the various strands and to pull together the various efforts against this exchange, a single approach was not required, much more than that. And to that end, in 1998, at Treasury in Treasury Enforcement I established the Black Market Peso Exchange Working Group. This working group devoted to the development of a comprehensive action plan to combat the black market peso exchange brings together in a coordinated effort the tools of the Treasury Department, the tools of the Justice Department, and all of our enforcement bureaus and regulatory agencies, not

only within the Treasury Department but also external to the department.

This group has developed an internal but innovative action plan that serves as a blueprint for coordinated, effective attack on the black market peso exchange. The plan, which is not publicly available, will continue to evolve. The action plan is premised on three basic principles: coordination and consultation among government agencies in order to ensure smart and tough enforcement of existing laws against participants in the black market peso exchange; international cooperation with our key allies; and finally outreach to the private sector.

Since the early 1980s, we have successfully investigated and successfully prosecuted individuals laundering drug proceeds through the black market peso exchange. In the past eight years alone, Customs undercover operations have led to the seizure of $800 million, approximately 2,100 arrests, and the seizure of 100,000 pounds of cocaine. In addition, the IRS has investigated approximately 250 cases also related to the black market peso exchange.

The working group integrates law enforcement and regulatory efforts with intelligence data support. Through the Black Market Peso Exchange Working Group, we have ensured that each of the participating agencies is aware of information available to the others, as well as has means of accessing such information. Additionally, and in close coordination with Ms. Kertzman, it has created an analytical subgroup devoted to the analysis of shared information, not only our information that has been shared, but information that has been shared and received from Colombian authorities. This subgroup comprised of representatives from the Financial Crimes Enforcement Network, Customs, Justice, the IRS, and NDIC, the National Drug Intelligence Center, will join their counterparts in a bilateral task force initiative in Colombia, in Colombia, to review, analyze and discuss specific data that may well further the investigation and prosecution of cases against the black market peso exchange.

For this and other reasons, I am particularly pleased that Ms. Kertzman is here with us today and look forward to hearing her confirmation that this task force will meet in Bogota in the very near future. Such interagency work at home and abroad complements other resources. Customs, for example, in coordination with FinCEN has recently established a national Money Laundering Coordination Center to coordinate and make available to other agencies the intelligence generated from Customs undercover operations targeting the black market peso exchange. And about that, I expect you will hear a great deal more from Assistant Commissioner Bonni Tischler.

There is growing recognition that governments must deal firmly and effectively with increasingly illusive, sophisticated and well organized criminals adept at exploiting opportunities and vulnerabilities in any anti-money laundering regime. One of the reasons that the peso exchange has become so prominent is because of the efficacy, the effectiveness, as, Mr. Chairman, you pointed out, of the Bank Secrecy Act in trying to keep and keeping out dirty money from our system. It is not easy for them to put

dirty money in our financial system, and the exchange has developed, at least in part has expanded in response to that.

We must strive to work together, all governments, in a more coordinated fashion. And we must establish mechanisms that ease the exchange of information, permit, encourage and increase collaboration, and improve cooperation bilaterally and multilaterally. The department has made important progress in this area. There is improved internal coordination of international anti-money laundering efforts across a broad range of federal agencies and regulators and programs with regard to the black market peso exchange efforts. For example, the departments of Treasury and Justice co-chaired two days of talks with senior officials from Colombia's Customs, Foreign Trade and Banking Superintendents offices on the black market peso exchange. We have not only discussed what is going on, but we have discussed what steps each could take separately as well as steps that we could take collectively to combat the problem.

These informal discussions represent an important breakthrough, ushering in a number of cooperative initiatives and programs important to the law enforcement efforts in both countries. In addition, Treasury in close consultation with Justice and the State Department has begun to work with governments and officials from the Free Trade Zones of Aruba and Panama. Bringing together all of these key players in order to bring the collective weight of our resources, experience and insights to bear on this money laundering system is integral to our overall black market peso exchange strategy.

The department is also promoting several multilateral initiatives that build upon these bilateral efforts and complement important work being undertaken by organizations such as the Financial Action Task Force. FATF, which is what the Financial Action Task Force is often referred to, brings legal, financial, and law enforcement experts into the policymaking process. Our action plan intends to build on this critical aspect of FATF's anti-money laundering programs by proposing expansion of the process to incorporate trade and business represents and focusing upcoming meetings on trade related money laundering, a point, Mr. Chairman, that you made in your opening statement.

Mr. Chairman, it is important for us to keep in mind that money laundering is a global problem with serious repercussions in other countries. The United States is not alone in facing this challenge and we are increasingly dependent on the cooperation of our neighbors. We have a lot of work to do at home, too, particularly in the private sector. The first step in forming an effective partnership with the private sector must be to educate the public and the business community about this exchange, this system. FinCEN took an important first step in July of 1997 by initiating a series of meetings with local and national banks in the Miami area.

These meetings culminated in a final meeting in November 1997, after which FinCEN published its first advisory describing the black market peso exchange to the law enforcement and financial communities. FinCEN is issuing a follow-up to its advisory this very day that updates the financial community on what we have

learned as a result of regulatory measures and investigative efforts undertaken recently.

Also, as a part of our effort to work with the business community, United States Customs Service is launching a national campaign today alerting businesses to the black market peso exchange system and what to look for in order to avoid being used as part of the money laundering scheme. In support of these efforts, this week I will be speaking to the Association of Home Appliance Manufacturers to educate them about this important issue. The Department of Treasury has also begun an education process in the business communities of Colombia, Aruba and Panama. I am pleased to report that all three governments have displayed great willingness to work with us in developing a coordinated approach to this problem.

Mr. Chairman, by holding this hearing and recognizing the significance of a highly complex and systematically invasive criminal operation, the caucus is making an important contribution towards further informing our country's debate about one of our most serious national security threats: narcotics related money laundering.

In closing, I believe that our strategy paves the way to make significant inroads against this system. We will seek to employ our most effective tools to attack the black market peso system at its choke points. We will work with our international partners and we will reach out to the financial and business communities to emphasize the important role they can and must continue to play in this fight. I would be happy to answer any questions you or any other members of the committee have. Thank you very much.

[The prepared statement of Mr. Johnson follows:]

**THE COLOMBIAN BLACK MARKET PESO EXCHANGE**

**Testimony of James E. Johnson**
**Under Secretary for Enforcement**
**U.S. Department of the Treasury**
**Before the**
**Caucus on International Narcotics Control United States Senate**
**June 21, 1999**

Mr. Chairman and members of the Caucus, thank you for the opportunity to discuss what law enforcement believes to be one of the most insidious forms of drug money laundering, the Colombian Black Market Peso Exchange (BMPE). This system of laundering drug proceeds has been used by Colombia's drug syndicates for a number of years.

Mr. Chairman, I would again like to thank you, this Caucus, and other concerned officials for your leadership and efforts on this vital matter. Your vigilance has helped the federal government maintain the BMPE as a major target of its anti-money laundering efforts. In addition, I would like to thank you personally for your unflagging support of our overall counter-drug efforts, particularly those of the U.S. Customs Service.

As this Caucus is well aware, international crime constitutes a national security threat. It also is a threat brought home to us directly – on our streets, in our schools, and within our communities. Such crime, particularly as it relates to drugs, is the work of international criminal enterprises.

Money laundering is critical to the survival and growth of these organizations. As President Clinton remarked to the United Nations on the fiftieth anniversary of its creation:

> We must not allow criminals to wash the blood off profits from the sale of drugs, from terror or organized crime. Together we must

> say ... to organized criminals, terrorists, drug traffickers and smugglers, you have nowhere to run and nowhere to hide.

At the same time, following the money trail is an effective means of attacking the organizations. Indeed, if money laundering is the "life blood" of crime, it is also, as Secretary Rubin has observed, "the Achilles heel, as it gives us a way to attack the leaders of criminal organizations." So it is with the BMPE and its link to the Colombian drug traffickers. An attack on the BMPE -- one of the systems sustaining Colombian drug cartels -- constitutes an attack on the cartels themselves. Our gains against this money laundering system ultimately mean fewer drugs on our streets, less drug-related violence, and more lives saved.

We have taken several steps designed to enhance our efforts in this fight. We have worked to design and implement smart and tough law enforcement initiatives focused specifically on the BMPE system. Our efforts have resulted in successful cases and significant seizures. We look to further build upon these efforts through close cooperation with our international partners, including the Government of Colombia, as well as outreach to and a partnership with the private sector. I will provide you with a detailed accounting regarding these efforts below, but briefly summarized, they include:

> Continuing to make solid cases against BMPE participants at every "choke point" of the system;
>
> Improving, through an inter-agency working group, coordination of and consultation on law enforcement operations directed at the BMPE;
>
> Improving international cooperation, by enlisting the collaboration of foreign governments, particularly Colombia; and

Establishing partnerships with the private sector by reaching out to the U.S. and international business communities.

In order to place the foregoing initiatives in their proper context, I would like to take a few moments to briefly summarize the operations of the system itself.

**Colombian Black Market Peso Exchange System**

To the best of our knowledge, the BMPE is the largest continuing money laundering system in the Western Hemisphere. Anecdotal U.S. law enforcement evidence and estimates from Colombian customs authorities indicate that the system may be responsible for laundering as much as $5 billion annually.

The BMPE first was created in the 1950s when importers, attempting to avoid the requirements of Colombian law, including taxes and duties, began buying U.S. dollars on the black market. Then, as now, Colombian importers needed large amounts of U.S. dollars to purchase foreign goods for domestic sale. Access to U.S. dollars that Colombian importers need, however, is regulated by Colombian law and administered by the country's central bank. Before the Colombian central bank converts pesos to dollars it requires that the importer certify that necessary import permits have been obtained and that duties and taxes have been paid.

As Colombian drug trafficking became prevalent, the traffickers soon recognized the value of this system. Indeed, there are now three principal groups making use of the BMPE and on whom we continue to focus: drug traffickers who makes millions of U.S. dollars off sales of his poison, peso brokers who converts the illicit dollars into usable Colombian pesos, and

Colombian importers who provide the Colombian pesos to the peso broker in exchange for the U.S. dollars.

Alvin James of the Financial Crimes Enforcement Network (FinCEN) will provide much greater detail on the process, but the following briefly summarizes the BMPE in the drug context: Colombian drug traffickers' proceeds from the sale of drugs are in U.S. dollars and are located in the U.S. The traffickers sell these dollars to black market Colombian peso brokers, who have operatives in the U.S. Once the peso broker takes possession of the currency in the U.S., the trafficker receives the agreed upon amount as pesos, discounted by as much as 25 percent. The size of the commission reflects the risks incurred by the peso broker, who must place the cash in the U.S. financial system despite the reporting and record-keeping requirements of the Bank Secrecy Act (BSA). At this point, having received the pesos and transferred the money laundering burden to the broker, the drug trafficker steps out of the laundering process.

Once the peso broker owns the U.S. currency, his goal is to quickly resell the dollars at a profit. The peso broker's customer is often a Colombian importer who wants U.S. dollars to engage in international trade. The importers who use the peso brokers intend to smuggle their goods into Colombia.

The Colombian importer usually wants the dollars in a more manageable and less conspicuous form than currency. To accommodate the importer, the peso broker's first task is to place most of the U.S. currency in the U.S. financial system. As noted above, such placement must be accomplished in ways that minimize the chances of detection in light of the BSA

reporting and record-keeping requirements: structuring below the currency reporting thresholds, commingling drug money with legitimate currency deposits of a business, or outbound smuggling of the currency which is then placed in a foreign financial institution and then returned to the United States.

The Colombian importer pays for the dollars by providing pesos to the broker in Colombia. The peso broker then transfers the dollars at the instruction of the importer to the merchant providing goods to the smuggler. The merchant is often in the United States, but also may be in other places that commonly do business with Colombia. Once the dollars are placed in a merchant's account, proof of their nexus to a narcotics transaction becomes much more difficult. Unless there is proof that the merchant had knowledge of the laundering scheme, he may claim to be an innocent owner, and the drug dollars become an indistinguishable element of general commerce.

It is important to note that just as money laundering generally is a global problem, so too is the BMPE. Indeed, the businesses that are being paid by or at the direction of the dollar/peso broker are not limited to one particular country. Through our undercover and other enforcement operations, we have learned of money laundering activities involving the BMPE in countries in Asia and Europe, as well as the United States.

**Our Response**

As noted, our response to the BMPE has three main components: tough and smart law enforcement; international cooperation; and outreach to the private sector. This overall program

has been developed and is being overseen by the recently formed Black Market Peso Exchange Working Group.

The BMPE Working Group

Building on the work of other coordinating mechanisms, including the Interagency Coordination Group, the BMPE Working Group brings together the tools of Treasury's and Justice's enforcement bureaus and the regulatory agencies. This effort ensures that we use all available resources to mount a comprehensive attack against the BMPE system as a whole.

The BMPE Working Group integrates law enforcement and regulatory efforts with intelligence data support. In addition to Treasury's law enforcement bureaus and agencies (Customs, IRS-CID, the Bureau of Alcohol, Tobacco and Firearms, the Office of the Comptroller of the Currency, FinCEN, and the Office of Foreign Assets Control), the BMPE Working Group includes: the Department of Justice; the Drug Enforcement Administration (DEA), the Federal Bureau of Investigation (FBI), the National Drug Intelligence Center (NDIC), the Federal Reserve Board, and the United States Postal Inspection Service.

With such wide participation, the BMPE Working Group helps ensure that all available legal and regulatory tools are used in a comprehensive attack against the BMPE. The participation of the Department of Justice ensures that all strategic initiatives designed and implemented by the BMPE Working Group are legally sound. Participation of FinCEN and NDIC ensures that Bank Secrecy Act information, including suspicious activity reports, and other data are thoroughly analyzed. The federal bank regulatory agencies ensure that information

developed by the Working Group that helps identify suspicious activity related to the BMPE is communicated to financial institutions, which then will be better able to identify and report such suspicious activity to law enforcement. Finally, the participation of Customs, IRS, DEA, and FBI ensure that their investigative resources and talents are used effectively and in a coordinated manner.

The BMPE Working Group helps provide each of the participating agencies information available through others, as well as means of accessing such information. Additionally, and in coordination with Fanny Kertzman, the Director of Colombia's Revenue and Customs Service (DIAN), it has created an analytical subgroup devoted to the analysis of shared information, including that received from Colombian authorities. This subgroup, composed of representatives from FinCEN, Customs, Justice, the IRS, OFAC, and NDIC, will join their counterparts in a bilateral task force initiative in Colombia to review, analyze, and discuss specific data that may further the investigation and prosecution of cases against the BMPE. For this and other reasons, I am particularly pleased that DIAN Director Kertzman is here with us today and look forward to hearing her confirmation that this task force will meet in Bogotá in the very near future.

Our interagency work at home and abroad complements other resources. Customs, for example, in coordination with FinCEN, has recently established a national Money Laundering Coordination Center (MLCC) which will help coordinate the intelligence generated from undercover operations targeting the BMPE conducted by Customs and other participating agencies. Customs expects the Center to be fully operational by December of this year. Customs also has employed the "Numerically Integrated Profiling System" (NIPS), that has historically

been used to identify trade fraud and related anomalies, in an effort to identify export commodities and businesses that are a part of the Colombian Black Market Peso Exchange system.

Smart and Tough Enforcement of Laws

A system this complex requires a comprehensive response that combines all resources available to law enforcement and regulators. Since the early 1980's, we have successfully investigated and prosecuted individuals laundering drug proceeds through the BMPE. The U.S. Customs Service reports that over the past eight years alone, its undercover operations have led to the seizure of $800 million in cash and monetary instruments, 2,100 arrests, and the seizure of over 100,000 pounds of cocaine. These figures include two of the largest single seizures of cash in the history of federal law enforcement, $22 million in Operation CASACAM in Miami and $15 million in Operation Omega in Los Angeles.

In addition, the Internal Revenue Service's Criminal Investigation Division has investigated approximately 250 cases directly involving the BMPE. The investigations revealed the wide range of businesses that, through import and export activities (in those cases, of auto, truck, and airplane parts) can be exploited by the BMPE.

International Cooperation

Notwithstanding certain investigative successes, the BMPE continues its operations. Further gains depend greatly on extending this fight to the international arena. This is fitting, since the BMPE is a serious international threat. The business community in Colombia has

suffered serious market loss because of the BMPE system that essentially fuels the Colombian contraband market. This contraband market, largely financed by drug money, offers goods at subsidized prices, courtesy of the narcotics traffickers.

There is growing recognition among governments that they must deal firmly and effectively with elusive, sophisticated and well-financed criminals. Integral to our anti-BMPE efforts is working more closely with such governments in developing an effective response to the threat of money laundering. We must strive to improve bilateral and multilateral cooperation and information exchange.

To further this goal, Treasury has had high-level discussions with several Colombian officials over the past nine months. Early in the fall of 1998, Secretary Rubin, Deputy Secretary Summers, and I met with President Pastrana, who committed to work closely with the United States on a variety of issues. Since that time, there have been numerous other high level contacts between Treasury officials and the government of Colombia focusing specifically on the BMPE.

In addition, the Departments of Treasury and Justice co-chaired two days of talks with senior officials from Colombia's Customs, Foreign Trade, and Banking Superintendence offices on BMPE and what steps each could take separately and collectively to combat the problem. These informal discussions represented an important breakthrough, ushering in a number of cooperative initiatives and programs important to law enforcement efforts in both countries. The United States has begun similar work with governments and officials from the free trade zones of Aruba and Panama. Bringing together all of these key players in order to bring the collective

weight of our resources, experiences, and efforts to bear on this money laundering system is integral to our BMPE strategy.

The United States also is promoting several multilateral initiatives through organizations such as the Financial Action Task Force (FATF).[1] FATF brings legal, financial and law enforcement experts into the policy making process. The BMPE action plan intends to build on such anti-money laundering programs by proposing expansion of the process to incorporate trade and business representatives and focus upcoming meetings on trade related money laundering. In addition, the United States is working with regional organizations, such as the Caribbean Financial Action Task Force, to focus attention on free trade zones and the extent to which businesses are being used for, or are facilitating money laundering.

Partnerships with the Private Sector

Finally, we will enlist the private sector in this fight. All of the Treasury law enforcement bureaus have traditionally furthered their missions through outreach and partnerships to relevant private sector interests. Our fight against the BMPE is no different. The first step in forming this partnership with the private sector must be to engage the public and business community on the essential aspects of the BMPE. FinCEN took an important first step in July 1997, by initiating a series of meetings with local and national banks in the Miami area. In these meetings, FinCEN shared information that could help banks identify suspicious activity related to BMPE. We also received invaluable information from the banking community

[1] The FATF was established by G-7 Heads of State in 1989 and is now composed of 26 member countries, whose purpose is to develop and promote standards and policies to combat money laundering.

regarding its view of this problem. These meetings culminated in a FinCEN advisory describing the BMPE to the law enforcement and financial communities.

We are seeing results from these outreach efforts to the private sector. For example, suspicious activity reports (SARs) being filed by financial institutions specifically addressing the BMPE have increased from 27 in 1997 to 118 in 1998. As of mid-June 1999, 98 SARs have been filed citing the BMPE.

Moving forward, this collaboration with the private sector will be vital. It reduces the risks that business and financial institutions are inadvertently facilitating the BMPE. It also provides policy makers with the benefit of private sector experience and expertise while assuring that policies reflect and meet the private sector's needs and concerns.

Indeed, this is a two-way process. Companies and industries need to know that their otherwise standard business activities are being used by some to further the BMPE, that their goods may be financed by narco-dollars, and that their goods are illegally smuggled into Colombia and sold at substantially lower prices driving out legitimate businesses. We in turn would like to hear from the business community as to what procedures they have or can put in place to make sure that they are not used in this way.

As a part of our effort to work with the business community, U.S. Customs is launching a national campaign today, alerting businesses to the BMPE system and its indicators. FinCEN is issuing a follow-up to its 1997 Advisory that updates the financial community on what we have

learned as a result of recent regulatory measures. I will have an opportunity to discuss these advisories further next week, when I speak the 1999 annual meeting of the Association of Home Appliance Manufacturers.

Our efforts are not – and cannot -- be limited to the U.S. business community. The BMPE involves businesses not only in the U.S. and Colombia, but also in Asia, Europe and other parts of the America. We intend to engage the international business community, bilaterally as we have done in Colombia, and multilaterally. We are pursuing the expansion of FATF participation to the international business community just as it was expanded to the banking community. We are supporting a CFATF meeting that will specifically address free trade zone issues and money laundering. We also intend to pursue a broader alliance against BMPE with other regional international organizations such as the Asia Pacific Group on Money Laundering.

**CONCLUSION**

In conclusion, Mr. Chairman, I would like to reiterate the Caucus' contribution toward our country's understanding of one of its most serious national security threats -- drug money laundering.

I believe that our strategy will help make significant inroads against the BMPE system. We have much work ahead of us and will continue to consult with other agencies and Congress as we pursue this mission.

I would be happy to answer any questions you and or the other Members may have. Thank you.

Senator GRASSLEY. We will wait till Ms. Tischler testifies before having a series of questions, but just let me make a statement and in a sense asking you if this is a fair assumption. As I indicated in my opening remarks, I do not see this hearing, unless something dramatic comes out of it contrary wise, to be a call for new laws or new regulations, and I think your testimony implies the same thing, that we are talking about the enforcement of existing law, that we are talking about how do we develop cooperation between the private and public sectors within the United States and also bilaterally with other countries and also between the private sector and the governments of those countries and government to government, and enhancing that cooperation to make sure that we get maximum cooperation in solving this problem.

Mr. JOHNSON. Mr. Chairman, we have many tools available to us to address this problem and our initial step in developing this plan and moving forward is to see what we can do to maximize the use of those tools, the regulatory tools we have, the statutory tools we have, to maximize the resources of our international partners, and to get the business community very much engaged in this process.

This has been the primary focus. There may be areas and we would discuss those with the committee at a later time where we could tweak the existing laws, but that is not our effort at this time.

Senator GRASSLEY. And the extent to which usually you look to Congress for direction, this is also an instance that if the Congress, and particularly this caucus, and particularly the senators that are on this caucus individually or collectively can be helpful, also do not be bashful about suggesting certain things.

Mr. JOHNSON. We will not be.

Senator GRASSLEY. Ms. Tischler.

**STATEMENT OF BONNI G. TISCHLER, ASSISTANT COMMISSIONER, U.S. CUSTOMS SERVICE**

Ms. TISCHLER. Thank you, Mr. Chairman and Senator Sessions, for the opportunity to address you on the black market peso exchange or, as we call it, the BMPE. This trade based system of laundering drug proceeds has been utilized by Colombia's drug syndicates for a few years. Its existence, however, has not been widely publicized or understood outside of the highly specialized world of federal drug money laundering investigators and drug money launderers.

The BMPE process starts with a peso broker. For a fee, these brokers arrange the financial transactions necessary to launder the drug cartel's money. Broker activities include receiving and coordinating orders for money, locating sources of U.S. dollars, arranging pick-ups and directing the placement of funds. Within the broker's network are others who perform various services for a percentage of the broker's earnings. Those working for the brokers pick up cash, buy money orders and checks, open checking accounts, transport and smuggle money among other things.

The primary market in Colombia for large blocks of U.S. dollars is the Colombian importer. In order to purchase goods for import, the Colombian importer must first acquire U.S. dollars, which are the recognized instrument of trade in the Western Hemisphere. Ac-

cess to U.S. dollars is regulated by Colombian law and administered by their central bank. Before the Colombian Central Bank will convert pesos to dollars, they require certification that government import permits be obtained, thereby ensuring that the requisite Colombian duties and taxes have all been collected.

The Colombian Foreign Exchange and Trade regime tends to be expensive and naturally results in exposure to government scrutiny. An alternative, of course, is the underground system of BMPE brokers which offers the businessman a choice and the drug trafficker an opportunity. A key component to the BMPE money laundering process involves international trade. This is Customs core business and we are uniquely seated to address this issue. Today I am announcing a Customs initiative designed to identify and educate those businesses involved in international trade which are at risk of being victimized by drug money launderers.

An integral part of this program is a brochure which I have both on display and available to the caucus, developed jointly by the Customs Office of Investigations and the Office of Strategic Trade. The brochure will be utilized by Customs special agents and trade specialists in the business community to do the following: describe the BMPE process for the trade; highlight red flag or indicators of BMPE activity; provide U.S. businesses with a point of contact if they suspect they have been victimized by BMPE related activity.

Customs special agents, intelligence analysts and trade specialists have been analyzing outbound trade data, financial and payment data, including CTRs, CMIRs and the SARs, through the use of advanced targeting software such as the Numerically Integrated Profiling System, or as we refer to as NIPS. This will allow us to target this education and compliance program at those businesses who are likely to benefit from and utilize this important information.

Moreover, Customs intends to get the word out via other forms, such as trade publications, industry associations and via our world wide web site. I am pleased to have the occasion of this hearing to roll out this initiative and the brochure.

The Customs Service intends to aggressively pursue this educational compliance initiative. However, we are prepared and have indeed employed other tools available to us to detect and disrupt drug money laundering utilizing the BMPE. Among those tools are Customs undercover operations that are directed at the peso brokering system and which have over the last eight years resulted in the seizure of more than $800 million in cash and monetary instruments. These operations have also produced more than 2,100 arrests and the seizure of 100,000 pounds of cocaine.

Through an analysis of Customs BMPE investigations, we have demonstrated that they are 35 times more effective, i.e., seizure values versus expenditures, than that of all U.S. government counternarcotics programs. It is worth noting that civil forfeiture is a critical tool in these types of investigations. As a side note, were legislation such as H.R. 1658, the Civil Asset Reform Bill, offered by Chairman Hyde, enacted, this aspect of our enforcement efforts would be virtually shut down.

Customs intends to enhance and improve our undercover investigations by collecting and analyzing the intelligence they produce

through a single entity designated the Money Laundering Coordination Center or, as we call it, the MLCC. In addition to coordinating leads, information, and undercover activity and existing investigations, the MLCC will identify and compile a list of active Colombian money brokers along with the traffickers they service; identify and compile a list of banks, accounts and businesses utilized by those brokers and the traffickers; identify and track trends and patterns such as the amount and number of contracts let for money pick-ups in U.S. cities, seizures of money and drugs, as a result of BMPE operations, and the cost of doing business in each city and region in the U.S. as well as Europe and Asia. And the last, but not least, is to deconflict situations where different investigative entities are unknowingly targeting the same suspects, bank accounts or organizations.

The Customs Service also plans to invite other agencies who are involved in money laundering investigations to participate in the MLCC. In November 1998, a working group was convened at Customs to develop a strategy to assist Colombia on a number of issues including the BMPE. The working group has developed a strategy for training programs and assistance projects to further expand cooperation between the U.S. and Colombia.

Specific steps have been designed to improve the Colombian customs infrastructure, thereby strengthening their ability to deal with issues such as contraband smuggling, which is integral to the BMPE money laundering process. Included in the strategy are the following: a Customs mutual assistance agreement with Colombia which has been developed and is in the process of being vetted through the Departments of State and Justice. This new agreement will provide the framework for U.S. Customs Service and Colombian Customs to share information on issues such as the BMPE and trade issues related to contraband smuggling.

A training, technical assistance and short-term adviser package has been developed and been funded by the Department of State/INL. Many of the programs directly impact Colombia's ability to address the contraband smuggling and BMPE process. With approved DOJ asset forfeiture funding, Customs will assist the newly created national tax and Customs police with targeting and contraband efforts, trade compliance and investigative techniques training.

Finally, Customs has conducted basic intelligence and post-seizure analysis training of selected Colombian counterparts and provided them with PSA software and a database in Spanish. In addition, the Customs Service recently placed an attache in Bogota, Colombia. The attache will become an important focal point for Customs BMPE investigations, facilitating the exchange of information with the embassy country team as well as his Colombian law enforcement counterparts.

The BMPE is in no uncertain terms the ultimate nexus of legitimate and criminal trade activity. As you have heard this morning, U.S. Customs is doing everything it can to put an end to it. I will be happy to answer your questions, but I would like to thank you, Mr. Chairman, for the authorization bill, which among other things will provide over 360 agents for our Investigative Bridge Strategy, which should go a long way to putting a dent in this problem. Thank you.

[The prepared statement of Ms. Tischler follows:]

THE COLOMBIAN BLACK MARKET PESO EXCHANGE
Testimony of Bonni G. Tischler
Assistant Commissioner
U.S. Customs Service

Before the Senate Caucus on International Narcotics Control
June 21, 1999

Thank you, Mr. Chairman and members of the Caucus for the opportunity to address you on this very important topic, the Black Market Peso Exchange, or the BMPE. This trade based system of laundering drug proceeds has been utilized by Colombia's drug syndicates for a number of years. Its existence, however, has not been widely publicized or understood outside of the highly specialized world of federal drug money laundering investigators and drug money launderers.

**Background**

Money is a commodity. As with any other commodity, money can be bought, sold or traded. The U.S. dollar is the preferred currency worldwide. The demand for U.S. dollars can translate to huge profits for illegitimate money transmitters and brokers involved in the movement of narcotics proceeds throughout the world.

The BMPE process starts with a peso broker. For a fee, these brokers arrange the financial transactions necessary to launder the drug cartels' money. Broker activities include receiving and coordinating orders for money, locating sources of U.S. dollars, arranging pickups and directing placement of funds. Within the broker's network, are others who perform various services for a percentage of the brokers earnings. Those working for the brokers pick up cash, buy money orders and checks, open checking

accounts, transport and smuggle money, among other things.

The primary market in Colombia for large blocks of U.S. dollars is Colombian importers. In order to purchase goods for import, the Colombian importer must first acquire U.S. dollars, which are the recognized instrument of trade in the Western Hemisphere. Access to U.S. dollars is regulated by Colombian law and administered by their central bank. Before the Colombian central bank would convert pesos to dollars they require certification that government import permits be obtained, thereby insuring that the requisite Colombian duties and taxes are collected.

The Colombian Foreign Exchange and Trade regime tends to be expensive and naturally results in exposure to government scrutiny. An alternative is the underground system of BMPE brokers which offers the businessman a choice and the drug trafficker an opportunity

**U.S. Customs Approach**

The Customs Service has for some time approached drug money laundering by attacking systems or industries that are exploited by traffickers in addition to focusing on individual criminals and their organizations. Examples of this strategy can be found first in the Choza Rica/American Express Bank investigation in Laredo that addressed Casas de Cambio along the Mexican border and Operation Wiredrill in New York which attacked money remitters. In doing so Customs strategic planners have endeavored, and arguably succeeded, in each instance in changing the behavior of an entire industry, rendering a previously reliable system unreliable, raised the cost of doing business to the drug trafficker, and disrupted the all important money laundering cycle

in the long term. Experience has shown us that denying traffickers access to broad based systems, bringing about voluntary compliance in the impacted industries, is by far the most effective and efficient way to attack drug money laundering.

**Outreach to U.S. Business**

A key component to the BMPE money laundering process involves international trade. This is Customs core business and we are uniquely suited to address this issue. Today I am announcing a Customs initiative designed to identify and educate those businesses involved in international trade which are at risk of being victimized by drug money launderers. An integral part of this program is a brochure, which I have both on display and available to the Caucus, developed jointly by the Customs Office of Investigations and the Office of Strategic Trade. The brochure will be utilized by Customs Special Agents and Trade Specialists in the business community to do the following:

- Describe the BMPE Process,
- Highlight "red-flags" or indicators of BMPE activity,
- Provide U.S. businesses with a point of contact if they suspect they have been victimized by BMPE related activity.

Customs Special Agents, Intelligence Analysts, and Trade Specialists have been analyzing outbound trade data, financial and payment data including CTRs, CMIRs and SARs through the use of advanced targeting software such as the Numerically Integrated Profiling System or as we refer to it as "NIPS". This will allow us to target this education and compliance program on those businesses who are likely to benefit

from and utilize this important information. Moreover, Customs intends to get the word out via other forums such as trade publications, industry associations and via our World Wide Web site. I am indeed pleased to have the occasion of this hearing to roll out this initiative and the brochure.

The Customs Service intends to aggressively pursue this educational compliance initiative; however, we are prepared and have indeed employed other tools available to us to detect and disrupt drug money laundering utilizing the BMPE.

**Undercover Operations**

Among those tools are Customs undercover operations that are directed at the peso brokering system and which have, over 8 years, resulted in the seizure of more than $800,000,000.00 in cash and monetary instruments. These operations have also produced more than 2100 arrests and the seizure of 100,000 pounds of cocaine. The two largest single seizures of cash in the history of Federal law enforcement were made as a result of Customs undercover operations Casacam in Miami ($22,000,000.00) and Omega in Los Angeles ($19,000,000.00) targeting the BMPE.

Recently concluded undercover investigations such as Operation Casablanca and other investigations illustrate some recent success in BMPE investigations

**Operation Casablanca**

Operation Casablanca resulted in the arrest of 168 individuals, the indictment of 3 Mexican banks, two of which plead guilty to criminal money laundering charges, and the seizure of over $100 million in cash and monetary instruments. During Operation

Casablanca, U.S. Customs undercover agents dealt directly with peso brokers to arrange for money pick ups. The drug money was placed into accounts opened by corrupt Mexican bankers. From there, it moved through the banks' correspondent accounts in the U.S. before being sold through the BMPE and deposited in foreign and domestic accounts.

**Operation Double Impact**

Operation Double Impact, which was conducted by our San Juan Office, focused on an international heroin and cocaine smuggling organization. Profits from these drug sales were laundered through the BMPE at businesses in Floridan and San Juan. 30 targets were arrested and over $10 million in 70 identified accounts was frozen.

**Operation Primero**

Our Atlanta office conducted Operation Primero in which Customs undercover agents targeted the Cali Cartel's use of the BMPE in the U.S., Canada, Europe and Australia to launder drug proceeds. In one portion of the case, two Colombia peso brokers were indicted on 35 counts of money laundering and ultimately convicted

An analysis on Customs BMPE investigations Customs has demonstrated that they are 35 times more effective, i.e., seizure values vs. expenditures, than that of all U.S. government counter-narcotics programs.

**Intelligence, Coordination, and Training**

Customs intends to enhance and improve our undercover investigations by collecting and analyzing the intelligence they produce daily through a single entity designated the Money Laundering Coordination Center (MLCC). In addition to

coordinating leads, information, and undercover activity in existing investigations the MLCC will:

- Identify and compile a list of active Colombian money brokers along with the traffickers they service,
- Identify and compile a list of banks, accounts and businesses utilized by the brokers and traffickers,
- Identify and track trends and patterns such as the amount and number of contracts let for money pick-ups in U.S. cities, seizures of money and drugs as a result of BMPE operations, and the cost of doing business in each cities and regions in the US as well as Europe and Asia.
- Deconflict situations wherein different investigative entities are unknowingly targeting the same suspects, bank accounts or organizations.

The Customs Service plans to ask other agencies conducting money laundering investigations to participate in the MLCC.

**Asset Forfeiture Investigations**

The Customs Service also has the most extensive asset forfeiture program in federal law enforcement. We have 20 specially trained and equipped groups of Special Agents, Analysts, Auditors and contract personnel deployed in every Special Agent in Charge office in the United States. The Office of Investigations is in the process of augmenting five of those groups, in Los Angeles, Chicago, Miami, New York, and Houston, where BMPE activity is concentrated. Information and intelligence on bank accounts which contain drug proceeds placed by a BMPE broker will be referred to the

Asset Forfeiture Groups for seizure and forfeiture. As a side note, were legislation such as HR 1658 enacted, the Civil Asset Reform Bill offered by Chairman Hyde, this aspect of our enforcement efforts would be virtually shut down.

**Customs Colombia Working Group**

In November 1998, a working group was convened at Customs to develop a strategy to assist Colombia on a number of issues, including the BMPE. The working group has developed a strategy for proposed training programs and assistance projects to further expand cooperation between the U.S. and Colombia.

Specific steps have been designed to improve the Colombian Customs infrastructure, thereby strengthening their ability to deal with issues such as contraband smuggling, which is integral to the BMPE money laundering process.

Included in the strategy are:

A Customs Mutual Assistance Agreement with Colombia has been developed and is in the process of being vetted through the Departments of State and Justice. This new agreement will provide the framework for U.S. Customs Service and Colombian Customs to share information on issues such as BMPE and trade issues related to contraband smuggling. As an example, Colombian import data could be shared with U.S. Customs under the auspices of this agreement and compared to our export data. Anomalies could then be the basis of a bilateral investigation by US and Colombian Customs.

A training, technical assistance and short term advisor package has been developed and and funded by the Department of State/INL. Many of the

programs directly impact Colombia's ability to address the contraband smuggling and BMPE process. As an example, State/INL has agreed to fund three short term advisors to Colombia to work with the U.S. Customs Attache and Colombian counterparts to help combat the BMPE and to support the Colombian Joint Contraband Technical Task Force (JCTTF).

- With approved DOJ asset forfeiture funding, Customs will assist the newly created National Tax and Customs Police with targeting and contraband interdictions efforts, trade compliance, and investigate techniques training.
- Finally, Customs has conducted Basic Intelligence and Post Seizure Analysis (PSA) training of selected Colombian counterparts and provided them with PSA software and database in Spanish. In addition, we are currently working to provide the DIAN with laptop computers to assist in their analysis of seizure data on contraband merchandise and subsequent sharing with the U. S. Customs.

In addition, the Customs Service recently placed an Attache in Bogota, Colombia. The Attache will become an important focal point for Customs CBMPE investigations, facilitating the exchange of information with the Embassy Country Team as well as his Colombian law enforcement counterparts.

The BMPE is in no uncertain terms, the ultimate nexus of legitimate and criminal trade activity. As you have heard this morning, Customs is doing everything it can to put an end to it. Thank You.

Senator GRASSLEY. Well, thank you. Obviously we hope that we are successful getting that legislation to the President. Even though I direct—well, first of all, let me say thank you for both of you for your testimony. I may direct questions to one of you, but if the other one feels like answering or supplementing, that is okay with me. I will start with Ms. Tischler. In your testimony, you mentioned various operations such as Primero, Casablanca and Double Impact. Was Customs able to trace the origins of the profits to any particular drug organization?

Ms. TISCHLER. Well, as you know, Mr. Chairman, Casablanca traced the assets directly to the Cali Cartel and Primero managed to track the assets also to the cartel and some entrepreneurish subcartels, I guess you might call them. I have to point out that we have been fairly successful in tracking the origins of the illicit cash not only involved in BMPE but other methods of laundering back to the cartels. In over at least the last 20 years, we have had, I think, a somewhat of a significant impact on the cartels themselves.

Senator GRASSLEY. So the point that you just made referring to tracing it back to specific cartels, we are not dealing then with small sized organizations?

Ms. TISCHLER. No, sir. We are dealing with the large cartels, but I have to point out that these days since about 1995 when Operation Cornerstone was successfully completed, we found a lot of entrepreneurs within the context of the old cartels themselves, and I think it is equally important to sort of scale up our response. So while we are doing an investigation, if we find these smaller entrepreneurs, we obviously try to take their assets as well.

Senator GRASSLEY. What is the status of the Money Laundering Coordination Center that you spoke of in your testimony?

Ms. TISCHLER. The Money Laundering Coordination Center is up and running at FinCEN. FinCEN has supplied us with a base of software. It has been functioning as a deconfliction center and we have started to use it as an analysis tool, as it was originally intended.

Senator GRASSLEY. And it is up and running?

Ms. TISCHLER. Yes, sir.

Senator GRASSLEY. Okay. So it has gone way beyond the point of being an idea on paper?

Ms. TISCHLER. Yes, sir. We have been very successful through Treasury and FinCEN support. We have been more or less on schedule for getting this project together and up and running.

Senator GRASSLEY. And is it a joint operation with other U.S. agencies or strictly U.S. Customs?

Ms. TISCHLER. Customs put it up in conjunction with FinCEN, but we are now going to be inviting in participation by the Drug Enforcement Administration, the FBI, IRS and others.

Senator GRASSLEY. Just for the record and anybody listening, the acronym FinCEN, we have used it, we all know what it is, but just state for the record.

Ms. TISCHLER. It belongs to you. Why do you not do it?

Mr. Johnson. The Financial Crimes Enforcement Network.

Senator GRASSLEY. Thank you. In spite of the high stakes, only a few major corporations appear to be taking steps to combat

money laundering. After the issues of money laundering and the black market peso exchange were brought to the attention of both Whirlpool and the GE Corporations, both launched policies to keep closer tabs on the sales of their distributors. I would use GE as an example, limiting the number of goods that it sells to those intending to transport the goods to other countries. Whirlpool Corporation has stopped selling through independent distributors in Colombia after it appeared that peso brokers were buying refrigerators and other appliances.

Instead, Whirlpool currently only distributes its products to licensed dealers and registers all of its exports with Colombian and U.S. authorities. Ms. Tischler, are there other companies that are following the lead of Whirlpool and GE?

Ms. TISCHLER. I think a significant amount of outreach has been done with the major companies. Obviously, the industries that are most affected, as you have already talked about, really are the appliance industry, electronics, cigarettes, things that lend themselves to smuggling and fueling the black market peso exchange. I think that we have been working with some of the tobacco companies to get them on board with this effort so that they are not victimized by this trade.

I have to say also that we have been doing quite a bit of outreach in places like Miami where a major corporation may not be involved at all in the BMPE, but there is a distributor/broker who buys from large distributors and then resells the stuff in either Panama or Colombia. And so equally we have been trying to address that problem as well.

Senator GRASSLEY. What are some of these U.S. companies beyond GE and Whirlpool doing to combat money laundering? You do not necessarily have to name specific companies but just——

Ms. TISCHLER. Well, what we have been really trying to push them into is a similar environment that GE and Whirlpool have already demonstrated and that is know your client and know where your money is coming from and keep a lookout for the signs that you might be used. And that is why we put this pamphlet together. It basically lists the warning signs and that is where we are going with it. They, quite frequently when we talk to the companies, will say, well, we did not know, we were not aware of the signs, and that is why Commissioner Kelly thought it was very important to establish this pamphlet for distribution to all the major corporations.

Senator GRASSLEY. Maybe on this point, Secretary Johnson, you could fill in as well from your experience.

Mr. JOHNSON. Outreach is vitally important and, as Ms. Tischler indicated, there are some companies that are becoming increasingly vigilant. One of the reasons that Treasury felt it was important for me to speak as invited to the Association of Home Appliance Manufacturers is to make sure that, one, we have emphasized and done what we can to highlight the information that both Customs and FinCEN have assembled and make sure that the major appliance manufacturers are alerted to this problem and can benefit from the steps of some of their corporate examples.

Senator GRASSLEY. Can you make any sort of judgment of whether these policies have been successful in curbing the sales of products to those associated with the exchange?

Mr. JOHNSON. At this stage with respect to the policies, I cannot make an assessment as to whether or not they have been effective. I do know, though, that in other areas, in response to the FinCEN's earlier advisory, there has been an increased vigilance on the part of financial institutions about the black market peso exchange. And in fact, the number of suspicious activity reports that have been generated as a result of their responsiveness and sensitivity to the exchange has actually increased over the last three years.

Senator GRASSLEY. In October 1997, the Colombian government gave FinCEN a list of 300 Colombian companies that do business with peso brokers and also during this exchange, the Colombian government provided us a list of brand names that were bought from U.S. manufacturers. At the end of '97, FinCEN began contacting the manufacturers of these goods to discuss ways for them to avoid drug money. What were some of the recommendations that FinCEN has provided to U.S. manufacturers to heighten their level of awareness to avoid drug money?

Mr. JOHNSON. Some of the recommendations that have been provided generally by FinCEN include the recommendations that are listed in the Customs brochure as well as the recommendations that are listed in the FinCEN advisory which was also issued today. And that—and I can just highlight some of the recommendations—is to essentially identify transactions that do not—seem as if they are outside the normal operations of the business, where you have large scale transactions that are paid for by third parties that seem to be unknown or unrelated to either the entity that is receiving the goods or any other part of the transaction, where you have transactions that are paid for by large amounts of cash, transactions that are paid for by postal money orders, transactions that are paid for by third party checks. These are the sort of indicia that FinCEN and Customs have advised others to look for, businesses to look for as they do their best, and we expect them and hope that they will do their best not to be unwitting participants in this system.

Senator GRASSLEY. Have there been any prosecutions of any U.S. companies who have willingly ignored these warning signs?

Mr. JOHNSON. In your opening statement and I believe Ms. Tischler can address in detail the prosecution of a fabric manufacturer in New York, prosecuted in the Eastern District of New York, that was a witting participant in this money-laundering system.

Ms. TISCHLER. It is in the newspaper today. It is Mandelblatt & Company and, in fact, Customs and DEA managed to show where over a million dollars in drug proceeds was, in fact, laundered through this company. But I have to tell you offhand that in South Florida for a number of years the prosecutions have revolved around the import-export community and the distributors down there. So that I am not aware of any major corporations that have been brought to task for participating unwittingly or wittingly in the BMPE.

Senator GRASSLEY. More the small business types?

Ms. TISCHLER. Yes, sir, but as I am trying to gently point out, it is very difficult with a large corporate structure to get your hands around exactly who may or may not be facilitating the business. It is a lot easier to find that middleman or person who would, in fact, make the deal with somebody in the company, similar to the banks in terms of laundering money, so that quite frequently we have been able to get after the facilitator, so forth and so on.

Now I think with the new intense scrutiny and the type of outreach that Treasury and Customs has designed, I think that maybe we will be able to get around that problem. In other words, the object is not to put our companies in jail, the object is to solve the problem.

Senator GRASSLEY. Are there actions that the Colombian government could take that would increase the competitiveness of legitimate businesses that have to compete with the Sanandresitos?

Ms. TISCHLER. Actually, Ms. Kertzman would probably be better off answering that question, sir.

Senator GRASSLEY. Okay. Well, we will ask that of her. Just in case I forget to ask, I will ask her to think about addressing that when she comes to testify. Some American companies, and I would give Philip Morris as an example, have been accused of implicitly supporting the black market peso exchange in order to increase their market share in Colombia and avoid paying hefty Colombian taxes. Some Colombians have gone so far as to threaten to sue Philip Morris arguing that the volume of advertising that Philip Morris chooses to have in Colombia is not justified by levels of legitimate sales. How much validity would there be to that charge? Either one of you can take——

Mr. JOHNSON. As a law enforcement agency, it is our typical practice, whenever there is any sort of allegation of a criminal charge against a person or company, that unless we can address that in terms of an indictment or in terms of a complaint, we simply do not offer opinions on those sorts of charges.

Senator GRASSLEY. Okay. Does the U.S. government plan, and maybe you cannot answer either, to take any action against any of these companies?

Mr. JOHNSON. I can tell you that a key component of this strategy is tough and effective law enforcement and to the extent that there are companies that are witting participants in this exchange, wittingly facilitating what we think is a particularly pernicious form of money laundering, one of our goals is through the combining of our resources, through the enhancement of our analysis, is to bring effective investigations and prosecutions. So that if there are those that are out there that are facilitating this, willingly facilitating this criminal enterprise, this criminal system, they should know that we will be vigilant and we are intending to pursue this matter with a great deal of vigor.

Senator GRASSLEY. According to the Financial Crimes Information Network, the peso broker is the central link in what the network says quote, "is the most efficient and extensive money laundering system in the Western hemisphere." Obviously, there are engines that drive the system. The broker is a middleman in this process and is the one who buys the dollars from the drug traffickers or their agents, usually obtained from the sale of cocaine or

heroin by the drug trafficker, obviously on the streets of the United States or other parts of the world. What steps are your agencies using to intercept these middlemen in the process of exchanging U.S. dollars for Colombian pesos?

Mr. JOHNSON. As I indicated earlier, we want to attack this problem at every single one of the choke points and one of the key choke points is the peso broker himself. And steps may be taken in the form of undercover operations or the use of information that is obtained from the government of Colombia to go after these peso brokers.

Senator GRASSLEY. Define for me in your own words how successful you feel that Treasury agencies have been in identifying and prosecuting peso brokers?

Mr. JOHNSON. Overall I think in terms of moving against the exchange, Treasury bureaus, particularly Customs and IRS, have been very successful. But there is more that we can do. As Assistant Commissioner Tischler just indicated, there have been over 2,000 prosecutions in connection with the peso exchange at the Customs Service; over 250 related to the peso exchange at the IRS; over $800 million has been seized by Customs in connection with these operations. That is a tremendous, tremendous record. We are looking to do more.

Senator GRASSLEY. Could you tell us kind of the typical fine or prison sentence that is levied against the black market peso exchange?

Mr. JOHNSON. I do not have before me a summary that I could give you, Mr. Chairman, but I would happily submit such a summary for the record.

Senator GRASSLEY. Okay.

[The requested information follows:]

UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

August 31, 1999

The Honorable Charles E. Grassley
Chairman
Caucus on International Narcotics Control
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Thank you for your recent letter in which you requested information concerning the various types of fines and/or prison sentences for people involved in the Black Market Peso Exchange (BMPE) here in the United States.

Your correspondence provides me the opportunity to correct the record from that hearing. As reflected in my written testimony, the correct statement would be that there have been over 2,000 arrests by Customs in connection with BMPE activity, and over 250 by the Internal Revenue Service.

With regard to penalties for such activity, there are no statutes that explicitly criminalize participation in the Black Market Peso Exchange. Consequently, a person who participates in the BMPE would be charged with his or her underlying criminal conduct – most likely violations of money laundering statutes and the Bank Secrecy Act (BSA). The individual would thereby be subject to the criminal and civil penalties that correspond with these violations. The maximum statutory criminal penalty for violations of money laundering statutes is a fine of not more than $500,000 or twice the value of the property involved (whichever is greater), and/or imprisonment for not more than twenty years. Additional sentences and/or fines may be imposed if the person is found to have failed to comply with BSA reporting requirements, or if financial transactions were structured in such a way as to evade BSA reporting requirements. For failing to comply with the BSA reporting requirements, a violator may be fined $250,000 and/or imprisoned for not more than five years. Finally, an individual convicted of structuring transactions to evade BSA reporting requirements may be imprisoned for not more than five years.

As to the types of fines and sentences for people involved in the BMPE here in the United States, two cases serve as examples. In the first case, an investigation into the money laundering activities of BMJ Fabrics, a New York firm, led to the arrest and conviction of the company's owner for violation of Title 18 USC 1956. For his involvement in the BMPE money laundering system, the owner was sentenced to 24 months in prison and 36 months probation.

In the second case, also involving the BMPE, Adam Mandelblatt & Company filed a corporate plea for violation of 18 USC 1956 and was fined $1,000,000. In addition, four company employees were convicted of participating in the BMPE and also received sentences and/or fines.

An employee who maintained customer accounts received three years probation and was fined $5,000. Two bookkeepers were implicated and convicted; one received three years probation, and the other received three years probation and was fined $10,000. The owner's daughter who managed the location was sentenced to one year house arrest and was fined $50,000.

Thank you for your continued interest in the Black Market Peso Exchange and for your strong support of our efforts to attack and dismantle this money laundering system.

Sincerely,

James E. Johnson
Under Secretary
(Enforcement)

Senator GRASSLEY. There is obviously a fairly sophisticated system used to launder money. There are a lot of different players involved and they can be a constantly changing group of players. Are there any tools that you believe would improve Treasury's ability to deal with the threat?

Mr. JOHNSON. Well, among the tools that we are enhancing and using are the Money Laundering Coordination Center, the MLCC, that Assistant Commissioner Tischler just discussed. That is an effective tool. Building on an information exchange within the federal government is going to be key moving forward. We have substantial regulatory authorities already in place at Treasury and we will not be asking at this stage for more regulatory authorities to go after this system.

Senator GRASSLEY. Would you like to make some recommendations that you would like to take to reduce the abuse of the U.S. financial system?

Mr. JOHNSON. Well, we have in place to make sure that the financial system is not abused the very strong system that is put in place by the Bank Secrecy Act and the related acts that have been passed after the Bank Secrecy Act was first passed. That is a tremendous tool for us and the regulations that have sprung out of that, the authorizing act. The currency transaction reports have been helpful in our investigations. Suspicious activity reports, which are also a product of the Bank Secrecy Act, have been helpful in our investigations. But more importantly than that, both the currency transaction reporting requirement and the suspicious activity reporting requirement have formed an important bulwark that makes it more difficult for would-be money launderers to inject money into their system.

That is why narco-traffickers have gone to black market peso exchangers to do a job that is too risky for them to do themselves. It is the black market peso exchanger that assumes the risk of trying to inject the money into the system through structuring of transactions and other means to get it into the system. The system works well and we are not seeking additional authorities at this time.

Senator GRASSLEY. Is it difficult to get at this problem without hurting legitimate innocent businesses that are exploited in the process?

Mr. JOHNSON. Well, it is our hope through education that businesses can take the first steps so that they help themselves. Clearly, there may be some risk if it ends up that law enforcement finds out that drug money is going through their system and they have already shipped their goods and the money is stopped in some way before they get payment for those goods. But that is why they ought to be, they should be vigilant.

Senator GRASSLEY. I just have one more topic before I go to Senator Sessions. Peso brokers typically inject cash into the U.S. financial system using runners that are, I am told, are known as smirfs. They are perhaps unemployed Latin Americans who open multiple bank accounts in differing names, often using identity papers that have been forged or purchased from relatives of deceased Colombians to avoid bank official suspicion. These smirfs will deposit cash in incremental amounts in these multiple bank accounts at

amounts below $10,000 threshold that would otherwise trigger a bank report to the Treasury Department.

How are your respective agencies, specifically you, the Treasury Department, and within there, the IRS, FinCEN and Customs, working with bank officials to help them detect these smirfs?

Mr. JOHNSON. Well, with respect to bank officials, FinCEN very often engages in outreach and provides information about what is going on within the financial community. Law enforcement also at conferences will give examples of what smirfs do. And law enforcement as well remains vigilant. I recall when I first became a federal prosecutor in the Southern District of New York, one of the first cases that I brought was a case involving a smirf. That case had been investigated by the United States Postal Inspection Service. So there are a number of people watching the smirfs, a number of people, or little soldiers, as they are commonly called on the street, and there are a number of investigative agencies that are doing two things to help and regulatory agencies that are doing two things to help the banks.

One is education, which is done through outreach that is done by FinCEN, and the other is through effective enforcement and that is done by the United States Customs Service, the IRS and many others including the U.S. Postal Inspection Service and the DEA.

Senator GRASSLEY. Yeah. In the previous question, you gave some statistics about the thousands of people being prosecuted. Are some of these known smirfs and is it a very large percentage of the people that you are suggesting have been successfully prosecuted?

Mr. JOHNSON. The number that I gave in terms of prosecution is a number that extends back over years. Many of the people that are included in that number include those that tend to be lower on the scale, the people known as smirfs. But our goal is to bring the most effective prosecutions and to do that you need to work higher up on the food chain, as it were, in the organization, to go after not just the lower level people, but the focus of the United States Customs Service has been to work these cases to go higher up in the food chain and that is exactly what you saw quite successfully in Operation Casablanca.

Senator GRASSLEY. Okay. I thank both of you for my part. I now turn to Senator Sessions.

Senator SESSIONS. Thank you, Mr. Chairman. Well, I do not think there is any doubt that for well over 20 years I think Ms. Tischler mentioned Colombian cartels have sold tremendous sums of illegal drugs in the United States and have made profits off of it. Every time somebody buys the smallest amount of cocaine, a part of that money ends up in the hands of the Colombian cartel feeding that underground empire. So it is a very serious thing and we are talking about five or $6 billion per year profit to Colombia. That is money, American money, primarily almost totally, in their hands that they have made profits off of these illegal drugs. So I am very much of the belief that to the extent that we can reduce that profit, take away that money, we ought to do so.

And my experience as a federal prosecutor for 15 years is that the Customs Service has been very effective in doing that, perhaps the most effective, forfeiture of assets, and I was very concerned, Ms. Tischler, that you concluded that the House legislation that is

pending that would curb your ability to forfeit would quote "virtually shut down that operation." If it is anything like that, we need to give the most careful scrutiny to it and ought to be very reluctant to undermine your ability to identify this kind of illegality.

As a matter of fact, the current law of forfeiting assets requires that the person have it from an illegal source and that there is knowledge and intent there. It is a pretty high standard in my view and what we are talking about today is a very vague problem. And I want to ask some questions about it as we go along.

You did mention that there were $800 million in cash seized in the last eight years. That is a little bit high now. That is not all Customs actual seizures; is it? You got good numbers on that or what does that include?

Ms. TISCHLER. Sir, it is not just cash. It is real property and other assets.

Senator SESSIONS. Well, $800 million is a lot of money.

Ms. TISCHLER. Yes, sir.

Senator SESSIONS. And it helps to—you share that with local law enforcement officials?

Ms. TISCHLER. Yes, sir. Yes, sir.

Senator SESSIONS. And that helps them to be able to continue to be able to fund their cooperative effort with federal agencies against drugs?

Ms. TISCHLER. It certainly does. I know I do not have to tell you that when the forfeiture funds, both the Justice fund and what is now the Treasury fund, were established, it was to make really crime or the attack on crime pay for itself through utilizing assets that we seized from the traffickers. So I have been doing this—since 1980 I have been involved in money laundering. And one of the best tools we have is asset forfeiture and I truly believe that we have taken assets where we have done it and dismantled groups because of the cash because they can replace their cocaine.

Senator SESSIONS. Well, is it not true that over the last 20 years that more and more restrictions have been placed and controls over the federal government's agent's ability to seize assets and they put some pretty strict controls on it now internally?

Ms. TISCHLER. Yes, sir.

Senator SESSIONS. More than it was at the beginning?

Ms. TISCHLER. Yes, sir.

Senator SESSIONS. And, in fact, the number of forfeiture filings are down, is that correct, by the federal government?

Ms. TISCHLER. I do not know. You would have to ask the Justice Department. I know that at Customs when we are looking at taking assets, we have a committee, for instance, at the agency that actually reviews the circumstances surrounding the forfeitures and whether or not they would be good forfeitures in conjunction with the U.S. attorneys out in the districts. So I feel that there are some like real tight controls that have resulted over the years from when not only the money laundering law but the portion of Title 21 that allowed us to, in fact, effect seizures and forfeitures were first invented and for good cause. There were some excesses, but I truly believe that the U.S. attorneys and the agencies themselves take a really strict look at potential forfeitures in terms of actually what

they are seizing and who they are seizing it from, whether it is legitimate.

Senator SESSIONS. Well, I know when we talk about money laundering, that connotes a criminal act and we have got a situation it strikes me in Colombia that they used to have 40 percent tariffs which really created this black market. When you have a tariff that high, you tend to create a black market and out of that historical background, that now with what—a ten percent tariff—is that the tariff?

Ms. TISCHLER. Yeah. I think they have got it down to—but you know when we first started out in the early 1980s in Colombia, they had a $20,000 a day restriction on the amount of U.S. dollars that could go into their financial institutions, and I know that that was rescinded maybe five or ten years ago. I am not really sure. And that was when we really started seeing large amounts of cash outbound from the U.S. directly to Colombia. Prior to that, we saw it going into Panama. So it is a very convoluted problem as all countries try to strike a balance with their trade and with possible illicit enterprises.

You know the type of BMPE that is going on now is not exactly new. Colombia and other places have had a problem with smuggled, what they consider contraband to get around their import laws and——

Senator SESSIONS. Let us talk about that a little bit. So you have got a constant problem of it. We have zones in Aruba and Panama that are popular. America and companies from other nations are selling products there; is that correct?

Ms. TISCHLER. Everybody is selling products.

Mr. JOHNSON. That is correct.

Senator SESSIONS. And we are suggesting that because a significant involvement by people from Colombia using money that came from illegal drug operations to involve themselves in those duty free zones to buy products to make a profit and launder their money, I suppose, we are suggesting that American corporations ought not to sell there, and is that a fair thing to, a fair burden to place on American corporations, number one? And number two, do we expect German and Japanese corporations also not to sell in those zones if we stop?

Mr. JOHNSON. I do not think we have suggested or directed to American corporations to steer clear of their zones. We have suggested they ought to be careful in conducting their transactions.

Senator SESSIONS. Well, be careful. That suggests I mean we know a significant portion of the products bought there are being bought with drug money proceeds ultimately; do we not?

Mr. JOHNSON. That has been——

Senator SESSIONS. I am just trying to get to the basic question here, the basic moral legal question. If you go to one of these markets and you sell washing machines or cameras and you know that some of these people are bringing money that came from the drug industry, is that something that the U.S. Customs Service/Treasury Department would object to and condemn them for?

Mr. JOHNSON. In the hypothetical that you have posited, if someone knows that they are getting funds that are part of a narcotics transaction, they should not be participating in that transaction.

Senator SESSIONS. Well, part of a transaction. I do not know what that means exactly and I do not know what the answer is, but I am wrestling with this thing. It seems to me that we may be punishing the American worker by denying them at least the ability to sell products to these countries that have made large sums of money off our people from dope. Can we make it too difficult and could it hurt our ability to export and cost us jobs while at the same time not really making any progress against the drug cartels?

Mr. JOHNSON. Senator Sessions, the struggle that you have just indicated is, I hope, reflected in the balance that we are trying to achieve in our approach, which is not just indicating to companies that there are certain transactions that are problematic but engaging with our international partners not just in Colombia but also around the globe because you are right. If we embark on an approach that just focuses on U.S. companies and there are other companies around the world that are perfectly willing to engage in this sort of a transaction, wittingly or no, then we will not have accomplished what we are hoping to achieve here which is striking at the heart of this exchange. That is why we have an approach that just does not talk about enforcement, that just does not talk about outreach, outreach to companies here in the United States, but where we explore broader outreach and where we engage our international partners through a variety of fora.

Senator SESSIONS. Well, I guess my question is you are not prepared—I mean I think we all know that a substantial amount of money in these Free Trade Zones comes from illegal drug smuggling. I do not know how much. Some say 25 percent of the imports to Colombia come out of these zones and are undermining or around and defeating Colombian tariff laws, but I do not sense that you are prepared to say therefore that no American business can do business with those zones; are you?

Mr. JOHNSON. We are not prepared to say that.

Senator SESSIONS. But you are saying somehow if you do, you might not be the best corporate citizen in the world; is that right?

Mr. JOHNSON. I——

Senator GRASSLEY. Well, the very least, if they are knowingly doing it, they are violating U.S. law.

Mr. JOHNSON. There is a difference between participating in——

Senator SESSIONS. Where would the law be? Where would the violation be?

Mr. JOHNSON. There is a difference between participating in a transaction that goes through the zone and knowingly facilitating a narco-transaction. That is why we have tried to highlight for companies and for financial institutions certain red flags about transactions that then may be problematic and they may not want to become engaged in.

Senator SESSIONS. Would you be specific on what it is that would highlight that? Am I using my time too much, Mr. Chairman?

Senator GRASSLEY. No, no. The only reason I interrupted you is because—and you further refined what I said, so I was somewhat mistaken—knowingly participating through these business endeavors is one thing. I meant to say knowingly participating in the laundering of money is what the law refers to; right?

Mr. JOHNSON. That is correct, sir.

Senator GRASSLEY. So I want to stand corrected on that. I just wanted to clarify that if they were doing that, they were violating——

Senator SESSIONS. I agree.

Senator GRASSLEY [continuing]. Existing law.

Senator SESSIONS. I think that is correct. But I am not sure a business who sells to a group of people, some of which he probably rightly should understand have gotten money from drug dealers, that is not money laundering; is it?

Mr. JOHNSON. It depends on the business person's state of mind, but I can give, if you wanted a specific——

Senator SESSIONS. Well, let me just say let us just take a real simple. I have a business in downtown Alabama.

Mr. JOHNSON. Okay.

Senator SESSIONS. And a guy comes in who is a drug dealer and wants to buy a TV from me. And I sell it to him. Have I committed a crime? Have I laundered money for a drug dealer?

Mr. JOHNSON. If the drug dealer comes in and wants to buy a TV from you and that is all you know, then you know it is——

Senator SESSIONS. Pulls out cash, small bills.

Mr. JOHNSON. If it is over $10,000 of cash and you have not filed an IRS Form 8300, then you have got a problem. And you should be careful if this narcotics trafficker, this drug dealer comes in and, say, has bank checks that are drafts from banks that have nothing to do, that seem to have nothing to do with that transaction. You ought to at least be careful. We are not saying that if you are not careful, then automatically prosecution will pursue, but we are saying that as part of this effort, our overall effort to make sure that those who are selling poison on our streets are not walking away with profits or goods or other proceeds from that. People ought to be careful. They ought to have their eyes wide open.

And the Customs brochure which flags certain items that folks should be careful about and the FinCEN advisory that also flags certain indicia or factors that financial institutions ought to be wary of are helpful. They are steps in what we think is the right direction.

Senator SESSIONS. Well, I do not think it is a crime under the main street business scenario I just gave you. I do not think that is money laundering, although I am somewhat rusty on those code sections. But it just troubles me. I think we need to be careful how we do it. We should not overreact because if we do not watch it, due to the fact that huge sums of money for years are pouring into Colombia that are drug profits, most of what we sell to Colombia is going to be purchased at least in part from drug profits, and I am not sure we do any good for us or Colombia to refuse to sell to them under those circumstances. I do believe that we ought to attack this drug problem with intensity. I believe that the more we break up the small drug sales on the streets of America, that is fewer dollars that end up in Colombia to begin with.

The more we drive down demand and drive down usage in the United States, we reduce them. That is the best way to reduce their power and wealth. Also, forfeiting their assets under traditional law and, for heaven sakes, we do not need to undermine the

law we have already got. We probably ought to look for ways to increase our legitimate money laundering forfeiture cases and I think if we could continue to study this black market peso exchange, Mr. Chairman, we may be able to identify chinks in their armor there and maybe develop further ways to disturb this industry which is promoting death around the world for great personal profit. Thank you for your leadership.

Senator GRASSLEY. I have no further questions, just a reminder that if other members who could not be here for this panel have questions, that you would respond in writing. Thank you very much for your expert testimony and more importantly thank you for your ongoing experience on this, and your testimony suggesting doing what you can do to stay on top of the problem both involving our government as well as the encouragement of our private sector. Thank you very much.

Mr. JOHNSON. Thank you, Mr. Chairman.

Senator GRASSLEY. Our next panelist is a person by the name of Al James. He is Senior Policy Analyst for the Financial Crimes and Enforcement Network, and I welcome him today, and I thank him in advance for his testimony. Here is a person that I think is going to in some detail shed some light on what is an incredibly complex system as he takes us through step by step how the process of money laundering works, how it involves the use of legitimate American business in the process, and the role played by the broker that exchanges the dollars for pesos. We welcome you, Mr. James. Thank you very much.

**STATEMENT OF AL JAMES, SENIOR POLICY ANALYST, FINANCIAL CRIMES AND ENFORCEMENT NETWORK**

Mr. JAMES. Thank you, Mr. Chairman. I am very honored to be here this morning to discuss the workings of the Colombian black market peso exchange system, perhaps the single largest avenue for the laundering of proceeds of narcotics trafficking in the United States. I have been a federal law enforcement officer for over 20 years. I have spent the last eight years involved in one aspect or another within investigations of the Colombian black market peso exchange.

Under Secretary Johnson has already introduced to you the basic workings of this system. My testimony will expand on his description and also provide you with the many complexities of this system. I have submitted a statement for the record and with your permission, Mr. Chairman, I would like to summarize that statement at this time.

Senator GRASSLEY. Yes, please do.

Mr. JAMES. As an aid to easily understanding the Colombian black market peso exchange, it is helpful to first look at the various entities involved in this system. In its simplest form, this system involved two countries, the United States and Colombia. The individuals who participate in this system are the Colombian wholesale narcotics traffickers, Colombian dollar/peso brokers, the Colombian importer smugglers of trade goods, U.S. bankers and U.S. suppliers of trade goods.

The commodities involved in this system are the Colombian narcotics, U.S. dollars, Colombia pesos and trade goods such as con-

sumer electronics, cigarettes, liquor, household appliances, auto parts, textiles and footwear.

The scenario begins with a narcotics trafficker in Colombia who ships drugs to the United States. In the United States, these drugs are sold for currency even at the wholesale level. The Colombian trafficker often owns several million dollars in currency that is being held in a stash house in the United States. In order for the trafficker to reap the benefits of his ill-gotten gains, he must convert his currency into a usable format by placing it in a bank. Due to the Bank Secrecy Act and U.S. money laundering laws, the trafficker risks detection by engaging in large currency transactions with U.S. banks.

As an alternative, the trafficker can sell his currency to a dollar/peso broker in Colombia. The dollar/peso broker pays the trafficker in pesos in Colombia. It is important to note that the trafficker steps out of the transaction at this point, having effectively laundered his funds. The dollar/peso broker assumes the risk of handling the narcotics currency in the U.S. For this reason, the dollars are often sold at a substantial discount from the official Colombian dollar/peso exchange rate.

In turn, the dollar/peso broker sells dollars to otherwise legitimate Colombian importers who plan to smuggle their purchases into Colombia in order to evade Colombian taxes and tariffs. These smugglers pay the dollar/peso broker in pesos in Colombia. The dollar/peso broker assumes the risk of converting the currency purchases from the Colombian trafficker to a form that can be resold to the Colombian importer smuggler. The dollar/peso broker does this by using operatives in the U.S. known as smirfs to place this currency in U.S. banks. The placement is usually accomplished by either structured transactions to multiple nominee accounts controlled by the dollar/peso broker or by deposits to the accounts of businesses who normally receive large amounts of cash.

In some instances, placement occurs by bulk transfers to Mexico where the currency is deposited into Mexican banks or foreign banks operating in Mexico. In either case, the money is returned to the U.S. by way of these banks' foreign correspondent accounts with U.S. banks. Once the Colombian importer smuggler pays the dollar/peso broker for the dollars, the broker transfers those dollars on behalf of the smuggler to the supplier of trade goods. These transactions may be in the form of a wire transfer, a check or a bank draft.

Occasionally, the banks are bypassed entirely and currency is delivered directly to the supplier of trade goods. In each of these cases, what is important is that none of these instruments of payment are drawn on the account of the Colombian importer. It should be noted that the suppliers are not always in the United States. In addition to the U.S., the goods may be shipped from Panama or other foreign ports and may be supplied by Asian and European multinational manufacturers as well as those based in the United States. In these cases, the payment transfers may go from the United States placement accounts to foreign banks in the appropriate destinations.

To complete the cycle, the trade goods are shipped from the supplier and smuggled into Colombia. In Colombia, these trade goods

make up what we call the contraband market. That market is comprised predominantly, as I have stated, of consumer electronics, cigarettes, liquor, household goods, auto parts, textiles and footwear. These items are generated by multinational manufacturers based not only in the United States but Asia and Europe as well. The legitimate business community in Colombia has suffered serious economic harm because of a contraband market subsidized by drug money courtesy of the narcotics traffickers. The cycle is now complete. The contraband market generates pesos for the Colombian importer smuggler.

In conclusion, Mr. Chairman, I want to reiterate what a honor it is for me to appear before this caucus. As a law enforcement agent, I am personally acquainted with the immense damage caused to our young, in particular, and our country in general by narcotics traffickers. I am also very familiar with the enormous arsenal that they have at their disposal. They are hiding in the free enterprise system that is designed to assure our prosperity.

But as Under Secretary Johnson has stated, we are approaching them and their organizations in new ways, better armed by technology, in a more coordinated fashion and in closer cooperation with our colleagues and other law enforcement agencies here in the United States as well as abroad. The initiatives outlined here today by Under Secretary Johnson are very positive, making it more and more difficult for the narcotics trafficker to take advantage of his ill-gotten gains.

By understanding these efforts, we may eventually rid our country of this terrible plague. Thank you, Mr. Chairman, for this opportunity to address the caucus on this serious narcotics money laundering problem.

[The prepared statement of Mr. James follows:]

**Testimony of Alvin C. James**
**Senior Policy Advisor for Money Laundering Enforcement**
**Financial Crimes Enforcement Network**
**U.S. Department of the Treasury**

**Before the**

**Senate Caucus on International Narcotics Control**
**United States Senate**

**June 21, 1999**

Mr. Chairman and Members of the Caucus, I am very honored to be here this morning to discuss the workings of the Colombian Black Market Peso Exchange System – perhaps the single largest avenues for the laundering of proceeds of narcotics trafficking in the United States. I have been a federal law enforcement officer for over 20 years. I have spent the last eight years involved in investigations of the Colombian black market peso exchange.

This system involves the use of the Colombian Black Market Peso Exchange as a mechanism to launder substantial amounts of currency from U.S. narcotics sales. Estimates from law enforcement and the Colombian government indicate that this system may be responsible for laundering approximately $5 billion in wholesale Colombian narcotics proceeds each year. This laundering system infects the financing of trade goods to Colombia, such as cigarettes, liquor, appliances, consumer electronics, auto parts, textiles and footwear.

In my testimony, I will address the basic concept driving the Colombian Black Market Peso Exchange System and explain how the Colombian narco-traffickers are manipulating it to launder their U.S. drug proceeds.

**Origin of the System**

The Colombian Black Market Peso Exchange did not arise from narcotics trafficking, but was developed in the 1950s as a response to certain economic policies put in place by the Colombian government. The implementation of these policies resulted in high tariffs on goods imported into Colombia. In addition, authorities placed restrictions on the exchange or ownership of U.S. dollars.

U.S. dollars have long been the primary medium of foreign trade in the Western Hemisphere. As a consequence, the Colombian importer must obtain a supply of U.S. dollars to pay for the goods he wants to import. The government of Colombia restricted the supply of U.S. dollars as a means to enforce compliance with their trade policies. We know that in response many Colombians, ignoring the trade restrictions, turned to the

black market. Dollar/peso brokers grew up to meet the demand. These "brokers" operated what was in effect a parallel currency exchange system, taking in pesos from Colombian importers and making dollars available to those importers. The Colombian dollar/peso broker offered the Colombian importers the option to purchase dollars discreetly, without the government's knowledge, thus avoiding regulatory scrutiny. The Colombian importers smuggled the trade goods into Colombia, evading the high Colombian tariffs and taxes.

Historically, the system's rate of exchange was established by the availability of U.S. dollars for sale on the black market. The more readily available the dollars were in the U.S., the lower the exchange rate. The scarcer these dollars were the higher the exchange rate. In maintaining this trade of U.S. dollars as a commodity, the dollar/peso broker replenished his U.S. account with new dollars, purchased from Colombian exporters who sold goods such as coffee, oil, flowers or emeralds in the United States. The dollar/peso broker deposited these dollars into his U.S. account, paying the exporter with pesos in Colombia.

It should be noted that until recently, the black market exchange rates had been fairly consistent with the rate for U.S. dollars set by the Colombian central bank. Although, the dollar/peso broker was paying a slight premium for the dollars, he would pass the extra cost on to his customers along with his fee. This extra cost for the dollars was acceptable to the Colombian importer because he was thus evading the tariffs and taxes on the goods sold in Colombia. This system operated along these lines until a new source of U.S. dollars became available to the peso/dollar brokers. That source was narco-dollars.

The Colombian narcotics trafficker transports drugs to the U.S. where they are sold for U.S. currency. The U.S. currency that is passed up from street sales to pay the wholesaler is amassed in secret locations called "stash houses." These stash houses are usually located in residential areas of the main drug distribution centers, such as Manhattan, Miami, Houston, Chicago, and Los Angeles. At any given time, there may be several million dollars belonging to one Colombian narcotics trafficker in these stash houses.

In the late 1970's, when Colombian cocaine trafficking began in earnest, the currency was deposited in bulk in U.S. banks. As federal law enforcement became aware of this problem, they exercised their authority under the Bank Secrecy Act (BSA) to eliminate anonymous large-scale currency transactions. As the Congress adopted other anti-money laundering laws, transactions involving criminal proceeds became even more difficult for the narcotics trafficker.

The Colombian narcotics trafficker has a constant need to repatriate a large part of his drug sale proceeds to Colombia in the form of Colombian pesos. He needs these pesos to operate his illicit business, attempt to avoid government intervention in his activities, and maintain his wealthy lifestyle. It is important to note that the narcotics trafficker's situation is the opposite of the Colombian dollar/peso broker, since the trafficker has

dollars in the U.S. and needs pesos in Colombia; the peso broker has pesos in Colombia and needs dollars in the U.S.

The trafficker sells the dollars to the broker. The broker pays for the dollars with pesos in Colombia. The trafficker pays the broker well. We know that as an incentive for doing business together, the narcotics trafficker sells the currency to the dollar/peso broker at a substantial discount, often amounting to as much as 30 percent. As a result of this discount and the relatively unlimited supply of drug dollars, brokers have no need to look toward legitimate sources of funds. The effect is that all BMPE dollars now originate as narcotics dollars.

As in most businesses, the broker passes on some of this discount to his customers. As a result, the dollar/peso broker is now able to offer his clients, notably Colombian importers, not only a discrete source of U.S. dollars, but at a rate significantly less than the rate offered by the Colombian central bank.

The dollar/peso broker uses two parallel bank accounts to facilitate the sale of dollars to the Colombian importer. The first was a peso account in Colombia. The second was an U.S. dollar account in the United States. The dollar/peso broker takes an order for U.S. dollars and receives payment in pesos in Colombia. The dollars are not delivered to the Colombian purchaser, but instead at the time of order, the purchaser instructs the dollar/peso broker to deliver the U.S. dollars to the trade goods supplier to whom he owes payment. These suppliers are often in the U.S., although they may also be in Panama or other ports of trade in Asia or Europe. The trade goods are shipped to Colombia and smuggled into the country to avoid tariffs and taxes as noted above

Mr. Chairman, what I have just outlined is the foundation of the Black Market Peso Exchange system. It is also important to note that once the trafficker has sold the dollars, located in the United States and has received his pesos in accounts in Colombia, he has effectively laundered those dollars. It is now the broker who has assumed the risk of placing the dollars into U.S. financial institutions, business accounts or smuggling them into Mexico. The trafficker's connection to this scheme increasingly becomes more and more difficult to make. The Colombian importer has managed to buy U.S. dollars at a very competitive rate with which to pay for his goods. Thus, all the parties involved reap a substantial financial benefit from this relationship that facilitates narcotics trafficking and infuses international trade with narco-dollars.

**How the money is placed in the System**

There is only one flaw in this system, the narco-dollars are almost as much of a problem for the dollar/peso broker as they are for the trafficker from whom they were purchased. That is, the currency has to be placed into the financial system, and its size and composition attracts suspicion almost automatically, unless it is structured down into packets that fall below the radar screen. The most common method of placement is by structuring transactions below the BSA reporting threshold of $10,000. In actuality, most

banks have a much lower threshold for scrutiny of currency transactions. The structured deposits are usually reduced to be less than the bank's voluntary compliance threshold, which is usually around $3,000. Operatives of the broker place the currency in bank accounts opened in nominee names but controlled by the peso broker.

Another common method of placement is to add the purchased narcotics currency to the regular deposit of a business that normally deposits large amounts of currency. The business most frequently used in this regard is the money transmitter who offers their services to Colombians working in the U.S. who wish to transmit funds in small increments to Colombia. Once the proceeds are in their accounts the dollar/peso broker instructs them to transfer these funds either directly to the trade goods supplier or to a holding account controlled by the broker. These businesses must of course consciously aid and abet the trafficker in the process. Often these Colombian money transmitter businesses are so overtaken by this process, that they have no legitimate clients and falsify all their internal records to disguise the actual laundering purpose of their activities.

In some instances, placement occurs by smuggling the currency into Mexico where the money has primarily been deposited in Mexican banks. Law enforcement sources have indicated a shift following Operation Casablanca. We are seeing now is a depositing of the smuggled U.S. dollars into foreign banks operating in Mexico. In either case, these banks have correspondent relationships with U.S. banks. The dollars are placed back in the U.S. system via those bank's foreign correspondent accounts.

A final method of placement occurs when some currency bypasses the banks and goes directly to the supplier of trade goods. This currency is delivered to this supplier on behalf of the Colombian smuggler's account. Most U.S. suppliers resist this type of transaction, but recent intelligence indicates this particular scenario is on the increase.

**The Supplier**

Mr. Chairman, I have already indicated why this system arose, its mechanics and how all of the major players benefit. I would like to now address the role of businesses in supplying the trade goods. The dollar/peso broker sells dollars to otherwise legitimate Colombian importers who plan to smuggle their purchases into Colombia in order to evade Colombian taxes and tariffs.

As I stated earlier, once the Colombian importer/smuggler pays the dollar/peso broker for the dollars, the broker then transfers those dollars, on behalf of the smuggler, to the supplier of trade goods. Generally, these suppliers are wholesale distributors. However, in certain instances the transfer may be made directly to the manufacturer of the goods in question. These transactions may be in the form of a wire transfer, a check or a bank draft. The important point here is that none of these instruments are drawn on the account of the Colombian importer. It is also important to state that the mere receipt of

these funds, without more, is not to suggest complicity in or even knowledge of the money laundering aspect of the transaction.

Based on the analysis of data received from undercover operations and of seizure data provided by Colombian officials, we know that the suppliers are not unique to the United States. The suppliers also include multi-national manufacturers or distributors from Asia, primarily Japan and Korea, as well as Europe. These foreign suppliers are most often based in the U.S. or Panama.

**Contraband Market**

As I have earlier stated, the cycle is complete once the trade goods are shipped from the supplier and smuggled into Colombia. In Colombia, these trade goods make up what we call the "contraband" market. Information collected by law enforcement currently indicates that the market is comprised of cigarettes, liquor, consumer electronics, household appliances, auto parts, textiles and footwear.

Once in Colombia these goods are often sold by individuals or small businesses called "contrabandistas." The businesses are often located in small strip mall type outlets call "San Andrecetos." The Colombian government estimates there are over 50,000 of these individual outlets. Since they do not have to include the duties and tariffs in their cost and they usually do not charge the Colombian sales tax, they are able to offer the goods at a substantially reduced price. In fact, legitimate Colombian retailers complain that they can often purchase their products cheaper in the San Andrecetos, than they can buy them wholesale in the legitimate market place. They find themselves competing with a market subsidized by drug money courtesy of the Colombian narcotics traffickers.

The pesos generated by these retail sales complete this laundering cycle. The Colombian businessman then returns to the dollar/peso broker to pay for more narco-dollars with those pesos.

**Conclusion**

Mr. Chairman, I want to reiterate what an honor it is for me to appear before this Caucus. As a law enforcement agent for over twenty years, I am personally acquainted with the immense damage caused to our young people in particular, but our country in general by narco-traffickers. I am also very familiar with the enormous arsenal that these criminals have at their disposal. They are hiding in the free enterprise system, designed to assure our prosperity. But, we are approaching them and their organizations in new ways, better armed by technology, in a more coordinated fashion and in closer cooperation with our colleagues in other law enforcement agencies here in the United States as well as abroad.

I have had the privilege of being a member of the interagency Colombia Black Market Peso Exchange working group put together by Under Secretary Johnson, described earlier

this morning. I have seen traditional methods, not discarded but enhanced by new thinking being taken by law enforcement under the leadership of Under Secretary Johnson to combat this complex and critically important money laundering system. Under Secretary Johnson has endorsed and put in place an action plan designed to impact the system as a whole, as well as the individuals who operate within it.

Thank you, Mr. Chairman, for this opportunity to address the Caucus on this serious money-laundering problem.

Senator GRASSLEY. Well, thank you, Mr. James. I appreciate very much your visual. Would it be fair to say even though I would not expect you to be an authority on relationships between Colombia and other drug producing countries with Europe, for example, but could you possibly, do you think you could draw the same sort of a relationship between Colombian and European business people and smirfs there and that sort of thing? Or is this kind of something that is unique just to the United States and to Colombia?

Mr. JAMES. It is certainly predominant in the United States and back to Colombia, Mr. Chairman, but law enforcement intelligence does indicate that we are beginning to see similar operations in Europe and Asia. Actually, wherever Colombian narcotics are sold, this type of system is beginning to spring up.

Senator GRASSLEY. The Colombian government released information to the U.S. concerning black market importers and the manufacturers of their American products. It was hoped that the United States government could target American firms in the hopes of persuading them to cease selling to those suspected of being associated with the peso exchange. FinCEN itself launched an initiative that was designed to alert American manufacturers about the exchange. It also distributed an alert to those firms importing to Colombia complete with warning signs of transactions involving narco-dollars. How responsive have U.S. firms been to these warnings?

Mr. JAMES. In my experience and we are just really beginning this outreach with the U.S. business community, they have been to a large degree very receptive to these warnings. Some have taken considerable steps in dealing with this program individually and they have also been open to working with us in a partnership to deal with it together.

Senator GRASSLEY. The previous panel testified that particularly small firms selling products for narco-dollars have been prosecuted, but I would like to ask you whether or not you know of the government prosecuting any major corporation selling products for narco-dollars?

Mr. JAMES. Not to my knowledge, Mr. Chairman, not at this date.

Senator GRASSLEY. How can it determine when a company has been negligent or simply been taken advantage of?

Mr. JAMES. This is a very difficult process of proof, Mr. Chairman, and it turns to either the knowledge on the part of the company that they are accepting drug dollars or such a blatant disregard for the possibility that it can be demonstrated clearly that they should have known that they are accepting drug dollars. But those elements of proof at this time are very difficult to come by and, in fact, increasing the knowledge and awareness of this problem within the business and financial community will also help us on the other side of that problem to demonstrate that a particular company in the future knew or should have known about this system and tried to avoid it.

Senator GRASSLEY. Let me go to a key aspect of the exchange and that is the American bank accounts that serve as depository for drug tainted dollars. One of the difficulties of tracking these accounts is the fact that the deposits to these accounts are consistently less than $10,000 so that they obviously fall below the report-

ing requirements. These accounts may be held by isolated individuals who are not themselves directly involved with the drug trade but serve as agents of the peso brokers. Is there any pattern of financial activity that you can share with us in this public forum that would allow FinCEN to identify the use of these accounts as black market accounts?

Mr. JAMES. Yes, Mr. Chairman. We have conducted a continuing partnership with the financial community in regard to this issue actually preceding the hearing in the House in 1997, and although it is very difficult for a bank to identify these accounts strictly based on the account holder or the deposits into that account, it is possible to identify it if you combine that information with the activity going out of the account. After working with the financial community in that regard, we are very gratified to see that the suspicious activity reports filed with the government by the banking community have increased substantially in identifying specific black market peso related transactions to alert law enforcement of this possibility.

Senator GRASSLEY. Okay.

Mr. JAMES. The bankers—excuse me.

Senator GRASSLEY. Well, I think you have answered that question and I get from your answer there that that is an initiative of our government to encourage banks to do more. Are there strategies that banks are pursuing on their own initiative to identify such accounts?

Mr. JAMES. Yes, there are. The banks are instituting artificial intelligence programs within their banking computer systems to further identify black market peso related transactions where it would be difficult for an individual to spot these. The computers are being tuned to take advantage of their expanded knowledge of what these trends and patterns look like. And once again, when they are identified, to file suspicious activity reports, alerting law enforcement of this possibility.

Senator GRASSLEY. Yeah. Give us some idea how these peso brokers get people, these smirfs, et cetera, to open accounts for them in the United States and what type of people, if there is any characterization you could give about them?

Mr. JAMES. The normal process can take two routes. It can either be a Colombian tourist coming to the United States who is absolutely innocent of drug trafficking but may go to a black market peso broker to buy dollars to fund a trip and that way the peso broker finds out that individual is coming to the United States and requests that while they are here they open one or more bank accounts in the area that they are visiting in their name, using their correct identification, but then turning over control of that account to the peso broker. That accounts for about half of these nominee accounts that we know of.

The other half are usually opened by individuals who are peripheral players or actors in the narcotics distribution networks.

Senator GRASSLEY. So people who are already on the edge of the law?

Mr. JAMES. Yes, sir.

Senator GRASSLEY. And I suppose also tremendous financial incentive to do this?

Mr. JAMES. They are paid to do this, absolutely. So are the Colombian tourists.

Senator GRASSLEY. And paid well, too?

Mr. JAMES. Yes, sir. Usually it is. It is not uncommon for the peso broker to offer $1000 or $2000 to a Colombian tourist to open two or three accounts, basically almost funding their trip to the United States.

Senator GRASSLEY. How many U.S. accounts does a typical peso broker need in order to conduct business?

Mr. JAMES. The peso brokers are pyramidal in structure and may handle millions of dollars at a time down to tens of thousands of dollars at a time. The typical peso broker smirfing operation that we have encountered usually has 50 to 100 nominee accounts for any particular cell.

Senator GRASSLEY. How many accounts?

Mr. JAMES. 50 to 100 accounts for any particular cell that is buying black market dollars and then having that cell deposit them into a series of nominee bank accounts.

Senator GRASSLEY. Now, we want to remember the history of the black market peso exchange. It is not a product of the drug cartels, but it existed a long time beforehand as a result of high tariffs and duty rates that Colombia charges on imports. How did the peso brokers obtain dollars from the drug cartels before involved in the exchange?

Mr. JAMES. Actually the dollar, when the black market peso exchange initially arose, the Colombian peso broker obtained his dollars not from the drug cartels but from Colombian exporters who might sell such items as coffee or emeralds or flowers in the United States. Those sales would generate dollars and rather than repatriate those dollars to Colombia through a correspondent banking relationship, the peso broker would step in, buy the dollars in the United States, deposit them to his account and in turn pay the Colombian exporter in pesos in Colombia.

Senator GRASSLEY. Could you shed some light on the fact that peso brokers get a good cut and then obviously take a good deal of the profit out of the drug trade? Why don't the drug cartels deal directly with Colombian importers who need dollars?

Mr. JAMES. I think that the answer is twofold. First of all, the Colombian peso broker was there first and he has a clientele already built up with the Colombian importers and they were comfortable doing business in that regard. The other half of the answer is that these Colombian businessmen do not wish to be associated with the drug cartels either, and although things have evolved to the point where they surely must know they are buying drug dollars, they would not wish to contact the cartel people directly in that regard.

Senator GRASSLEY. You have mentioned that this is the largest money laundering system known to the U.S. law enforcement. Are there any other similar systems even though this one might be classified as the largest?

Mr. JAMES. Yes, Mr. Chairman. The black market peso exchange is an underground financial system. There are similar systems throughout the world which arose for similar reasons. The Hawala system prevalent in the Middle East and India and the Chinese un-

derground banking system in use in the Far East are examples of similar systems. All of these underground financial systems are especially susceptible to money laundering by criminal enterprises arising from the ethnic area that gave rise to the financial system. The black market peso system is the largest because of the huge financial magnitude of the Colombian narcotics enterprise.

Senator GRASSLEY. How is the narcotics trafficker making a profit on these dollars if he is selling them for less than face value?

Mr. JAMES. Mr. Chairman, the narcotics trafficker's original margin of profit is so large that they can afford to offer their dollars for sale at substantial discounts in order to reduce their risk of detection. Even after that substantial discount, they will still make a tremendous profit on their proceeds.

Senator GRASSLEY. If a law enforcement officer intercepts the drug dollars after they have been sold and transferred to a business account, are they still subject to seizure as drug proceeds?

Mr. JAMES. While the dollars, Mr. Chairman, may still be subject to seizure, these circumstances present law enforcement with a new set of problems. The law enforcement officer in order to sustain this seizure must prove that the current owner of the proceeds, that is usually in our case here the supplier of the trade goods, knew or should have known that these dollars were generated by an illegal activity. As we have said here, this often may not, in fact, be the case and even if it is the case, it is often very difficult to prove.

Senator GRASSLEY. Senator Sessions.

Senator SESSIONS. Thank you. Mr. Chairman, I was looking at that diagram or picture there. It is a good thing. It strikes me as very interesting that the Colombian drug smuggler's cash American money that his agents receive for the sale of drugs in the United States, they try to keep that in United States banks? That is not carried back to Colombia in the form of cash?

Mr. JAMES. The most general answer is no, Senator Sessions. That is generally not what they need in Colombia. They need Colombian pesos. However, as Assistant Commissioner Tischler described earlier, since the cartels have been fragmented in the last five or six years, it is very difficult to state anything in absolutes on this process. And certainly we have numerous instances of large amounts of currency being bulk transferred back to Colombia, although that is not the prevalent means of laundering it.

Senator SESSIONS. The cartels are fractured but they are still capable of distributing as much cocaine as we can consume in the United States?

Mr. JAMES. Yes, sir.

Senator SESSIONS. Now with regard to the transfer of the preferred method of transferring American cash to American banks, that strikes me as—you have been in the FinCEN group—how long have you been with them?

Mr. JAMES. I have been with FinCEN directly for about one year, sir. I have been with IRS criminal investigation for 21 years prior to that.

Senator SESSIONS. Well, it strikes me that is the best target of actually seizing the money and breaking the cycle. Would you comment on that? That bank, identifying that as a deposit from an ille-

gal drug sale, that money would then be forfeitable as the proceeds of a illegal drug sale. That is a correct statement of the law on that, if you can prove it?

Mr. JAMES. That is the catch, yes, sir. If you can prove it.

Senator SESSIONS. So the question is can we help you or can you improve your ability to identify those deposits and increase your seizures in American banks?

Mr. JAMES. Yes, sir, I think we can improve our ability. As a matter of fact, it has become clear in a series of close and very cooperative partnership meetings with the American banks involved in this process that what we need is to bring a third party, that is the American business community, to the table along with us. And I believe that the three of us, the three groups working together, can make some significant inroads in this process which we have been unable to make to date.

Senator SESSIONS. When you say bring the business to you, does that mean to help you obtain the information you need or are you calling on them to stop selling their products to people who might otherwise appear to be on the surface legitimate purchasers of products?

Mr. JAMES. No, Senator Sessions. I appreciate you asking me that question. We are not advocating that American companies or any other companies for that matter stop selling trade goods in this process. The cancer in this process is really the financing mechanism for that international trade. The demand, I believe, will exist in Colombia even though the drug dollars are taken out of the system. If you will, the Colombian will still want to purchase the computer, the washing machine or what have you.

So what we need to do is see to it that these goods are not financed initially with these narcotics dollars and I believe that is where the business community can help us with information and policies which will allow them and their bankers to be more careful about the financing mechanisms that they accept.

Senator SESSIONS. Well, I do not know. I do not know whether you can do that or not. Could the Colombian drug dealers with their large sums of money, is it difficult for them to convert that into the euro, for example, and purchase products from Europe? What kind of controls are available there?

Mr. JAMES. I must admit, Senator Sessions, that the law enforcement community is to some degree holding its breath to see exactly how that is going to work. However, the Financial Action Task Force sponsored by the G–7 countries has encouraged and been considerably successful in getting the European communities to institute financial and currency reporting mechanisms similar to those in the United States which should generate the same resistance to this process that we have encountered here in the U.S. However, since it still happens in the United States, I believe, of course, it will happen with the euro as well.

Senator SESSIONS. Well, are you suggesting that this is a silver bullet, a major breakthrough, a way that we are going to deal a new and powerful blow against the cartels?

Mr. JAMES. I am not sure I would describe it at least as the ultimate silver bullet, but I do believe that by making it more and more difficult for the Colombian trafficker to reap the benefits of

his ill-gotten gains, we will make serious inroads in his ability to sell this poison on our streets.

Senator SESSIONS. Well, we have been working at it for 20 years.

Mr. JAMES. Yes, sir.

Senator SESSIONS. And we have thought we have had some very good programs that never seem to have done much, make much of a dent into this effort, and I do appreciate your work and dedication to it. It is an often thankless task and often dangerous and we complain about the government in Colombia, but the whole of the Colombian Supreme Court virtually was assassinated. Judges who have stood up against these traffickers are killed on a routine basis. Police officers have to be incredibly courageous to do their duty and it is a very, very difficult thing to think that we are going to solve our drug problem by focusing on Colombia.

I am not sure where we are headed. I think we must not lose our own commitment to reduce demand here through law enforcement and education and treatment and that sort of thing, but we certainly are dealing with an empire that is powerful and deadly and rich and I appreciate your work on it. Thank you, Mr. Chairman.

Mr. JAMES. Thank you.

Senator GRASSLEY. Thank you, Senator Sessions. Mr. James, that is the last questions we have for you at this particular moment. And so I want to thank you for your participation and for particularly the hard work you went to to provide the visuals for us today for a complete understanding of this.

We are going to ask everybody to stay—you can leave the table if you want to. We are going to ask everybody to just stay seated for a minute. We are going to have just a slight delay. I will explain the delay this way, that our third panel is someone who has very extensive experience with the black market peso exchange. The testimony will outline how someone gets started as a peso broker, how connections are made and why the system works the way it does and we are going to refer to our witness as Carlos. Obviously not the real name.

He has agreed to testify only with the agreement that we keep his identity secret. He will be hidden in order to protect himself and his family from possible retribution. To accommodate this, at this point, we are going to ask the security to close the doors, ask the audience to remain seated, and also for the cameras to be turned off temporarily or pointed away from witnesses at this time, especially the camera behind the dias. So we will just be very patient while this all takes place at this point.

We are ready to commence now, and I thank you very much for agreeing to be here today, and as I indicated before you came in, we are going to refer to you as Carlos. We thank you very much and would you please begin your testimony and we want you to feel very comfortable and to know that we will do whatever we can to make sure that your identity is not known. Would you begin with your statement, please?

**STATEMENT OF ANONYMOUS WITNESS, "CARLOS", A PESO BROKER**

CARLOS. Yes. I am a little bit nervous so I will speak slowly. I have been in business in Colombia for more than 30 years. I have owned several business companies dealing in different trades. Before I talk how I deal on the black market peso exchange, if I could, I would like to describe briefly how the Colombian black market exchange started.

The birth of the black market was about 30 to 35 years ago. When I got into business in Colombia, Colombia had and still has high import tariffs and expensive taxes. Because of the high taxes and tariffs combined with the fact it was actually illegal to possess U.S. currency in Colombia, the black market was created. Back then if you were caught with U.S. dollars, you could go to prison depending on the amount of dollars you had. That has changed but today still anyone who wants to legally import goods into Colombia will have to pay up to 20 to 25 percent in taxes and anywhere from five to 35 percent in duties and tariffs. This can add an additional 60 percent to the cost of imported items.

When the government made it legal to possess dollars, a peso broker like myself had to just make sure you offer a rate at a better exchange rate than the government so you can make a profit. In other words, you had to sell it cheaper than what the government used to sell it.

Now I will explain how I am a dollar/peso broker and how this system helps launder millions of dollars of drug money for narcotic traffickers. In the 1980s, I was already buying checks in U.S. dollars and exchanging them for Colombian pesos. Since I was already doing business in the United States, a business friend of mine asked me if I was interested in buying U.S. dollars in bulk cash in the United States in exchange for being given Colombian pesos in Colombia. I knew this money belonged to drug traffickers because of the threat that comes with doing this business. I will talk about this, the risk, shortly. Everyone in this black market business knows that U.S. dollars they are dealing in are from drug sales in the United States. This was a very lucrative business for me and once you start it, it is difficult to stop. I learned this business very quickly.

Narcotic traffickers have a basic need. They need their drug dollars in the United States laundered and they need pesos in Colombia. As I said, I started laundering money for drug traffickers many years ago. I worked with these traffickers, buying their U.S. currency and laundering their money by selling their dollars in return for pesos. These drug dollars are used to buy goods in Miami, New York and other places. The goods are smuggled into Colombia and sold in the market at cheap prices. No one can compete with these prices.

Let me describe a typical business day for me. I receive a phone call from a representative of a drug trafficker. This is a person that is in charge of laundering the money for the trafficker. This happens sometimes three or four times a day from different traffickers because I have built my credibility with them. Sometimes he visits you at the office. As much drug money as the trafficker has from the sale of his drugs, I can sell that amount for pesos in the black

market. We make a contract, like a handshake, no paper, and determine what percentage the exchange will be.

When I buy the U.S. currency I buy it for a fraction price or a discount no matter what the price is on the black market. Sometimes I watch the exchange rate so before I sell these dollars, I have to watch for a few days to see what the selling price is. It is a like a stock on the stock exchange. It goes up and down. If the black market exchange rate and the sale price changes and drops, the traffickers do not care, they just want the price we fixed before. When I receive the dollars in the U.S., I have eight to ten days to give them the equivalent back in the pesos minus my commission.

In the meantime, the phone is ringing and I am being asked if I have any dollars for sale. These phone calls are from the contrabandistas and from associates that I know that are businessmen that import U.S. and other goods into Colombia. They do this by smuggling the goods in order to avoid the high taxes and tariffs I mentioned earlier. In Colombia, we call these men contrabandistas. They buy these U.S. dollars, the drug dollars I have for sale, and pay me in Colombian pesos. They use the drug dollars in the USA to pay for the U.S. goods they import into Colombia. Many times they bring in containers of goods like appliances or computers or so on. It could be car parts. They avoid paying the government by paying off a Customs official at a port in Colombia. Other times they just smuggle by boat from Panama or Aruba.

The process I have described helps to keep the black market going. Because of taxes, we choose to do business illegally outside of normal legal channels established by the government of Colombia. Other brokers and I work together to keep the dollar/peso exchange rate favorable to as compared to the exchange rate established by the government of Colombia. When it is said that the peso/dollar broker sells on the black market, it means he sells the dollars to the numerous contrabandistas in Colombia who have need for U.S. dollars in order to pay for the goods and services in the United States. If a contrabandista needs $500,000, for example, in U.S. dollars in order to pay for household appliances in the United States, the contrabandista will call me or another broker like myself and ask to buy the U.S. dollars I have so he can pay for appliances in the states.

I sell the contrabandistas U.S. dollars at an exchange rate that is better than buying pesos from the government but an exchange rate that is higher than a rate that I contracted with the trafficker. The trafficker gets pesos, I make money, and the smuggler pays for his goods in the U.S. The smuggler gives me the bank account information or the information on the company from which he is purchasing appliances and I wire the currency from one of my accounts in the U.S. paying the debt for the appliances. This is usually to a company or a distributor in the U.S. This is how the U.S. dollars are laundered and changed into pesos without the dollar ever physically leaving the United States.

I have sent large amounts of currency all over the United States, particularly to New York and Miami, Florida, to authorized distributors of Sony, Whirlpool, Kodak, General Electric and many more. 90 percent of the money sent to Whirlpool was for authorized

distributors in Miami. I have also sent money to companies that deal in fabrics, yarn, cosmetics and other durable goods. As much drug money as a trafficker has, I can sell it for pesos.

Now let me talk to you about the risk. I mentioned that the trafficker people give you eight to ten days. These are business days. Once you agree, you have to deliver him pesos. There is rarely an exception. Basically after the contract you make, the trafficker has no more risk. You do. If the trafficker does not receive the money in time or not at all, they will torture or kill you or your family. In many cases, they will burn the house down with a relative inside unless they are paid in full.

I personally know a dollar/peso broker like myself who lost several hundred thousand dollars in the U.S. because of the police. The traffickers sent thugs to his mother's house and were going to murder her by burning her house down with her inside. Some brokers I know helped and paid off the debt to save her. Sometimes people are not so lucky. If they find out you are an informer, they will kidnap you, even if they are paid. Sometimes the informer is tortured and killed. When these traffickers are ripped off, they either kidnap you or someone close to you. Then they tie the person to a pole in a hidden room. They torture you and let you die of starvation in your own filth and waste.

In conclusion, I would like to say that as a result of extremely high taxes and tariffs, the Colombian government created its own black market of peso exchange and the contrabandistas. For businessmen, smuggling has become a regular part of the Colombian business system in order to survive. That is why tons of merchandise is smuggled in by the contrabandistas which results in their need for U.S. dollars to pay for the smuggled merchandise. There is no limit to the amount of U.S. currency these contrabandistas can buy because the number of contrabandistas in the trade is so numerous. In my opinion, the way to stop this problem is for the government of Colombia to reduce these ridiculously high tariffs and taxes. This would allow Colombia's businessmen to import goods and operate legally within the Colombian business system. This would immediately stop the contrabandistas since it would be no longer profitable to bring in smuggled goods.

[The prepared statement of anonymous witness "Carlos" follows:]

Statement of Anonymous Witness
Caucus on International Narcotics Control Hearing
June 21, 1999

I've been in business in Colombia for more than 30 years. I have owned several successful companies dealing in different trades. Before I talk about how I deal on the Black Market Peso Exchange , if I could, I would like to describe briefly how the Colombian Black Market Exchange started.

About 30 to 35 years ago, when I got into business in Colombia, Colombia had and still has high import tariffs and expensive taxes. Because of the high taxes and tariffs combined with the fact it was actually illegal to possess U.S. currency in Colombia, a black market was created. Back then, if you were caught with U.S. dollars you could go to prison. That has changed, but today still, anyone who wants to legally import goods into Colombia will have to pay up to twenty to twenty-five percent in taxes and anywhere from five to thirty percent in duties and tariffs. This can add an additional sixty percent to the cost of an imported item. When the Government made it legal to possess dollars, a peso broker, like myself, would have to just make sure you offer a rate at a better exchange rate than the government so you could make a profit.

Now I will explain how I am a dollar/peso broker and how this system helps launder millions of dollars of drug money for narcotics traffickers. In the 1980's, I was already buying checks written in U.S. dollars and exchanging them for Colombian pesos. Since I was already doing business in the United States, a business friend of mine asked me if I was interested in buying U.S. dollars in bulk cash in the U.S.A. in exchange for being given Colombian pesos in Colombia. I knew this money belonged to the drug traffickers because of the threat that comes with doing this business. I will talk about the risks shortly. Everyone in this black market business knows that the U.S. dollars they are dealing in are from drug sales in the U.S.A. This was a very lucrative business for me and once you start it is difficult to stop. I learned this business very quickly.

Narcotic traffickers have a basic need, they need their drug dollars in the U.S. laundered and they need pesos in Colombia. As I said, I started laundering money for drug traffickers many years ago. I worked with these traffickers, buying their U.S. currency and laundering their money by selling their dollars in return for pesos. These drug dollars are used to buy goods in Miami, New York, and other places. The goods are smuggled into Colombia and sold in the market at cheap prices. No one can compete with these prices.

Let me describe a typical business day for me. I receive a phone call from a representative of the drug trafficker. This is the person that is in charge of laundering the money for the trafficker. This happens sometimes 3 or 4 times a day from different traffickers because I have built my credibility with them. Sometimes he visits you at your office. As much drug money as the trafficker has from the sale of his drugs, I can sell that amount for pesos in the black market. We make a contract, like a hand shake, no paper and determine what percentage the exchange will be.

When I buy the U.S. currency, I buy it for a fraction price or discount, no matter what the price is on the black market. Sometimes I watch the exchange rate so before I sell these dollars I have to watch for a few days to see what the selling price is. It is like watching a stock on the Stock Exchange, it goes up and down. If the black market exchange rate and the sale price changes and drops, the traffickers don't care. They just want the price we fixed before. When I receive the dollars in the U.S. I have 8 to 10 days to give them the equivalent back in the pesos minus my commission. In the meantime, the phone is ringing and I am being asked if I have any dollars for sale. These calls are from many associates I know that are businessmen that import U.S. and other goods into Colombia. They do this by smuggling the goods in order to avoid paying the high taxes and tariffs as I mentioned earlier. In Colombia, we call these men "Contrabandistas." They buy these U.S. dollars, the drug dollars I have for sale and pay me in Colombian pesos. They use the drug dollars in the U.S.A. to pay for the U.S. goods they import into Colombia. Many times they bring in containers of goods like appliances or computers. It could even be car parts. They avoid paying the Government by paying off a Customs Official at a port in Colombia. Other times they just smuggle by boat from Panama and Aruba.

The process I have described helps to keep the black market going. Because of taxes we choose to do business illegally outside of the normal legal channels established by the Government of Colombia. Other brokers and I work together to keep the dollar/peso exchange rate favorable to as compared to the exchange rate established by the Government of Colombia. When it is said that the peso/dollar broker sells on the black market, it means he sells the dollars to the numerous Contrabandistas in Colombia who have a need for U.S. dollars in order to pay for the goods and services in the United States. If a Contrabandista needs $500,000 in U.S. Dollars in order to pay for household appliances in the United States, the Contrabandista will call me or another broker like myself and ask to buy the U.S. dollars I have so he can pay for the appliances in the states.

I sell the Contrabandista U.S. dollars at an exchange rate that is better than buying pesos from the government but at an exchange rate that is higher than a rate that I contracted with the trafficker. The trafficker gets peso, I make money, and the smuggler pays for his goods in the U.S.. The smuggler gives me the bank account information or the information of the company from which he is purchasing the appliances and I wire the currency from one of my accounts in the U.S. paying the debt for the appliances. This is usually to a company or distributor in the U.S.. This is how the U.S. dollars are laundered and changed into pesos without the dollars ever physically leaving the United States.

I have sent large amounts of currency all over the United states, particularly to New York, and Miami, Florida to authorized distributors of Sony, Whirlpool, Kodak and General Electric. Ninety percent of the money sent to Whirlpool was for authorized distributors in Miami. I have also sent money to companies that deal in fabrics, yarn, cosmetics, and other durable goods. As much drug money as the trafficker has, I can sell it for pesos.

Now let me talk about the risks. I mentioned that the traffickers people give you 8 to 10 days. These are business days. Once you agree, you have to deliver him pesos. There is rarely an exception. Basically, after the contract you make, the trafficker has no more risk, you do. If the trafficker doesn't receive their money in time, or not at all, they will torture or kill you or your

family. In many cases they will burn the house down with a relative inside unless they are paid in full. I personally know of a dollar/peso broker, like myself, who lost several hundred thousand dollars in the U.S. because of the police. The traffickers sent thugs to his mother's house and were going to murder her by burning her house down with her in it. Some brokers I know of helped and paid off the debt to save her. Sometimes people are not so lucky.

If they ever find out you are an informer, they will kidnap you even if they are paid. Sometimes the informer is tortured and killed . When these traffickers are ripped off they either kidnap you or someone close to you, then they tie the person to a pole in a hidden room. The torture you and let you die of starvation in your own filth and waste.

In conclusion, I would like to say that as a result of the extremely high taxes and tariffs, the Colombian government created its own black market dollar/peso exchange and the Contrabandistas. For businessmen smuggling has become a regular part of the Colombian business system in order to survive. That is why tons of merchandise is smuggled in by the Contrabandistas which results in their need for U.S. dollars to pay for the smuggled merchandise. There is no limit to the amount of U.S. currency these Contrabandistas can buy because the number of Contrabandistas in the trade is so numerous. In my opinion, the way to stop this problem is for the government of Colombia to reduce these ridiculously high tariffs and taxes. This would allow Colombian businessmen to import goods and operate legally within the Colombian business system. This would immediately stop the Contrabandistas, since it would no longer be profitable to bring in smuggled goods.

Senator GRASSLEY. We thank you very much, Carlos, for sharing your experience with the United States Congress and for your willingness to be here to be a real live example of a very important, probably the most important, intermediary in this process of getting the American profit from drug trafficking out of our country home to Colombia.

I understand from your testimony that the traffickers will give you a large amount of money and then expect you to return a percentage of it to them in pesos within a certain time frame. You said usually eight to ten business days. Do the traffickers require you to put up any collateral for the dollars that they ask you to exchange?

CARLOS. The only collateral that you put up is your life, your family, no other. They think that is more important than properties.

Senator GRASSLEY. So you sacrifice everything, in a sense.

CARLOS. Exactly.

Senator GRASSLEY. Do you always, in the truest sense of the word, is what you said that you have to put up for collateral your life and the lives of loved ones, is there some element of trust that is established over time?

CARLOS. Oh, yes, very much. They will not sell to anybody I mean off the street. They have to know you, your background, that you pay well, that you are responsible in that kind of business, and eventually they will sell you 100,000, next deal will be 200 or 300, it depends how well you respond to them.

Senator GRASSLEY. And you obviously have had some interchange with other peso brokers, I assume. Do you think that in your case or in every case, there is no collateral other than as you say family and friends whose lives are at stake that has to be put up or in some instances does it take collateral?

CARLOS. No, there is no collateral.

Senator GRASSLEY. Okay. That is good enough.

CARLOS. Oh, okay.

Senator GRASSLEY. Is it more accurate to describe peso brokers as independent agents working for themselves or as agents of the drug cartel?

CARLOS. No, independent. Everybody is independent.

Senator GRASSLEY. Do the businessmen, the smugglers that you call contrabandistas, know where the money is coming from?

CARLOS. 99 percent of them. It is common knowledge in Colombia that the black market is from drug money.

Senator GRASSLEY. Okay. You indicate in your testimony that you send money to authorize dealers of U.S. goods, for example, Whirlpool. What about actual manufacturers or companies that produce these goods?

CARLOS. Very rarely. It is almost directly distributors through Miami, New York. Very rarely to the manufacturer himself.

Senator GRASSLEY. You are saying that some companies at least at the distributor or authorized dealer level know that the goods are being sold to Colombia. Does this mean that some also know the source of the money?

CARLOS. About the distributors, I can say some do. Now the manufacturers themselves, I do not know.

Senator GRASSLEY. How much will a peso broker make on an average transaction?

CARLOS. It can range from one to 1.5 percent.

Senator GRASSLEY. Are money brokers like yourself regulated by the Colombian government?

CARLOS. No, not at all.

Senator GRASSLEY. You mentioned in your testimony that you have used wire transfers to pay for goods not only in the United States but in other foreign countries. What other countries have you done transactions with?

CARLOS. Japan, Panama, Brazil, Venezuela, many others I don't remember, the Orient, South Korea.

Senator GRASSLEY. Yeah. What about Europe?

CARLOS. Yes, but very little. Some to buy some machinery.

Senator GRASSLEY. Okay. Can you tell us specific companies that receive funds?

CARLOS. Can you repeat the question, please?

Senator GRASSLEY. Could you tell us specific companies that have received funds?

CARLOS. I can tell you the distributors of Whirlpool, General Electric, Johnson and Johnson. I can go on to list many others. If I have more time, I can.

Senator GRASSLEY. I would suggest that what you do then in conjunction with my staff so we preserve your identity make sure that we have as long of a list as you can give us of companies. I should say, as you said, distributors of companies that you have done business with, that you know have received specific funds. Do they look at what amount and which account it is to be credited to?

CARLOS. The distributors just look at the amount. They call the bank and they see if the money is credited to the account and that is it.

Senator GRASSLEY. Okay. Senator Sessions.

Senator SESSIONS. Thank you, Carlos, for sharing your insight into this problem. I think some of our free trade advocates would agree that high tariffs and high taxes cause black markets to begin with and I think you have made that point. Let me ask you do you have any idea what percentage of the sales of these kind of consumer goods that go to Colombia are purchased one way or the other by drug laundered funds?

CARLOS. The smuggled ones, the smuggled goods?

Senator SESSIONS. Yes. Smuggled ones, I guess, at first.

CARLOS. Yes, the contrabandista. I would say 95 percent.

Senator SESSIONS. What would happen if there were some way that the United States could stop its businesses from accepting funds and stop shipping products? Would the brokers be able to find other countries that would sell the products?

CARLOS. It is not the question of the brokers, the peso brokers. It is a question of contrabandista. It is a question of the businessman. He will probably buy goods from another country. I am sorry. They can buy shoes from Brazil, which is a very big article, or some other things from Venezuela or from South Korea. Many other countries will sell.

Senator SESSIONS. Are there some of these distributors who are openly aware that this is directly drug money or do you try to avoid explicit recognition of that fact?

CARLOS. Like I said before, it is common knowledge. A lot of them do know, but if they ask me or they ask the smuggler, they will probably say it is not. But it is common knowledge and most of the distributors in Miami or the free zone of Miami are from Colombians, are Colombian owned companies.

Senator SESSIONS. So the free trade zone in Miami, the people who are making these transactions are many, a large percentage are native Colombians?

CARLOS. I will not say all of them, but, yes, and they do a lot of business with Colombia.

Senator SESSIONS. And is that who you deal with yourself?

CARLOS. Mostly distributors—they are all over. To tell you the truth, it is all over Miami, not only the free zone, distributors in Miami and a lot from Panama.

Senator SESSIONS. Is it fair to say you often attempt to do business with people who have Colombian connections, distributors of merchandise?

CARLOS. Yes, again, but I am not the buyer of the merchandise. The contrabandista is and he tells me who to ship it to.

Senator SESSIONS. And so you do not personally negotiate the purchase.

CARLOS. I am not a contrabandista.

Senator SESSIONS. Okay. But this is from your information, what you have learned over the years.

CARLOS. 100 percent.

Senator SESSIONS. You have mentioned the fact that if you do not follow through on your commitment to drug traffickers that you and your family's lives are in danger. Is it fair to say that throughout the nation of Colombia, that law enforcement people and others who take action against these cartel members, that their lives and family's lives are in danger?

CARLOS. I am sorry. I lost—could you rephrase, please?

Senator SESSIONS. Yes. When you deal with a Colombian drug cartel, you have to follow through on your commitments.

CARLOS. Yes.

Senator SESSIONS. Or you or your family's life is in danger?

CARLOS. Yes.

Senator SESSIONS. Share for us the extent to which throughout the nation of Colombia, judges, police, and others who challenge the cartel, to what extent are their lives and their family's lives at risk?

CARLOS. Very much. Lately, the Colombian police have done a lot. Colombian banks. Now it is very hard to be a Colombian broker, a peso broker, by the bank's regulations. I will say the last two years and with the present person the laws are, banking laws are very strict. It is not easy to deposit $20,000 or $30,000 in a bank without being noticeable. Before it was. So now it is very hard to be a dollar/peso broker in Colombia. It is very dangerous for Colombian laws.

Senator SESSIONS. So the Colombian government is making some successful steps toward making it more difficult to launder these funds?

CARLOS. Oh, yes, yes, they are.

Senator SESSIONS. And but ultimately you believe the black market will continue. I believe you said to stop this problem, it will be necessary for the government of Colombia to reduce these ridiculously high tariffs and taxes. Do you think it will continue as long as you have a 60 percent tax in effect on imported goods?

CARLOS. Yes, I heard that Ms. Fanny Kertzman and maybe it will help her what I am going to say. In Colombia, when you import something, right off the bat, you have a 16 percent tax, sales tax, plus the tariffs, plus a lot of other expenses and plus a lot of other paperwork. If you really want to stop the black market, you can do it I will not say today, but if you reduce drastically those tariffs and the taxes, it will last about a month, and everybody would become legal.

Senator SESSIONS. There would not be any advantage to being illegal; is that correct?

CARLOS. Yes. What I am going to say is going to sound a little awkward, but these contrabandistas are legit businessmen. Okay. They buy the funds. I understand this. But they are not, they would rather do legit business than what they are doing now. Now it is uncomfortable and these are people who want to make a living importing merchandise. If the tariffs went down, like in the United States, you do not have cars smuggled in or textiles. Your tariffs, I suppose they are very low. So it is not worth it to smuggle anything in. So if the tariffs and taxes were lower, nobody will go through the hassle of trying to bribe a Customs officer or anything like that.

Senator SESSIONS. Thank you very much for providing us this rare insight into how this business actually occurs, Mr. Chairman, and, Carlos, we thank you for sharing it with us and I understand the need for the security and we thank you for coming.

CARLOS. Thank you. Yes.

Senator GRASSLEY. One last thank you and would you please stay seated until we know that everything is all right. And I think the cameras should be a little more cautious about being turned off or turned away from the witness. I do not think they were when we brought the witness in and I would like to have respect for his security. Even though he is hooded, it is still very important that we do that. So when the police say that it is okay to proceed, then we will proceed and when you are out, then I will introduce our fourth and last witness. Is it okay to proceed now? I want to thank all in our audience for your cooperation for the safety of Carlos.

FOLLOWUP QUESTION FOR "CARLOS"

In your testimony, you mention various companies that do business in the Black Market Peso exchange. Could you list these companies that have received funds, and mention some of the items that are sold?

Carlos supplied the following list:

Companies: Sony; Whirlpool; Kodak; General Electric; Madame Shikse & CIA.LTD; Caja Agraria; Comrecializadora Siglo XXILLDA; Multicentro Del Blumer C.A.; Surtiblumer C.A.; Motorola; Aiwa Electric; and Toshiba.

Goods: Scotch (Black Label-Johnny Walker brand); Marlboro Cigarettes; Johnson and Johnson; Mattel Brand Toys; Cell Phones (manufacturers Erickson and Nokia); Emerson; Perfume; and Patton Ceiling Fans.

Senator GRASSLEY. Our fourth and final panel consists of Ms. Fanny Kertzman, Director General of Taxes and Customs for the Government of Colombia, and also we have another witness, former U.S. Ambassador to Venezuela, Michael Skol. Mrs. Kertzman was recently appointed by President Andres Pastrana and I welcome her and thank you for your courage in appearing before the caucus today, and Ambassador Skol, you served as ambassador from 1990 to 1993 and you are currently president of Skol and Associates, a consulting firm here in Washington, D.C.

And before you begin, Ms. Kertzman, I want to thank your ambassador who was here for a short period of time this morning for his interest in this issue not only for today's appearance but also because he has expressed concern over these very issues so many times that he has visited my office and we very much appreciate your president's interest in this issue, his cooperation with our country, his trying to make very substantive changes within his own country, but also I think the presence of your ambassador on these issues before members of Congress is an appreciation or an expression of that as well.

And my staff reminds me that I pronounced your name wrong. Mr. Skol.

Mr. SKOL. Thank you, sir.

Senator GRASSLEY. You bet. Ms. Kertzman, would you proceed, please.

## STATEMENT OF HON. FANNY KERTZMAN, DIRECTOR GENERAL OF TAXES AND CUSTOMS, GOVERNMENT OF COLOMBIA

Ms. KERTZMAN. Thank you very much. I want to thank the Senate Caucus on International Narcotics Control and especially your chairman, Senator Charles Grassley, Senator Sessions, for the opportunity to address one of the most serious problems facing Colombia which is contraband. The government of Andres Pastrana has made a point of his fight against corruption in general and one of the most important points is the fight against contraband. Contraband in Colombia amounts to near $5 billion a year, which means with a total import of $15 billion a year, it means that almost 25 percent of all the imports that are made into Colombia are contraband.

And the reason for that is not that the taxes are very high. We lowered our taxes on imports in 1992 and what happened is that contraband raised by the result of opening the economy and I think that the main reason for this huge amount of contraband into the country is mainly the narcotics trafficking. The problem of narcotics trafficking is not only a problem of the U.S. or only a problem of Colombia. It is a problem for all of us. For Colombians, we have the harm that is done to our youth just the same as here in the U.S., but in Colombia, we have the problem of corruption, contraband, the danger that people are—you were asking now this other witness about the danger that people are in in Colombia. It is not only the judges, the policemen, the army, it is also us officials of Colombian government that we have to go protected. I have

about nine guards. My family has about six guards and it is only because we are fighting against contraband and tax evasion.

It costs, contraband costs to the Colombian state, each year about $840 million in tax revenue and duties that are not paid. And why there is such a high contraband is not to pay duties so to make unlawful competition to the other producers in Colombia, but also to launder money as I said. Also there is contraband of chemical precursors and the contraband of the point of view of export of illegal substances.

The link between narco-trafficking and contraband is very clear. This merchandise that is smuggled into Colombia is bought with an exchange rate for the dollar of 1,000 pesos per dollar when the rate in the market is 1,600 pesos per dollar. That is why it is such a good business to smuggle goods into Colombia and it adds to the profits of the narco-traffickers. I have to stress the point that the dirty dollars are not deposited in Colombian banks. They, you just heard all the explanation of how it works, but I want to make clear that in Colombia, it is not possible to open an account in dollars, only in pesos.

The dollars that come into Colombia sometimes come dollars in cash. When we caught dollars in cash, it is about $300,000 every time they are caught at the airports with people, in their luggage or taped to their bodies, but that is not the most common way of laundering the profits of narcotics. All the actors in the chain of contraband are accomplices to this crime. The producer, the manufacturer of the goods here in the U.S. or in Japan or in Korea, who knows that he is selling the goods to someone that finally will smuggle them into Colombia.

The distributor who is selling the goods to the smuggler, the peso broker, the smuggler itself and the consumer in Colombia who buys the smuggled goods know that the product he is buying was paid with money from narco-traffickers. All of them are equally guilty of the same crime, that they are selling goods that are going to be smuggled into Colombia and paid with dirty money.

With all these problems we have with contraband, I would like to stress that we are working very closely with U.S. government. We have received all the cooperation that we need, especially from the U.S. Customs Service, the Department of the Treasury, Department of Justice, DEA, FBI, FinCEN, OFAC, and in general the agencies that somehow are related to this issue. We are signing an agreement with Customs. It is all ready for the signature and I think it is going to be signed on September that will be interchange of information between U.S. Customs and the Colombian Customs and we are working together with them already in the cases, the specific case of contraband and money laundering.

For the first time in Colombia, there are people in jail for contraband. Contraband is a crime and tax evasion is also a crime in Colombia, but there is no one in jail for tax evasion. Now in Colombia there are about 20 or 22 people in jail for a case of contraband and for you it might be a very low figure, but for Colombia it is a record to have 22 people in jail for contraband.

There also has been some progress with the private sector. We are trying that the private sector be aware that they cannot sell their goods to smugglers and there are some companies such as

Whirlpool Corporation and Daewoo in Korea that have as a policy not to sell to the contrabandistas. And Whirlpool Corporation just signed a compliance agreement with the government of Colombia that they are not selling through the distributors in Miami and in Panama. They are selling only one unit of every dishwasher or something like that, and Daewoo has a policy not to sell to the Sanandresitos in Colombia.

For those who are not aware what the Sanandresitos are, this is our big malls that exist in Colombia where they sell only smuggled goods. There are Sanandresitos in every major city in Colombia. People go to buy appliances and liquor, cigarettes; it is much cheaper than in the legal market, of course, because they are not paying taxes. They are very well organized and it is a phenomenon that I think it exists only in Colombia.

There are cases of contraband that are very clear. The case of tobacco, for example. Nearly 90 percent of the total of cigarettes imported into Colombia are contraband. Local companies have 55 percent of the market. 45 percent of the market is imported cigarettes. Only ten percent of them are imported legally. 90 percent of all the cigarettes that come into Colombia are contraband. In the case of liquor, 85 percent of the total liquor that is imported in Colombia is contraband.

Six years ago there were 18 legal distributors of imported liquors in Colombia. Now only three of them remain. They went into bankruptcy because of the unlawful competition of contraband. For Colombia, it is a problem the Colon Free Trade Zone located in Panama. The Panamanian government has been very reluctant to provide figures regarding exports from the free zone, but in Colombia, we estimate that $1.2 billion a year come from the Colon Free Trade Zone illegally into Colombia. The Sanandresitos buy their goods mainly in the Colon Free Trade Zone.

We are trying to work together with U.S. government in this fight against contraband. We are asking for funds to buy X-ray machines for the ports and the airports. They do not exist. We want to work together with the U.S. government, but I want to say again that contraband is not a problem only in Colombia. Such as drug trafficking, the problem is international problem, not only a problem of U.S. and Colombia, but all the countries. I just want to end by saying that contraband is the second stage of narco-trafficking. It is the most efficient way of money laundering and from that point of view we together have to work on this. Thank you very much.

[The prepared statement of Ms. Kertzman follows:]

# Contraband, Money Laundering, and Peso Brokerage

Fanny Kertzman

**Director of Revenue and Customs Service**

Government of Colombia

I would like to thank the members of the Caucus on International Narcotics Control and, specially, your Chairman, Senator Charles Grassley, for the opportunity to present one of the most serious problems of my country: contraband.

My name is Fanny Kertzman, I am the Director of the Revenue and Customs Service in Colombia, DIAN. I assumed this position in August of 1998, when I was appointed by the current President, Andres Pastrana. The institution that I direct is dedicated to guaranteeing the compliance of tax and customs obligations by my countrymen, and to facilitate the operations of international trade.

The DIAN is an entity of the Ministry of Finance and, therefore, develops the policy and programs of the central government. One of the main priorities of the current government is to combat tax evasion and contraband. My Directorate co-ordinates efforts of the other entities of the government in the fight against contraband.

Although contraband has been a constant phenomenon throughout Colombia's history, over the past few years it has become one of the main scourges, a source of destabilization and, particularly, has adversely affected the country's productive sector. Because of contraband, millions of Colombians have lost their jobs, to the extent that the unemployment rate in Colombia is close to 19.5%, which was undoubtedly exacerbated by the unlawful competition sponsored by this phenomenon.

It is ironic that although Colombia has substantially reduced import tariffs and now has an average tariff close to 8.7%, contraband has increased instead of decreased. This is only explained if we take into account the relationship between contraband and other big problems that threaten my country: narcotraffic and money laundering.

Contrabands' impact on commercial, industrial and job generating activities has been devastating, specially in recent years, when its links with drug traffic and money laundering have been more than evident.

Contraband in Colombia is of unimaginable magnitude and has been quantified by varying estimates. Some have calculated that open contraband accounts for US$2.5 billion dollars per year; and that technical contraband and under-invoicing amounts accounts for an equal value, which adds up to a total contraband figure of US$5 billion. Compared to total imports in 1998 amounting to US$15 billion, the result suggests that contraband accounts for 25% of legal imports. In terms of GDP, contraband ranges between 2% and 3.5% of Colombian GDP.

The economic costs are extremely high, not only from the standpoint of jobs lost to unlawful competition, but also due to the tax revenue lost by the State. According to recent estimates of the DIAN, in 1998, open contraband amounted to US$2.3 billion. With an effective 16.6% tax rate (for VAT and Duty), the losses to the national treasury during last year could exceed US$390 million. This does not take into account technical contraband, through which merchandise is smuggled under a different tariff heading in order to pay fewer taxes; nor under-invoicing, where lower prices are invoiced to reduce taxation, as well. Of a total contraband estimate of US$5 billion, annual fiscal losses in 1998 accounted for US$840 million, although this figure could be an overestimate, as technical contraband and under-invoicing pay a certain amount of taxes, unlike the case of open contraband.

54.1%, on average, of the Nation's ordinary income over the past few years has been transferred by the National Government to provinces in the form of fiscal transfers and municipality shares. Therefore, departments, municipalities, and Indian reservation have lost earnings amounting to US$454 million on account of contraband, which has affected the supply of basic services to Colombia's population in the areas of education, health, water, and basic sanitation, recreation and sports, and other social investment funds to be allocated locally.

In the opinion of renowned experts, money laundering and drug traffic are the most decisive factors, as large profits derived therefrom lead to a dollar price well below the price paid by legal importers, a fact that leads to unfair and disturbing competition for the market of foreign goods.

**1. The Chain of Contraband and Money Laundering**

In Colombia, contraband is an established business. In open contraband, goods are smuggled to avoid taxation, to launder moneys earned illegally through drug traffic, to import raw materials for drug traffic (chemical components); and to feed the war through weapon contraband.

It cannot be denied that all elements of the contraband chain, such as the manufacturer, transporter, distributor, retainer, peso broker, and even the consumer contribute significantly to the entire process.

The mechanism, in the case of drug traffic money laundering, is the following:

1. Producers in different countries, such as the United States, England, Korea, Japan and China, sell their merchandise to distributors located in Miami, Los Angeles, Panama, Aruba and other Caribbean countries.

2. Colombian smugglers purchase the merchandise from these distributors or, in some cases, directly from the manufacturers.

3. The smugglers are contacted by peso brokers who provide the dollars, supposedly earned through drug traffic, to pay their suppliers.

4. It is assumed that these dollars are derived from drug traffic, as they are sold at a significant discount compared to the official prevailing price in Colombia (Col.$1,000 against Col.$1,650).

5. The smugglers deposits in Colombian peso accounts the equivalent to the sum paid in dollars to the supplier. Here, it is worth pointing out that in Colombia there are no bank accounts in dollars. This means that the dollars do not enter Colombia, but rather are paid to the suppliers in the United States, Panama, Aruba, or Caribbean countries.

The Colombian government believes that many of the multinational companies perfectly know the mechanism described above and are aware of the fact that their products finally enter Colombia. Consequently, the government intends to develop among these companies a "know your client" campaign, as the one operating in the financial sector, to prevent multinational companies from selling their products to distributors who are suspected of being involved in the money laundering scheme.

The US Government has understood this initiative. It is necessary to create an awareness of the fact that any member of this criminal chain, from the

manufacturer in a foreign country to the buyer in the streets of Colombia, may be an accomplice, either by action or omission.

Another link in the chain is the Colombian customs official, who receives bribe from smugglers. Drug traffic moneys have permeated practically every level of Colombian society. Part of the drug traffic chain are the peso broker mechanism and the smugglers. Contraband isnot limited to fiscal losses and unlawful competition. It also has serious consequences on the moral of society, on values, on the perception of what is legal and what is not. Contraband is the cause of corruption problems in the Colombian customs authority, which lead to official rotation and hinders proper training and lasting jobs, as well as demoralizes honest officials, and worse yet, even produces death threats.

Over the past year, two Colombian customs officials were assassinated. In one case, it was because a female customs agent refused to allow a shipment of weapons and military uniforms to be smuggled into the country, which meant her death sentence.

Money laundering does not only occur in the context of contraband. Constantly shipments of dollars are seized, which are introduced illegally into the country. During the last three months of 1998, nearly US$300,000 were seized every week from travellers entering the El Dorado Airport in Bogotá. It is also common for shipments of contraband goods to carry dollars hidden inside electronic appliances.

Hence the need to have X-ray equipment in all customs checkpoints in the country. At present, no port of entry has this type of equipment. We are requesting the US Congress and the US Government to donate this equipment to the country. This would contribute to control contraband, dollar laundering, as well as the entry of chemical precursors and export of illegal drugs. US Customs Service is going to provide technical assistance to assess the actual needs for this equipment and the specifications required to meet Colombia's customs needs.

**2. Contraband: An International Cooperation Issue**

In spite of control activities developed by the customs authority, the achievements have been scarce vis-à-vis the magnitude of this phenomenon. Last year, only US$153 million in merchandise was seized, which reveals the impotence of Colombian authorities faced with contraband. This figure accounts for merely 6% of total contraband.

The Pastrana Administration has received strong support from the US Government in various forms that are described below.

The creation of cooperation agreements for customs-related issues with other countries is an efficient tool for obtaining information in development of investigations and to procure technical assistance for purposes of improving control procedures. Such is the case of the agreement to be signed shortly between the US Customs Service and Colombian Customs Authorities.

This agreement provides for exchange of information, cooperation, training, technical assistance, and joint investigation of contraband and money laundering cases.

Furthermore, the Colombian government has received assistance and aid from the Department of Justice, the Treasury Department, FINCEN, OFAC, FBI, DEA, NDIC, and other agencies involved in drug traffic and money laundering problems. The Justice Department allocated US$1.85 million of the Forfeiture Assets Fund to the fiscal and customs police, which is the armed body working under the National Tax and Customs Directorate, for the purchase of equipment and training. The funds have not entered Colombia yet, due to problems with the Colombian authorities regarding the legal mechanism for introducing this moneys specifically bound for the agency selected by the Justice Department.

With the Justice Department, DEA, IRS, and the US Customs Service there is an ongoing joint work to investigate, underveil and prosecute cases of money laundering via the peso broker mechanism, contraband, and tax evasion.

Officials of the US Embassy in Colombia, who are members of the mentioned agencies, work together with DIAN officials on specific cases and Colombian authorities have received all necessary cooperation.

A Joint Task Force is being created, by top-level customs and tax officials of DIAN and by officials of various US Government agencies, such as the Justice Department, Customs, and the IRS. This task force will work on specific investigations leading to unveil contraband, money laundering, and peso brokering cases. The first meeting will take place in Bogotá during the first week of July and will be attended by five officials from the mentioned agencies.

Special mention deserve the Treasury Department, in general, and US Customs, in particular, as well as the Department of Justice. These institutions have collaborated with Colombia in its fight against contraband.

Furthermore, and with the support of the Colombian and US commercial and diplomatic authorities, work is underway to obtain the commitment of multinational companies to control their distribution channels through client knowledge practices, to keep their products from being used to launder money via contraband.

The list of specially designated narcotics traffickers has contributed in the fight against narcotrafficking and could be a useful tool in the fight against contraband as a money laundering facilitator. However, I must indicate that the Colombian Constitutional Court determined that two individuals included on the list, have not being declared guilty of narcotrafficking and ordered the Colombian Administration to inform this situation to the US Administration. The information regarding the individuals or companies that will form part of such list could be more useful if it is maintained at the level of prosecuting offices while the final results of the investigations are issued and the delinquents are declared guilty.

**3. Contraband Goods**

According to various studies carried out on the subject and to constant seizures by customs authorities, the products subject to contraband are, among others:

- Liquor and alcoholic beverages
- Cigarettes
- Electric and electronic appliances
- Textiles
- Clothing
- Computers
- Automotive parts (where used spare parts constitute a major problem)
- Perfumes
- Jewelry
- Vehicles (including cases of vehicles stolen in Venezuela and the United States)
- Footwear and tennis shoes
- Processed foods
- Chicken parts
- Tires
- Chemical products (among which are chemical precursors) and organic chemical products
- Iron, steel, and their products
- Cement
- Toys
- Rice

- Gasoline along the Venezuelan border
- Semi-trailers

**4. The Case of Cigarettes**

According to figures from Colombian tobacco manufacturers, between 1991 and 1994, legal imports accounted for 9% of the total cigarettes market; domestic production supplied 33%; and the remaining 58% was accounted for by contraband.

The routes for introducing cigarettes into the country are Aruba and Panama. It has been estimated that if the amount of cigarettes arriving in these two countries were for local consumption, each Panamanian or inhabitant of Aruba, men, women, and children would have to smoke ten packs of cigarettes per day.

The main brand names traded illegally are Marlboro and Belmont, whereby the latter is manufactured in Venezuela by Cigarrería Bigott, under licensing of British American Tobacco. Other brands, such as Kent and Kool, are also traded illegally.

Whereas in 1984, the national cigarette industry supplied 85% of the domestic market, in 1995 this percentage only accounted for a 30% share of consumption measured by volume.

It is estimated that the price per pack to the public is US$1 dollar and the wholesale price is US$0.50 with a 50% difference at retail level, contraband profits are estimated to be approximately US$500 million per year.

Whereas Philip Morris has a price ex works of US$1.71 per pack, invoices for imports arriving on the Colombian market are for US$0.24.

**5. Liquor Contraband**

The contraband of liquor and alcoholic beverages is one of the most sensitive, as the tax structure for these products has a noticeable disturbing effect on the national and departmental tax revenue.

In addition to the existence of a national culture or tradition of liquor contraband, it is considered that this tax structure to which these goods are subjected when imported is the reason that stimulates illegal trade thereof. Liquor in general has a 20% duty, a 40% consumption tax, and a 20%, 25%, and 35% VAT, depending on the alcoholic content of the beverages.

According to estimates of the Colombian Association of Liquor and Wine Importers - ACODIL - in 1997, the total foreign liquor sales in Colombia was 1,475,175 cases, of which 76.3% were accounted for by illegally imported liquor and only 23.7% to legal imports. Of the total number of cases of contraband liquor consumed, the highest percentage is accounted for by whisky with 87.4%, equivalent to 984,200 cases, which compared to 174,143 legally imported cases, gives a clear idea of the magnitude of illegal whisky trade.

The problem of liquor contraband focuses particularly on the major Scotch whisky brands sold by producers in the United Kingdom to distributors in Panama and Aruba.

As in the previously described contraband cases, liquor and cigarettes are believed to be purchased with drug traffic dollars.

**6. Place of Origin**

It is estimated that 55% of contraband is accounted for by consumer goods (most of which are distributed through Sanandresitos, which are huge malls established in all Colombian cities, where contraband goods are sold openly, violating all customs and tax regulations). Of these goods, 40% come from Panama and Central America; 33% from Ecuador and Venezuela; 13% from North America; 8% from the Far East; and 3% from the Caribbean, mainly Aruba.

**7. Colon Free Zone**

Most of the articles imported by Colombia from the Colon Free Zone are very similar to those offered in the Sanandresitos. The Panamanian Government has been very reluctant to provide figures regarding re-exports from the Free Zone, but some estimates have been made. In 1997 and 1998, merchandise valued at US$1.5 and US$1.2 billion entered Colombia from the Colon Free Zone, and approximately 10% were registered legally, which gives an idea of the magnitude of the contraband problem.

Excluding the Colon Free Zone, imports declared in Colombia as proceeding from Panama amount to US$70 million, whereas the aforementioned country claims to export only US$1.3 million in merchandise to Colombia.

Colombia is the main buyer of the Colon Free Zone. Between 1991 and 1995 its share went from 10% to 27% of total purchases originating in this zone.

The Colon Free Zone is the main supplier of merchandise smuggled into Colombia.

**8. The Case of "*Sanandresitos*"**

Nowhere in the world is there such an extensive phenomenon as that of *Sanandresitos* in Colombia. They are like an extension of shopping malls, where practically only contraband goods are sold. There are *Sanandresitos* in most Colombian cities. In Bogotá, for example there are more than six large complexes of this type.

The expression "*Sanandresitos*" comes from San Andrés, an island which is a free port. *Sanandresito* sales are estimated to account for 26% of the trade GDP. *Sanandresitos* also sell domestic merchandise, in somewhat over 30% of all sales. In the case of domestically produced merchandise, it has been detected that most of them are manufactured goods with fake brand names.

According to a study performed by Universidad Nacional, in 1996, US$878 million were laundered through *Sanandresitos*. Gross sales at these centers amounted to US$2.1 billion, 61% of which (US$1.2 billion) were accounted for by items illegally smuggled into the country. The sales in these establishments have increased exponentially. In 1985, they accounted for 13.7% of trade GDP, whereas in 1996, the share was 25.6%. Likewise, the area dedicated to this type of business has also increased very rapidly, particularly during the 1990s.

In Bogotá, in 1996, there were 8,571 *Sanandresito* shops. Nation-wide the number of stores was 13,176, of which 11,247 were in business. At present, this type of business begins to be saturated.

In 1978, the number of sales points in Bogotá, Medellín, Cali, Barranquilla, and Bucaramanga, was 2,452. In 1987, in Bogotá alone, there were 2,400 shops. Over the past nine years, the number of *Sanandresito* stores has more than trebled: from 2,400 to 8,571. The physical area occupied by these establishments went from 38,000 square meters in 1985 to 102,853 square meters in 1996, with a significant increase since 1992, of more than 8,000 square meters, to reach a peak of an additional 12,900 square meters in 1995.

As explained earlier, open contraband in the *Sanandresitos* is an important money laundering tool. A business based on contraband, whose main supplier is the Colon Free Zone, where the dollar costs 60% less than the official dollar in Colombia, must necessarily be linked to money laundering. In spite of the seriousness of the problem, Colombian society is permissive vis-à-vis this phenomenon. The fact that *Sanandresitos* are constantly visited by customers shows how the infringement of rules is tolerated. It does not exceed the degree of society's aversion to these illegal activities.

Municipalities grant operating licenses to shopping malls where *Sanandresitos* are established and, even the banks place branches in these areas. DIAN has undertaken an aggressive advertising campaign against *Sanandresitos*, to create an awareness among the population of the fact that buying contraband means taking the jobs away from honest Colombians.

**9. Actions Undertaken**

As a comprehensive strategy in the struggle against contraband, the need to modernize the customs authority has been identified, in order to achieve more efficient control, while facilitating foreign trade for companies legally established.

Part of the contraband activity may be associated to the difficulties encountered in foreign trade operations, which result from a great deal of red tape in customs processes.

Therefore, work is underway to pass a legal reform that will simplify and expedite procedures related to foreign trade operations.

In addition to the above, the Customs Century XXI computerized system is being developed, which will allow customs procedures to be performed electronically, thus reducing time and cost significantly, and particularly increasing the control of the customs administration. These strategies will enable the establishment of a more efficient customs authority, which will facilitate foreign trade operations following a vision of service, while effectively controlling evasion and contraband. This system has been developed with resources from World Bank.

In this head-on struggle against contraband, the National Government has also developed a series of actions which attempt, in a comprehensive manner, to reduce illegal trade and unlawful competition, while increasing revenue from external taxation. These strategies include:

**10. Fiscal and Customs Police Force**

One of the most recent measures was the creation and implementation of the Fiscal and Customs Police. This is a police body, under the direction of DIAN, made up of 1,000 men led by a police general, dedicated exclusively to repressing contraband and fighting against tax evasion.

In the same manner as the Antinarcotic Police has succeeded with the support of the US Government in the fight against drug traficking, we hope to obtain the same level of cooperation to fight contraband, the second stage of this crime.

The Fiscal and Customs Police is an ancillary body to the tax customs and exchange control processes, mainly in regard to the development of strategic operations against evasion, contraband, and infringement of the exchange regulations; the arrest of persons responsible for related crimes; merchandise confiscation, development of intelligence activities, support to the inspection and judicial police duties, and providing the security required in development of certain administrative tasks.

It is hoped that the results in the struggle against contraband will improve substantially with the implementation of this new body, to the extent that there will be controls in many parts of the national territory, where there is no physical presence of customs authorities today, or where there is a need for strengthening the presence of customs authorities, for example the special customs zones. At present, nearly 600 men have joined this group nation-wide, particularly at the most neuralgic ports; and by the end of the first half of the year, the figure will be 1,000 men. They have been properly trained through 3-month seminar-workshops held at the Police Academy, with the participation of DIAN officials.

The US Customs Service, the Justice Department, and DEA have training programs and provide assistance to the Fiscal and Customs Police, which are already taking place or are budgeted and scheduled.

**11. Changes on Contraband Penal Types**

Contraband and attitudes related therewith were typified as a crime through Law 383 of 1997, in order to make prevention and repression through criminal recourse more effective. In 1998's Tax Reform, contained in Law 488 of December 24, 1988, important changes were introduced, as follows:

- The so-called "personal contraband quota" was reduced from 1,000 to 100 monthly minimum legal wages. In the past, the introduction of contraband merchandise into the country valued at less than US$153,000 was not considered a crime. Currently, it is not a crime when the price does not exceed US$15,000. It was not possible to eliminate, once and for all, such a permissive treatment in Congress when this Law was sanctioned.

- Penalties were increased for those favoring contraband, and for officials who contribute to the perpetration of the crime. Penalties for contraband were increased to eight years of imprisonment.

- Contraband has now become a crime, for which no bail can be posted when imprisoned.

**12. Currency Exchange Investigation on Contraband Activities**

The strategy has been established that whenever the Customs authorities seize contraband goods, a currency exchange investigation is simultaneously initiated, in order to determine the origin of such currency, and to verify compliance with formalities to channel it through the exchange market. From exchange breaches associated with contraband alone, DIAN received US$10 million in 1998 on account of fines.

**13. Creation of a the Financial Information and Analysis Unit**

Last week, the Colombian Congress approved the governmental initiative that creates an independent entity in charge of coordinating all activities on preventing and combating money laundering. The unit will contribute to the ongoing work developed by DIAN .

**14. Fight Against corruption**

One of the main commitments of the current Government is to fight against corruption. The Government has a strategy against corruption known as "de frente al país" or "facing the country". The strategy has two sides: the formation of ethic values and transparency. The strategy involves the participation of the private sector which will be overseeing and commenting on the activities undertaken by the public sector. The central Government has launched a web page www.anticorrupcion.gov.co where every citizen can learn about the transparency programs launched by the Government and can denounce practices deemed to be corrupt.

At the international level, Colombia is currently working within the OAS on the cooperation efforts against bribery and is considering joining the OECD Anti-Bribery Convention.

**15. Business Polls**

The business sector poll carried out by Fedesarrollo and Fenalco is a monthly statistical tool through which the Colombian business sector expresses its opinion on development, evaluation, and current problems of the activity. Among the problems analyzed, it is worth pointing out the following problems of the

sector: supply and sales situation, bank and suppliers credit, supply of domestic and foreign products, and contraband. The attached chart (Schedule I) shows the evolution between 1990 and 1999 (April) of the opinion of polled entrepreneurs in regard to the behavior of contraband as a business problem, measured in terms of the percentage of affirmative answers.

As illustrated in the chart, between January 1990 and mid 1992, a low percentage of businessmen considered this to be a problem, which revealed the lack of importance of contraband as a business issue. The evolution revealed a downward trend. As of that moment, and parallel to the significant increase of imports, following the country's economic liberalization, a noticeable upward trend is evidenced among polled individuals, which reached its peak in December 1995. At that point, 42% of the answers were affirmative, stating that contraband is a major issue.

As opposed to the foregoing, since January 1996, the trend reversed and, month after month, a significant reduction is observed in poll results, up to the point that 35% of the affirmative answers in January 1996 turned to 19% in February 1999, the latter being the lowest figure since May 1995. In March and April 1999, data shows a slight recovery.

**16. Colombian Foreign Trade: Measurement of Distortion in Import Figures – 1991 – 1996**

This study by the DIAN has complemented a series of studies and research documents developed on contraband and Colombia with quite interesting results and measurements.

The methodology used and the sources of information consulted allowed to conclude that the total distortion of Colombian imports in 1996 amounted to US$7.4 billion, of which open contraband, technical contraband and reduced invoicing accounted for a total US$5.8 billion - equivalent to 78.7% of the total distortion and to 45.3% of total imports, which amounted to US$12.8 billion that year.

The figures and measurement in this study allow to state that import trade is seriously permeated by illegal practices. Tax duty evasions continues to affect 41% of merchandise introduced into the country, out of a list of goods that ranges from electronic and mechanical appliances to textile products, toys, and recreation items.

The study decisively concludes that smuggled merchandise avoids controls in different ways: at Customs inspections, the goods smuggled amount to US$2.9

billion; without Customs inspection, the contraband amounts to US$1.6 billion; and that US$1.2 billion worth of merchandise entered Colombian territory declaring a lesser purchasing price.

**CONCLUSION**

Contraband is one of the worst scourges of Colombia's productive sector. It is closely linked to drug-traffic, as it is the most efficient mechanism for money laundering. It corrupts the Customs administration and all of Colombian society.

Customs officials work under constant threat and top officials of the Tax and Customs Administration need body guards. In my case, even my family has protection.

The actions underway seek international cooperation in the struggle against this phenomenon. Here, the response of the U.S. Government has been entirely positive as far as aid, assistance, and cooperation are concerned, as well as in the creation of the Joint Task Force. The Justice Department has offered training for Prosecuting Attorneys who investigate contraband cases and assistance has been provided to those working on money laundering cases. Training is also being requested in areas such as chemical components and illegal drug detection.

Operations in Colombia are guided directly to transport companies that protect contraband, by raiding warehouses established to store the merchandise, and at the level of all foreign trade intermediaries.

The cooperation of multinational organizations in understanding this phenomenon, and in committing in the struggle against all forms of crime described in this document is urgent. It is often claimed that conducting legitimate business in Colombia is difficult as a result of obstacles imposed by Customs authorities to foreign trade transactions. In this context, work is underway to pass a legal reform on Customs procedures, which will simplify paperwork and eliminate obsolete red tape.

In any case, legally established companies conduct their business in Colombia abiding by all regulations in force. There is no reason to believe that some can abide by the law and others can not. It is merely lack of willingness.

Whirlpool Corporation is proof of the fact that good faith in business is possible. They are in the process of signing a compliance agreement with Colombian Customs authorities, in which they commit to not sell their products to distributors in Panama and Florida, whom they know are engaged in contraband activities.

Another company, Daewoo of Korea, has the policy of not selling its products in Sanandresitos. These examples show that multinational companies are aware of the problem and that solutions can be found.

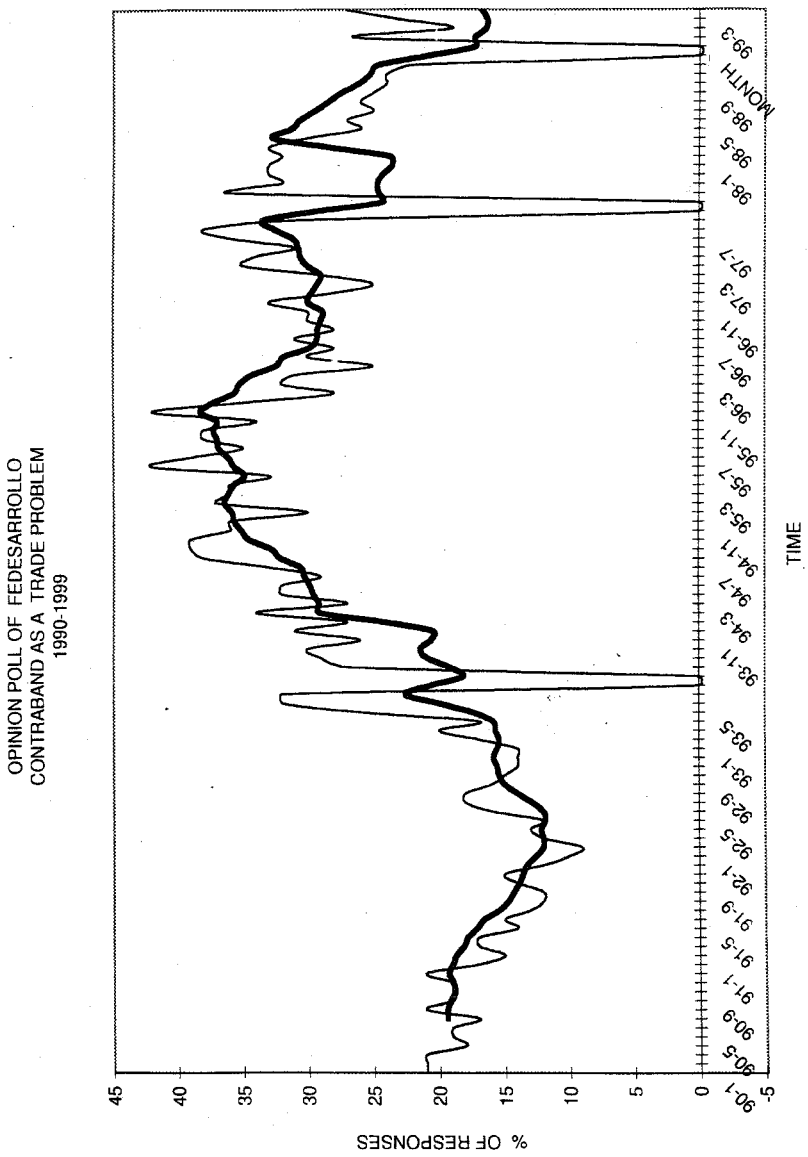
The medium term result should be to eliminate the money laundering mechanism which is an important link in the drug traffic chain.

**SHCHEDULE I**
**FEDESARROLLO OPINION POLL**
**CONTRABAND AS A TRADE PROBLEM**
**1990-1999**

| MONTH | PERCENTAGE OF RESPONSES |
|---|---|
| | |
| 90-1 | 21 |
| 90-2 | 21 |
| 90-3 | 21 |
| 90-4 | 18 |
| 90-5 | 19 |
| 90-6 | 19 |
| 90-7 | 17 |
| 90-8 | 21 |
| 90-9 | 19 |
| 90-10 | 19 |
| 90-11 | 19 |
| 90-12 | 21 |
| 91-1 | 17 |
| 91-2 | 15 |
| 91-3 | 17 |
| 91-4 | 17 |
| 91-5 | 14 |
| 91-6 | 15 |
| 91-7 | 13 |
| 91-8 | 12 |
| 91-9 | 12 |
| 91-10 | 14 |
| 91-11 | 15 |
| 91-12 | 12 |
| 92-1 | 10 |
| 92-2 | 9 |
| 92-3 | 12 |
| 92-4 | 13 |
| 92-5 | 12 |
| 92-6 | 16 |
| 92-7 | 18 |
| 92-8 | 18 |
| 92-9 | 16 |
| 92-10 | 15 |
| 92-11 | 14 |
| 92-12 | 14 |
| 93-1 | 14 |
| 93-2 | 17 |
| 93-3 | 20 |
| 93-4 | 17 |
| 93-5 | 26 |
| 93-6 | 32 |
| 93-7 | 32 |

| MONTH | PERCENTAGE OF RESPONSES |
|---|---|
| 93-8 | 27 |
| 93-9 | 29 |
| 93-10 | 30 |
| 93-11 | 26 |
| 93-12 | 31 |
| 94-1 | 27 |
| 94-2 | 34 |
| 94-3 | 27 |
| 94-4 | 32 |
| 94-5 | 32 |
| 94-6 | 29 |
| 94-7 | 33 |
| 94-8 | 38 |
| 94-9 | 39 |
| 94-10 | 39 |
| 94-11 | 36 |
| 94-12 | 36 |
| 95-1 | 30 |
| 95-2 | 37 |
| 95-3 | 36 |
| 95-4 | 36 |
| 95-5 | 33 |
| 95-6 | 42 |
| 95-7 | 39 |
| 95-8 | 35 |
| 95-9 | 38 |
| 95-10 | 38 |
| 95-11 | 34 |
| 95-12 | 42 |
| 96-1 | 35 |
| 96-2 | 28 |
| 96-3 | 32 |
| 96-4 | 31 |
| 96-5 | 25 |
| 96-6 | 30 |
| 96-7 | 28 |
| 96-8 | 31 |
| 96-9 | 28 |
| 96-10 | 30 |
| 96-11 | 30 |
| 96-12 | 33 |
| 97-1 | 28 |
| 97-2 | 25 |
| 97-3 | 29 |
| 97-4 | 35 |
| 97-5 | 34 |
| 97-6 | 31 |
| 97-7 | 36 |
| 97-8 | 38 |
| 97-9 | 31 |

| MONTH | PERCENTAGE OF RESPONSES |
|---|---|
| 97-10 | 36 |
| 97-11 | 32 |
| 97-12 | 33 |
| 98-1 | 33 |
| 98-2 | 32 |
| 98-3 | 33 |
| 98-4 | 30 |
| 98-5 | 26 |
| 98-6 | 27 |
| 98-7 | 25 |
| 98-8 | 26 |
| 98-9 | 25 |
| 98-10 | 24 |
| 98-11 | 24 |
| 98-12 | 22 |


OPINION POLL OF FEDESARROLLO
CONTRABAND AS A TRADE PROBLEM
1990-1999
% OF RESPONSES
45
40
35
30
25
20
15
10
5
0
-5
90-1
90-5
90-9
91-1
91-5
91-9
92-1
92-5
92-9
93-1
93-5
93-11
94-3
94-7
94-11
95-3
95-7
95-11
96-3
96-7
96-11
97-3
97-7
98-1
98-5
98-9
99-3
MONTH
TIME

**FISCAL COST OF SMUGGLING**
**1993 - 1998**
**(Million of Dollars)**

| CONCEPTS | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | TOTAL |
|---|---|---|---|---|---|---|---|
| SMUGGLING (1) | 2,613.0 | 2,812.0 | 2,771.0 | 2,275.0 | 2,663.0 | 2,328.0 | 15,462.0 |
| EFFECTIVE DUTY TARIFF (2) | 0.0381 | 0.0295 | 0.0171 | 0.021 | 0.0192 | 0.0113 | |
| TAX DEFICIENCY COLLECTION | 99.6 | 83.0 | 47.4 | 47.8 | 51.1 | 26.3 | 355.1 |
| EFFECTIVE VAT TARIFF (2) | 0.1398 | 0.1396 | 0.1385 | 0.159 | 0.1577 | 0.1548 | |
| VAT DEFICIENCY COLLECTION | 379.2 | 404.1 | 390.3 | 369.3 | 428.0 | 364.4 | 2,335.5 |
| **TOTAL DEFICIENCY COLLECTION (TOTAL FISCAL COST)** | **478.8** | **487.1** | **437.7** | **417.1** | **479.1** | **390.8** | **2,690.6** |

(1) data estimated in a study prepared for DIAN
(2) corresponds to the annual implicit tariff calculated by O.E.E

Senator GRASSLEY. Thank you, Ms. Kertzman. Ambassador Skol.

**STATEMENT OF AMBASSADOR MICHAEL SKOL, PRESIDENT, SKOL AND ASSOCIATES**

Mr. SKOL. Mr. Chairman, Senator Sessions, thank you very much. It is an honor and a pleasure to be here to contribute something to this discussion. The whole issue of contraband/money laundering is so complex, you cannot explain it in a sound bite and I think that is one of the reasons why there has not been the kind of activity on the part of people outside of the law enforcement community in the United States and it is hearings like this and the accompanying publicity which I think we hope will bring more companies, more people to understand what is going on and therefore to do something about it.

I also want to say that it is frankly a great honor to be sitting next to Fanny Kertzman who is one of the great dynamos against drug trafficking, against money laundering, against contraband in Colombia. You have heard all about how this system works. What I want to focus on is the point of view of the business community, both the American business community and the Colombian business community, and also to say something about business ethics. What is the right and proper in addition to the commercial thing to do here?

Let me point out something that has been said over and over again, but I want to focus especially on it. This process, contraband money laundering is bad, it is a terrible thing for two very good reasons. One is that it is an integral part of drug trafficking. Without money laundering, you would not have drug trafficking. For that reason it must be stopped. But from another point of view, it is also a terrible thing because of what it has done to legitimate free enterprise, to the free market, to honest and legitimate business in Colombia or anyplace where this touches upon.

Let me give you an example in a specific industry. I know the caucus is familiar with the example of the footwear industry, but it is worth putting on the record what has happened in the last years. During 1998, some nine million pairs of shoes were "legally," and I say "legally" in quotes, imported into Colombia. Of these, some seven million, all imported via Panama's Colon Free Trade Zone, were claimed at Customs to be valued at under $2 a pair. Five of the seven million were valued at under $1 a pair, and of these about one million were claimed to be worth three cents a pair. I spelled it out in my testimony because I did not want anyone to think that we had made a typographic error, three cents a pair.

And these represent only those pairs of shoes which actually went through Colombian Customs. Of the 40 million pairs of shoes that are estimated to go through Customs each year, 30 million pairs are described as pure contraband, pure meaning they do not go through Customs at all, and the other, most of the other ten million are undervalued at Customs.

Well, what is the result? What has been the result of all this? Ten years ago, there were six major shoe factories in the country, each employing over 1,500 workers. Today, four of the six have gone bankrupt and the remaining two are operating at 40 percent

of capacity. Why? It is simple to know why. They cannot compete with shoes that are deliberately way, way underpriced, under the manufacturer's cost by quite a bit. They cannot compete. They go bankrupt. It is also bad because contraband money laundering by eliminating much of legitimate in this case shoe manufacturing and legitimate shoe importing deprives the government of legitimate taxes and legitimate tariffs.

So it hurts the economy in every imaginable way. What I am suggesting here is, therefore, when we look at why should businesses, why should we all be involved, government or not, in doing something very actively and very aggressively about contraband money laundering, there are two very good reasons, and there is a confluence of interests. I can tell you that the private, legitimate, honest, private sector in Colombia has been for years frustrated that there has not been more interest such as that shown by this caucus hearing today, more interest, more activity, more awareness of what is happening to a fellow free market economy in another country because of this contraband.

I would insist that the U.S. business community or the Japanese or the European or any of those that are involved in this kind of activity has, therefore, a double reason to become very actively involved in fighting this kind of activity. There is a moral responsibility not to take part in any way in something which aids drug trafficking. But there is also in my opinion a business ethics responsibility for the free market, for the private sector community, the business community in the United States, not to undermine, actively undermine in any way the business community in another country which is trying to make a buck legitimately if it possibly can.

The time is ending when companies could say that they did not know, they were ignorant, that their products were somehow involved in contraband money laundering. The time is ending because there is now beginning, only in the past year or so, but it is now accelerating, a program of education, of letting people know and I very much applaud today's action announced by Customs in producing a pamphlet and actively going out, talking to manufacturers, telling them what is going on.

The time is also ending when a company can say, well, what we can do about it? We are not law enforcement after all; there is no way we can discover what is going on when the refrigerator or the pair of shoes finally gets to the last destination who is really paying for it. Well, this is not really true. There have been many examples in the past of how private business either because it was forced by law or pressured by public opinion or brought to this stage by its own business ethics to change the way it thinks about point of sale and where its responsibility ends.

The most important, the most obvious industry is the banking industry. The banking industry because of law and because of self-regulated practice now in many countries around the world, the United States, Europe, Colombia, the bankers know their customer. What we are saying is that the bankers and the manufacturers now have a responsibility also to know their customer's customer. And it is possible. There are investigative techniques. The law enforcement community, I am certain, is prepared to help show a

manufacturing company what is actually happening to its product downstream down the line.

This is also not so very far different from what has gone on in the chemical industry. Years ago, European, American chemical companies insisted that, well, if they were selling acetone or ether or the things which could be used as precursor chemicals in the manufacture of drugs, they also had legitimate uses so how could they know? Well, now they know and now there is an entire process supported by law whereby chemical companies that produce the precursor chemicals or chemicals that can be used for manufacturing of drugs, there are whole systems so that they find out just how that acetone, for example, is going to be used when it gets to Colombia.

Is it being imported by a manufacturer of nail polish remover? Fine. But not 100 million gallons of nail polish remover. These things are part of our tradition, part of the way companies and groups of companies have come to accept their responsibility. And frankly what is going to do it is not, I hope, I do not think legislation is necessary. What is going to happen, I think, is the gentle pressure of hearings like this one on companies that do not want to be identified in any way in the public mind as being connected downstream with drug, money laundering or the traffic in drugs. A company which spends tens of millions of dollars a year on buying the services of basketball stars to advertise its goods to children does not want to be identified in any way as doing something bad to those children.

So know your customer, know your customer's customer. This is possible. Another way of doing it, another voluntary way is to sell the product only through the legitimate distributor in that country, in this case in Colombia. If you are going to sell refrigerators or shoes or cigarettes or liquor, make sure that you sell it through your legitimate distributor in that country and not through Miami or Aruba or Curacao or the Panama Colon Free Zone.

Now, companies have begun to do this. This is extraordinarily important. They are showing that (a) it is possible to do these things and (b) Senator Sessions, they are showing, I think, that they think they can still make money selling goods legitimately and making sure that the system does not build and help drug money laundering. If, for example, a company is asked by its distributor to send a thousand refrigerators and a thousand washing machines and a thousand dryers to a customer in Miami, one could ask or send a private detective or ask Customs or the IRS to figure out whether that purchaser is building an apartment complex of a thousand apartments and that is why he needs all of these goods.

If that is the case, bravo for free enterprise. That is great development in the community in Miami. But if this person is not building an apartment complex and has no reason, no demonstrable reason to be purchasing a thousand of each, then certain questions have been asked. It has been raised here before that certain companies have been doing just these things. General Electric is the most quoted examples because General Electric happens to be a company long in the lead on ethics issues. Mr. Chairman, I have a copy that was sent to me yesterday of a letter that was sent to you by General Electric detailing some of the things that they are doing.

They are new policies. I hope that you will have this letter entered into the record. I think it would be very useful.

Senator GRASSLEY. I was planning on doing that during my closing remarks.

Mr. SKOL. Oh, I am sorry, sir, but I am glad that you are going to be doing that. In conclusion, I think there is a great many things the law enforcement community can do. There are things that governments can do. But I think that the business community of the United States operating in cooperation with law enforcement in the United States, the business community in Colombia, and the Colombian government, there is a moral, there is an ethical, there is a business reason to do it that I think they are capable of doing it, and the more we talk about it, I think the more they will do it. Thank you.

[The prepared statement of Mr. Skol follows:]

# CONTRABAND AND MONEY LAUNDERING IN LATIN AMERICA: THE PRIVATE SECTOR'S RESPONSIBILITY

**Testimony of**
**Ambassador Michael Skol**

**Senior Managing Director for Latin America**
**Decision Strategies/Fairfax International**

**Caucus on International Narcotics Control**
**United States Senate**

**June 21, 1999**

Mr. Chairman, I am indeed pleased, and honored, to be invited to speak at this hearing. The theme the Caucus has chosen to highlight is one of the most important facing this nation's relations with other countries. Yet because of its complexity – it takes more than a sound bite to explain the process – and its relative newness, the dangers of black market contraband money laundering are too little known and therefore too little acted upon by those outside the law enforcement community. It is precisely this kind of public airing which we can hope will lead to real corrective action by those not yet fully involved in efforts against this insidious practice.

My name is Michael Skol. I was for thirty years a U.S. Foreign Service Officer, a Latin-Americanist a large part of whose career was focussed on the Andean nations of South America. My interest and experience in drug trafficking and money laundering issues continued after I left the Service 3-1/2 years ago to enter the private sector. I am currently Senior Managing Director for Latin America of Decision Strategies/Fairfax International. I also have my own, small firm, Skol & Associates. My focus is the provision of anti-corruption (including anti-money laundering) and investigative services to private firms and governments. At the same time, I serve as Chairman of the U.S.-Colombian Business Partnership, an association of several of the largest U.S. companies with interests in Colombia.

You heard earlier today details from experts of how the black market contraband scheme works and how integral it is to the continuing operation of the traffic in narcotics to the United States. You have also listened to representatives of both the U.S. and Colombian Governments explain what is being done and what should be done to stop this practice. What I would like to discuss with you is this issue as it affects the private sectors both of the United States and of Latin American countries such as Colombia.

My first, and perhaps most important, basic point is that contraband money laundering is a bad idea for two very different reasons: it feeds and supports narcotics trafficking **and** it severely undermines the workings of honest business. In fact, the very process of undercutting the legitimate market further encourages a shift to the more lucrative trade in drugs. It is no moral excuse, but the fact is that a weak economy and substantial unemployment inevitably makes involvement in narcotics more attractive in certain circumstances. The whole concept behind the Andean Trade Preference Act, after all, was to reverse this trend, to help build legal employment opportunities to counter the drug trade. The advent of a link between contraband and money laundering in the service of narcotics reverses the effect of what has been a very sound anti-drug economic policy. Bad business drives out good business. And we all suffer.

Let me offer a specific example of this kind of distortion of the free market. The recent history of the footwear industry in Colombia is familiar to the Caucus. But the numbers are so dramatic that they are worth repeating. During 1998, some 9 million pairs of shoes were 'legally' imported into Colombia. Of these some 7 million (all imported via Panama's Colon Free Trade Zone) were claimed at Customs to be valued at under U$S 2. Five of the seven million were valued at under U$S 1. And of these about 1 million were, incredibly, claimed to be worth three cents a pair! And these figures represent only those pairs of shoes which actually went through Customs. An informed calculation is that an additional 30 million pairs were imported as 'pure' contraband – that is, not passing through Customs at all.

The direct result of this kind of practice has been a serious blow to Colombia's footwear industry – and to most of those who once worked there. Ten years ago, there were six major shoe factories in the country, each employing over 1500 workers. Today, four of the six have gone bankrupt, and the remaining two are operating at 40% of capacity. They simply could not compete – how could they? – with an onslaught of shoes from abroad whose low prices were subsidized by the drug traffickers' understandable willingness to sacrifice profit on a pair of shoes in exchange for a quick turn-around in money earned from the much higher profit trade in drugs.

I should also point out that contraband money laundering hurts government revenues as well, with lower customs collections due to under-valuation and the avoidance of passing through Customs at all, as well as lower tax income because tax-paying legitimate businesses make less money or go out of business altogether.

The significance of this dynamic is that we have a confluence of interests on which we surely can base a stronger cooperative policy: The private sector and governments in countries like Colombia have every bit as much a strictly **economic** interest in ending the practice of contraband money laundering as do the rest of us for essentially anti-narcotics reasons. Effective action in this area is not in any way an 'us vs. them' situation, but rather a win-win for all concerned (except the launderers and the traffickers). That, frankly, is why so many Colombian and other businessmen have been frustrated over the past few years over their inability to convince exporting countries of the need to take priority action.

This then leads me to the fundamental conclusion that the private sector of the United States and other countries has a double reason to become more active than it has been against the phenomenon of contraband money laundering. I would argue that the private sector has a moral responsibility not only aggressively to distance itself from anything which aids drug trafficking, but also a business ethics mandate to support and certainly not undermine the workings of the free market system.

There was a time when firms whose products were being used for contraband money laundering could honestly claim that they were ignorant of the practice. That time is rapidly ending. We know too much about just how it works and which products appear for sale at below-bargain prices throughout the region. The companies themselves have been repeatedly informed in detail by U.S. and other law enforcement agencies and by affected businessmen in Colombia and elsewhere.

And the time is ending also for those who insist that private companies have neither the wherewithal to discover where specific shipments wind up eventually, nor the means to take action against misuse of their products. The tools to do both are available.

No one expects private companies to act as if they were in the business of law enforcement. But it is arguably time to expand the common corporate ethics code to include certain new, self-imposed demands. First among these would be a theme familiar to bankers world-wide: "Know your customer." Or, perhaps, "Know your customer's customer." It is significant that a determined Colombian banking system was able to build on this concept and establish a system of controls so effective that the net result was to drive the money launderers elsewhere: to contraband in fact.

Now it is incumbent upon manufacturers to do likewise. The bankers have proven it possible. And the technology of professional due diligence investigation is readily available. If someone in Miami or Panama or Aruba wants to purchase a thousand refrigerators and an equal number of dishwashers and dryers, and it is discovered that he is building an apartment complex of a thousand units, then he should be congratulated for his contribution to development. But if there is no such explanation, then there should be no such sale. And distributors who violate the standard should be dismissed by the manufacturer.

Another useful rule in this new ethics canon would be for a company to insist on sales to a specific place only through legitimate distributors in that country, and not through third parties, as in free trade zones in other countries.

The fact is that a number of firms have begun voluntarily to do these very things. General Electric, a company long in the lead on ethics issues, is an example. And voluntary actions are, of course, much to be preferred over any new set of legal requirements. The private sector is quite capable of doing it on its own. And it is manifestly in its own interest to do so.

In conclusion, I would suggest that there is much for both governments and private firms to do in this area. Law enforcement agencies should be expected to help companies identify illegitimate conduits of their products. Governments like Colombia's must continue their efforts to increase penalties and prosecutions and improve their customs inspection procedures. Governments together must intensify actions to 'clean up' the dirty laundry operations in places like Miami, and Aruba, Curacao and the Colon Free Trade Zone in Panama. And those in the private sector who have not yet absorbed the facts of their (unwitting) complicity will have to do so and then act accordingly.

Thank you for this opportunity.

Senator GRASSLEY. I would like to call on Senator Sessions to ask the first round of questions.

Senator SESSIONS. Thank you, Mr. Chairman, and you make a very persuasive case and I think I understand, Ambassador Skol, a little more clearly. As I sat down last night for the first time and read the materials, I was asking myself who are we involving here? Who are we putting the pressure on and I do think, however, and Ms. Kertzman, I do think, however, that economics and free trade and lower prices is a reality. That is life in this world.

And if your taxes and regulations reach a certain level, you can expect people to figure out a way to get around those taxes, and to the extent to which that is a factor I think Colombia should look at that. Would it be possible, Director Kertzman, for Colombia to license or approve only certain importers, those that they have certified are complying with the law and paying the taxes?

In other words, it seems to me that who should determine who are the people bringing the dirty money in? A distributor for an American company or Colombia itself?

Ms. KERTZMAN. The first thing I want to say is that—and I want to repeat it—is that the tariffs and taxes are not as high in Colombia as you think. The rate of a tax including a value added tax on the tariff for imports is 16.6 percent. It is not 60. It is, you know, 16. So I think that——

Senator SESSIONS. The ten percent tariff in addition?

Ms. KERTZMAN. No, no. This is why in all the economy, for specific goods, there is value added taxes for many goods, but there is no value added tax, for example, for food. So if you import food, there is no value added tax on that and besides the tariffs are different. Tariffs in Columbia range from five percent to 20 percent, and there are specific tariffs for food again, cereals and rice, just like——

Senator SESSIONS. What is it on a washing machine?

Ms. KERTZMAN. For a washing machine, it is 20 percent.

Senator SESSIONS. Plus 16 percent.

Ms. KERTZMAN. Plus 16 percent.

Senator SESSIONS. You are talking about 36 percent which is pretty hefty tax.

Ms. KERTZMAN. Yes, but——

Senator SESSIONS. By American standards even.

Ms. KERTZMAN. No, no, we understand that and we try to have a policy of lowering tariffs for these kind of goods that we say in Colombia that they are contrabandistas that they can be smuggled. But Colombia is part of the Andean Pact so there is a common tariff for the countries for Venezuela, for Ecuador, Peru, Bolivia and Colombia. So Colombia cannot change its tariffs by itself.

The second question that you said is that we could do something from the point of view of authorities to let some people import into Colombia. We could do something like that. We could say that, for example, Whirlpool Corporation Colombia is the only authorized company to import goods of Whirlpool. But I think that it goes against the rules of the organization, for the WTO. I think it goes against the rules of WTO, but I will have to check on that. But the problem is that, yes, we decided that we are authorizing only certain importers but there is also open contraband, that it does not

go through Customs, and it comes from the sea to ports that are not authorized to function or just they are paying the people in Customs where we have a big problem of corruption. So we certainly can do things like you say and that is a very good idea, not to authorize any imports if the people have not paid their taxes, for example, but still the problem remains that they can avoid all kind of controls in Colombia.

Mr. SKOL. Senator, if I may add to that, I agree with you completely. If you eliminate all government controls and if you eliminate tariffs and taxes, you will eliminate most contraband. I think you would eliminate all regular traditional contraband. The problem with drug trafficking connected contraband is that the profits are so enormous that even if there were no tariffs, even if there were pure free trade, the drug traffickers and their money launderers could easily afford to sell pesos, sell dollars, well below the free market rate. They do not have to compete necessarily with a distorted market. They can compete.

Senator SESSIONS. I certainly agree with that and that is the corrupting influence of this terrible industry and it is corrupting and it is dangerous and it does defeat, brings in cash, and honest businesses are at a competitive disadvantage terribly by it and I do not know how to deal with it. I would just say this, Director Kertzman, I hear good things about your leadership. I congratulate you for the courage and determination you are showing.

I also believe that Colombia is a wonderful nation and I do not mean to suggest otherwise. I have worked with policemen from Colombia who testified in cases I prosecuted courageously and with skill and ability. I believe that it is a historic ally of the United States. I am very, very troubled by the internal warfare you are suffering, much of which driven by drug money and kidnapping. I think this nation should be trying to do more to help Colombia stabilize itself and be supportive in that area and do not mean to be suggesting that I am trying to blame Colombia for everything that goes wrong. We do have a mutual problem and we should work together to solve it. Thank you, Mr. Chairman.

Senator GRASSLEY. Before I ask my first question, you stated that you have to have how many body guards?

Ms. KERTZMAN. I have nine.

Senator GRASSLEY. Nine and your family has——

Ms. KERTZMAN. My kids have six.

Senator GRASSLEY. I was thinking if every United States Senator had to have that protection, I can name at least one senator who would not care to be in the United States Senate and I would assume that most would not like that sort of environment. I do not know how you do your work, but as has been stated and you have been complimented so much, I want to add mine to your going above what we would call in this country above and beyond the call of duty to do good for your people.

What tools if any do you have available to determine if an import has entered Colombia legally?

Ms. KERTZMAN. Well, we have the information system in Customs and we can look at the import declaration that they make. We can follow all the trace of the papers. So the system is there. We

can work on that. So it is very easy to follow the trace of an import that was made illegally.

Senator GRASSLEY. Okay. The Colombian government has frequently stressed the need for international cooperation to tackle the challenges of the exchange, the peso exchange, the black market peso exchange. One effort in this direction was the recent decision to share Customs information between our country and your country. How successful have these efforts proven to be?

Ms. KERTZMAN. Well, we already are working together in two big cases of smuggling and we are asking U.S. Customs for some information, but this information they are finding out if it is reserved, if they can give it to us. But anyway we are working together and we hope that we can sign this agreement between Customs which would allow them to give us the information that we are requesting at this point.

The problem that we have with the agreement is that the State Department said that it should be signed between governments and not between agencies. It was going to be signed between the Customs Service and the Colombian Customs. If it has to be signed between governments, it will take a long time in Colombia to be implemented because it has to go through Congress and be approved in Congress by a law. So we hope that we are trying to make this point with the State Department to have the agreement signed just between agencies. But we are working very, very closely, not only with Customs but also with the Justice Department and the DEA in specific cases.

Senator GRASSLEY. Did you say that that is our government or your government that wants it to be government to government as opposed to agency to agency?

Ms. KERTZMAN. It is your government.

Senator GRASSLEY. That is something that we should try to facilitate. If it is government to government, how much longer would it take that to be approved by your government then if it has to go through your congress?

Ms. KERTZMAN. Well, I do not know how long it would take, but it might be significant that it would not be signed because if it has go to through Congress, there are people in Congress in Colombia that do not like this agreement because some of them are somehow they receive money from the smugglers. So they would not like this agreement to be signed.

Senator GRASSLEY. It seems to me that we should have this caucus and our staff look into why this is a requirement on the part of our government and if there is an understanding that that is a tremendous impediment to the proper agreement that you feel you have to have to make this exchange of information be facilitated. Is that right?

Ms. KERTZMAN. Oh, thank you very much. I do not want to make a point against the U.S. government in this, but it really would be helpful if the agreement is signed between agencies because, not because there is some problem with U.S. government here, but because it will be very difficult for the agreement to go through Congress in Colombia.

Senator GRASSLEY. Yeah. Well, and it might be a technicality that our government does not understand the full impact of and it

may be something that is so small on somebody's radar screen that it is not given the proper attention that it ought to be given, and by the way I do not think you have to worry about criticizing our government. We feel free to criticize your government from time to time.

This is not the time for niceties. What we are trying to do is get information and get to the bottom of the issue. Well, then, this is just the end of my first question to you. Then do you kind of feel like except for this technicality we just talked about, that everything is pretty much in place to get the information and cooperation from the U.S. Customs that you feel you should have?

Ms. KERTZMAN. Yes, we think that there is all the willingness to give us information and with the agreement it would be easier, but they are cooperating with us in every possible way.

Senator GRASSLEY. Yeah. Many believe that the black market peso exchange began largely as a product of the structural economic conditions within Colombia; high tariffs and duty rates and restrictions on obtaining hard currency forced importers to seek alternative and cheaper means of obtaining dollars. Recently, though, as you stated, the government of Colombia has slashed tariffs. And yet the black market peso exchange continues to flourish.

Other than what Ambassador Skol has spoken about, are there any factors that underlie this trend to reduce tariffs and yet have the contrabandistas still exist?

Ms. KERTZMAN. I think that the most important incentive for contraband is not that tariffs are high, as I said, but that narcotrafficking exists and the relation is that the profits from narcotrafficking have to be laundered and they slice the price of the dollar in order to launder it. When the official dollar in Colombia is 1,600 pesos per dollar, the dollar of narco-trafficking is only 1,000 pesos. That is the main issue. That is the key why there is smuggling and why it is linked to contraband. So I think as long as narco-trafficking exists, there will be contraband because there is always the economic incentive to launder this money through this mechanism.

Senator GRASSLEY. Okay. I just have one other little point on that and then I will move on. The Colombian Central Bank has made efforts to ease up on restrictions for obtaining U.S. dollars. Do you think that would reduce the ability of peso brokers to trade dollars for pesos?

Ms. KERTZMAN. In Colombia, there are two markets for the dollar, what we call the Malcao combiyu [phonetic], which is the market that all the exports and imports of goods have to go through, and there is also the free market. The free market is everything different from exports and imports of goods and I do not think that there are many contras right now for dollars in Colombia and there are not any plans to make it easier for people to have accounts in dollars. I do not see any change coming from that. So conditions from that point of view that will not change in the short term.

Senator GRASSLEY. Colombian authorities have frequently complained that the Panamanian and Aruban free trade zones are primary routes for this contraband going to Colombia. We have heard testimony earlier today about the importance that peso brokers place on having these kinds of free trade zones where they can buy

and sell products. How cooperative have officials from both nations been in monitoring the transactions that take place within their zones?

Ms. KERTZMAN. Not cooperative at all. I do not have any information. They do not cooperate giving us information and there is no formal talks about anything. So we feel that we are completely alone in this fight.

Senator GRASSLEY. So then that probably means that they have not enacted any policies to attack contraband purchasing or money laundering?

Ms. KERTZMAN. I do not know about money laundering. What I know is about contraband, the case of the Caribbean countries, that surround Panama, Aruba and Panama, they do not have any willingness to combat contraband.

Senator GRASSLEY. Do you feel that more controls over goods at free zones could significantly decrease the ability of peso brokers to do business?

Ms. KERTZMAN. Yes, I think that would be very helpful because the companies here in the U.S. or in Japan or in Korea can say that they sell to distributors and after they issue orders they do not know where the merchandise is going. So that would be a very good way to fight the contraband.

Senator GRASSLEY. Do you have any recommendations for actions that you believe the United states should take to reduce its vulnerability to being exploited by these type of money laundering operations? In other words, I am inviting you to give suggestions to our government or even to be critical.

Ms. KERTZMAN. Yes, thank you for the opportunity and I just want to say that I totally agree with what Ambassador Skol just said. He said it is very important that private companies know their clients so that they have this policy just as in the financial sector that there is a list of designated narco-traffickers that kind of have accounts in those banks. There should be a similar policy here in the U.S. in respect to private companies because they have to know to whom they are selling their products and just as Ambassador Skol said, there is law enforcement.

If they say that they cannot know, and as it happened with chemical precursors, just a typical example, that it is possible to know your client if you want to do it, if you want really to fight contraband. I think that private companies here in the U.S. should make a commitment to this and maybe it should be something in the law, in the U.S. law, because contraband is just the same as narco-trafficking.

Senator GRASSLEY. And the extent to which American corporations would want to move very strongly in this direction, we have had a couple of instances of outstanding efforts within the corporation already mentioned today, but the extent to which other companies would want to do this, obviously the extent to which they needed the cooperation of your government, they would get it, I assume.

Ms. KERTZMAN. Of course they would. I was just saying that I was not sure if we could allow, for example, all the imports from the representative of Whirlpool because maybe it could violate

WTO, but we are willing to help on that and doing whatever is on our extent to work together on this.

Senator GRASSLEY. I just have a couple questions for you, Ambassador Skol. Many Colombian businessmen who operate through legitimate channels are facing intensive competitive pressure from the Sanandresitos who are often able to underprice them. And you have made that very clear in your own testimony. Because a legitimate businessman must pay government taxes, tariffs and duties, their products tend to be more expensive and you have made very clear to us that even though the free market might work with regard to the reduction of tariffs and the fact that the laundered money can still undercut legitimate business, I would like to have you tell us how have these businesses reacted to competition provided by the Sanandresitos?

Mr. SKOL. Mr. Chairman, unfortunately many legitimate companies have reacted to competition from Sanandresitos by using the black market money exchange and hiding their eyes frankly from that fact and so that they avoid—they save a lot of money. They avoid taxes. They buy some contraband products. There is a whole rainbow of differences among companies from the very illegitimate to the absolutely pure.

Unfortunately, many of the absolutely pure are also the about to become bankrupt. And there is a cumulative effect of all these illegalities, the corruption, the contraband, the money laundering, the avoidance of taxes which does make it very difficult for the legitimate businesses to function, but many of them, I would dare say most of them, are functioning legitimately, want to function legitimately. And today if a Colombian wants a General Electric refrigerator or a Whirlpool dryer, it is going to become very, very difficult to get their first choice illegitimately and the more manufacturers, the more government pressure on the contrabandistas and on the money launderers, every improvement in each area helps the other areas.

I hope you will get in the next weeks many letters from American companies, Mr. Chairman, telling you what they have been doing or what they are about to do. The more that do it, the more the Colombians will be faced with not being able to get their preferred products. If they want to get cheap stuff at the Sanandresitos, the Sanandresitos will go out of business. This is going to take quite a long time and there is a responsibility on the Colombian government progressively to attack the very nature of these Sanandresitos. I know it is very difficult for us to understand why an apparently illegitimate enterprise exists so openly, but it is imbedded in the political culture. There is a great deal of fear and it is going to take a lot of action on the part of people like Fanny Kertzman and others slowly to eradicate these kinds of things.

Legitimate business people want to do business legitimately. When they are faced with bankruptcy, they will cut corners, and I think it is incumbent upon all of us to help them do business legitimately.

Senator GRASSLEY. I presume that cartels threaten, of course, legitimate business in Colombia? Or not so?

Mr. SKOL. I have never heard of a threat against a legitimate business doing legitimate business. There are many threats against business people. They are kidnapped all the time. There is danger in Colombia, but I have never heard of a consistent threat against doing legitimate business. It is the workings of the market that causes legitimate business people to do illegitimate things.

Senator GRASSLEY. How have businesses in neighboring countries reacted to the competition of underpriced contraband?

Mr. SKOL. We do not have any—I do not have any statistics on this, but I have to assume that probably when you hold this hearing a year from now or two years from now, you will no longer use the word peso because there will be sucres and bolivianos and other currencies involved. One has to assume that some of this is happening. I do not have any statistics on this. It will begin to happen more in other countries as it is cleaned up in Colombia and then we are going to have to focus on those other countries.

Contraband, pure contraband, has existed throughout South America and Central America and the Caribbean for years. Paraguay, for example, is a country that if you look at the statistics, you think that every Paraguayan drinks a case of scotch whiskey and smokes seven cases of cigarettes every single day. That is not true, of course. It is all smuggled outside of the country to Brazil and Argentina. I know of no statistics, but I would be very surprised if drugs were not also using that particular system, in this case, cigarettes and whiskey, to launder their proceeds.

Senator GRASSLEY. My last question is very general in the sense that if you were listening to this discussion from the outside, this is something just between the United States and Colombia. Do you believe it is broader than that or could be, and if so, do you have any other examples?

Mr. SKOL. I have no other examples specifically, but I have to assume that it is going on in other countries. I assume it will happen in other countries. There is certainly contraband and smuggling in other countries and insofar as other countries are centers of either drug production or drug movements, then it would be surprising if it were not going on, but I cannot tell you that it is going on in other countries.

Senator GRASSLEY. Do you have any further questions?

Senator SESSIONS. No. I would just mention to the Ambassador and would ask him just briefly, I know of an incident recently where an American was kidnapped in Venezuela and taken to Colombia for ransom and I know of the destabilization in Colombia from the rebel forces that have taken over a portion of that country. Would you care to make any brief comments about your concerns for the region and to what extent drug trafficking is a bad factor in it?

Mr. SKOL. Oh, well, there are two great sources of money, large fundings, for the guerrilla movements, the two of them in Colombia. One is kidnapping. There is a phrase in Colombia. It is called commercial terrorism. I never heard of it anywhere else, but it is kidnapping for money. The other great source is drug trafficking, protecting and advancing drug trafficking. If it were not for drug trafficking and drug money laundering and everything we have been talking about here, the task of the Colombian government to

make peace with the guerrillas would be half as easy and it is still extraordinarily complicated and it will take a long time, but drugs are unquestionably a complicating factor in the problems, the peace problems in Colombia today.

People too often point to El Salvador or Guatemala and say, well, let us do the same things, and it only took several years there. Colombia has this additional terrible shadow of drug trafficking, which funds the guerrilla armies, and while that continues peace will be even more difficult to achieve.

Senator SESSIONS. Director, would you like to comment on that?

Ms. KERTZMAN. Yes. No, I would like just to say that guerrillas exist in Colombia, exist from the '50s. It is a very old problem in Colombia and they did not start as narco-traffickers, but they started as a real movement and then they moved into delinquency with kidnappings. They are not directly the narco-traffickers. They have the business of taking care of the crops of cocaine. They take care of them. But it seems that they are not directly the narco-traffickers.

Senator GRASSLEY. Okay. We have no further questions. The only thing is, particularly you, Ms. Kertzman, if there is one last statement or admonition or any sort of suggestion you want to make, I would give you another opportunity. Do you have anything to say in closing or I mean the last forum?

Ms. KERTZMAN. No. I mean the only thing that I would like to say is to thank you very much for your words that you have to me, both Senator Sessions and you, Mr. Chairman. I want to thank you very much for that and I want to thank you for the opportunity to be here and tell all the people here in the United States something that we already know in Colombia is that contraband is as big a problem as narco-trafficking and all the countries have to be in this together. Thank you very much.

Senator GRASSLEY. Yes. In 60 seconds, we will be done. I would just like to say as the hearing closes maybe one last observation, and we have heard a lot today about this very important issue and it ought to be clear to all of us that we in government, both here as well as in Colombia, and the business communities, and I might say there in both countries, have a job cut out for us. I would make clear that the purpose of this hearing is not and was not and will not in the future to be single out any companies as being involved in illegal acts.

We have heard the names of several businesses mentioned. It should be clear, however, that these companies and their products are being used. The issue for all of us is that our businesses and financial systems are being exploited by criminals to launder drug money. We have a shared responsibility working separately and also together to prevent this, and of course this means dialogue on what to do that involves government, business, and as part of the business sector the financial community specifically.

In this regard, I would draw attention to the efforts, as Ambassador Skol has already stated, of General Electric Company and its commitment to help and act as a leader. And I would introduce the aforementioned letter from GE that I received from its general counsel committing to such an effort and stating their past commitment to it.

[The letter from GE follows:]

E. Scott Gilbert
Counsel, Litigation and Legal Policy*
*Admitted in New York

3135 Easton Turnpike
Fairfield, CT 06431
Telephone: (203)373-2592; dialcomm: 229-2592
Email address: Scott.Gilbert@lsw.ge.com

June 20, 1999

VIA FACSIMILE

Honorable Charles E. Grassley
Chairman
Caucus on International Narcotics Control
United States Senate
Washington, D.C. 20510

Dear Senator Grassley:

The General Electric Company is firmly committed to preventing its products from being used in transactions associated with money laundering. In connection with Monday's hearing of the Senate Caucus on International Narcotics Control, I thought it might be helpful to provide the following brief outline of the comprehensive approach that GE has taken to money laundering prevention generally and in response to the particular problem of the Colombian black market peso exchange.

**Money Laundering Prevention: GE's Approach**

GE is a global manufacturing and services company that operates in a diverse range of industries including power generation, medical systems, aircraft engines, industrial systems, lighting, appliances, broadcasting, information services, plastics and financial services. Across our company, GE businesses are required to have both "know your customer" procedures -- to ensure that we do business with reputable customers and business partners -- and restrictions on the forms of payment that are accepted -- to prevent the acceptance of financial instruments, such as third party checks, which have become associated with money laundering activity. Our money laundering prevention programs are implemented at the individual business level, so they can be tailored to the particular risks of each industry.

**Money Laundering Prevention at GE Appliances**

We are particularly proud, for example, of the efforts of GE Appliances ("GEA"), which has focused on preventing appliances manufactured by GEA from being used in the black market peso exchange.

Before describing the extensive measures that GEA has implemented, I want to emphasize one fundamental point. GEA's compliance commitment to preventing the use of its products in contraband trade is in harmony with its commercial interests. GEA's commercial strategy is to serve the Latin American market through in-country distribution, rather than through exports by domestic dealers. In-country distributors provide service and build the reputation of the GE brand in their assigned territory; exporters based in Miami do not.

In Colombia, GEA distributes products through MABE Colombia, which is an affiliate of GEA's joint venture partner MABE, a large Mexican appliance company. MABE Colombia is just as affected by the artificially low pricing of contraband dealers as are other Colombian appliance distributors. MABE Colombia is a member of the Colombian Appliance Chamber, which is working to combat the contraband problem.

Far from acquiescing in the contraband trade, GEA has taken decisive action to prevent its products from being used in the illicit black market peso exchange:

**Restrictions on domestic dealers**

GEA requires its U.S.-based retail dealers to sell only to retail customers and prohibits domestic dealers from exporting. There is one exception: dealers are permitted to sell small amounts of appliances to foreign nationals who are purchasing products for personal use in their home country. This is called "baggage trade," and it is strictly defined: dealers can sell up to 10 appliances (no more than two of the same product line) to any customer for export outside the U. S.

**Restrictions on exports by in-country distributors**

In its agreements with in-country distributors, GE prohibits distributors from exporting out of their assigned territory.

**Training**

GEA trains its sales and credit and collection personnel on the requirements of its money laundering prevention program.

In addition, GEA has gone to extensive lengths to educate dealers on its export restrictions and – since the peso brokering problem was identified – on the importance of complying with U.S. money laundering prevention laws:

--face- to-face meetings conducted by senior GEA officials with dealers in the Miami area and with national accounts;

--written communications to domestic dealers reminding them of the importance of compliance with the export restrictions and with the money laundering laws (including Form 8300 compliance) and warning them that dealers will be terminated if they violate their agreements;

-- distribution of a comprehensive educational pamphlet explaining the money laundering prevention laws and the elements of a compliance program;

--deployment of a money laundering compliance section on GEA's CustomerNet, a web-based system for customer communication and product information.

**Audits**

GEA audits domestic dealers and in-country distributors both reactively and proactively. If, for example, GEA receives the serial numbers of appliances that have been found in an unauthorized dealer in another country, we trace the serial numbers and audit the dealer from which the products originated. Tracing is sometimes not possible if serial numbers have been eradicated in the products that have been questioned.

In addition, GE conducts random audits in high-risk markets like Miami to determine if there have been any violations of the export rules.

**Enforcement**

If, through audits or other means, we learn that either a domestic dealer or an in-country distributor has violated export restrictions or other terms of our agreements, we take concrete action, up to and including termination. GE has terminated dealers and distributors in Miami, Colombia and elsewhere for unauthorized exports. In those instances, we have not seen evidence of involvement in the black market peso exchange, but proof of unauthorized commercial activity was enough to justify terminations.

These terminations can be costly: GEA is typically threatened with wrongful termination litigation. GEA is currently a party in a lawsuit in federal court in Kentucky arising out of its termination of a Colombian distributor that was found to have violated its distribution agreement.

In sum, GE has implemented an aggressive, comprehensive approach to preventing its products from being used in the black market peso exchange. *We are not aware of any company that has done nearly as much.*

In the end, however, this problem can only be solved with a cooperative multi-national partnership between government and industry. We stand ready to work with our government as well as with the government of Colombia to find a comprehensive solution.

We would be happy to meet with you or your staff to provide further information about GE's efforts and to discuss a comprehensive strategy for addressing this problem.

Very truly yours,

E. Scott Gilbert

cc: William J. Olson, Staff Director

Senator GRASSLEY. I hope that coming out of today's hearing that we will see a major initiative by all the parties concerned to develop and implement a very comprehensive strategy. We all bear a responsibility to ensure that our trade and financial networks are not vulnerable to the criminal exploitation that we have heard about today.

And even though I am a small part of the United States government, I would want this caucus and I would expect that this caucus would be a focal point for facilitating part of this process, to even encouraging this process, and to some extent even being a judge of the adequacy after a period of time of whether enough is being done both by the respective governments and our respective business communities. With that, I adjourn the meeting and thank you all for your participation.

[Whereupon, at 12:25 p.m., the caucus was adjourned.]

○