



Money Laundering and Bulk Cash Smuggling: Challenges for the Mérida Initiative

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Brief Project Description

This Working Paper is the product of a joint project on U.S.-Mexico Security Cooperation coordinated by the Mexico Institute at the Woodrow Wilson Center and the Trans-Border Institute at the University of San Diego. As part of the project, a number of research papers have been commissioned that provide background on organized crime in Mexico, the United States, and Central America, and analyze specific challenges for cooperation between the United States and Mexico, including efforts to address the consumption of narcotics, money laundering, arms trafficking, intelligence sharing, police strengthening, judicial reform, and the protection of journalists. This paper is being released in a preliminary form to inform the public about key issues in the public and policy debate about the best way to confront drug trafficking and organized crime. Together the commissioned papers will form the basis of an edited volume to be released later in 2010. All papers, along with other background information and analysis, can be accessed online at the web pages of either the [Mexico Institute](#) or the [Trans-Border Institute](#) and are copyrighted to the author.

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The Scope of the Problem

Douglas Farah

It is widely accepted that cutting off the flow of money from the sale of cocaine in the United States to the Mexican drug trafficking organizations is one of the most efficient ways to decrease the power of the cartels. Without the cash influx there would be less money for corruption and the purchase of weapons, and cash seizures directly take away what the drug traffickers want most -- profits from their illicit activities.

On both sides of the border the smuggling of bulk cash and money laundering tied to the billions of dollars in profits is not just viewed as a problem for Mexico, but as a significant security threat to the United States. Parts of Mexico have seen the homicide rate skyrocket in recent years, particularly Ciudad Juárez. The Calderón administration has felt obligated to deploy the military to support and in some cases supplant local law enforcement because of the strength of the cartels and the deep seated corruption among the law enforcement and judicial structures.

"The prevention of money laundering and the financing of terror are today a matter of high priority, both nationally and internationally because they concern complex phenomena with serious economic and social consequences because they allow organized crime to finance criminal activities," said a recent Mexican policy statement. "These activities generate public insecurity and social destabilization and can severely damage the reputation of financial sectors and the country itself."¹

The 2009 National Drug Threat Assessment of the U.S. Department of Justice (NDIC report) described Mexican drug trafficking organizations as "the greatest organized crime threat to the United States."² The report found that drug trafficking organizations place a high priority on legitimizing the proceeds of their drug sales and that "bulk cash is a prominent method" for Mexican organizations to move their cash.³

Given the stated priorities of both governments to enhance the money laundering structures and halt bulk cash shipments, it is striking that direct funding for such efforts is a very small part of the Mérida Initiative.⁴ Some components of the Initiative, such as the non-intrusive inspection equipment at border check points, the training of prosecutors in financial crime investigations, and exchange of personnel for financial intelligence work

¹ "Tipologías Del GAFI Aplicables a Los Sectores Asegurador y de Remesas," Unidad de Inteligencia Financiera, Secretaría de Hacienda y Crédito Público Informe 2009.

² "National Drug Threat Assessment 2009," National Drug Intelligence Center, Department of Justice, January 2009, p. 43.

³ "National Drug Threat Assessment 2009," op cit., p. 45.

⁴ The Mérida Initiative, announced in 2008, has provided roughly \$400 million a year for three years to support Mexico's counter-narcotics efforts, primarily equipment, and \$65 million a year for the Central American nations for the same purpose. See: Manuel Roig Franza, "Anti-Drug Assistance Approved For Mexico," Washington Post, June 28, 2008.

touch on the financial issues but very little is directly aimed at the structural issues of money laundering and bulk cash shipments.

While Mexico has taken significant steps to allow the state to seize illicit funds and goods obtained from illicit funds, the near-unanimous consensus of those interviewed and the available literature is that very little is effectively being done to either impede the movement of drug money into the formal economy or significantly reduce the flow of bulk cash across the U.S.-Mexico border.

A recent International Monetary Fund assessment of Mexico's money laundering efforts found that of the 149 indictments issued for money laundering from 2004 through 2007, only 30 have gone through the judicial system, resulting in only 25 convictions. That is roughly only six convictions a year. The IMF report noted that "most of those convictions resulted from uncomplicated investigations arising out of seizures of cash at the airports and borders where the defendants were unable to demonstrate the legal origin of the funds. Given the level and sophistication of organized criminal activity in Mexico, these results reflect a disappointing lack of effectiveness in Mexico's money laundering offense."⁵

More bluntly, Dr. Edgardo Buscaglia of the Instituto Tecnológico Autónomo de México said, summarizing the sentiment expressed by many experts, efforts to combat money laundering "are a small dam in the middle of a large ocean."⁶

Current border detection architecture on both sides of the border is designed almost entirely to detect and halt the northward flow of cocaine and heroin. Despite years of discussions about the importance of cutting off bulk cash shipments, only over the past year have serious efforts begun to effectively monitor and interdict southbound flows of bulk cash and weapons. Even so, there is almost none of the infrastructure in place that would be necessary seriously tackle the issue.

In addition to these broad structural and funding issues, there are significant challenges in assessing the amounts of bulk cash shipments and money laundered through Mexico's formal and informal economies, and the relative importance of different methodologies to the cartels. This is in part because it is an illicit business that is highly lucrative and designed to make the money movements as opaque as possible. The first challenge is defining the scope of the problem.

Historically, Mexico has been the single greatest source of U.S. currency repatriated by a foreign country to the United States. Documented inflows from Mexico have customarily exceeded outbound reporting linked to legitimate sources such as worker remittances and cross-border commerce, exposing a substantial unexplained gap.

⁵ "Mexico: Detailed Assessment Report On Anti-Money Laundering and Combating the Financing of Terrorism," International Monetary Fund, Country Report 09/7, January 2009, p. 8.

⁶ Author interview, Mexico City, Feb. 4, 2010.

The gap has long been attributed, in part, to bulk cash smuggling associated with transnational criminal activity such as drug trafficking and alien smuggling activity.⁷ Regardless of the precise numbers, there is little doubt that bulk cash smuggling is an important element in the drug trade. The March 2007 seizure of \$207 million in cash from drug trafficking proceeds from a Mexico City residence is a dramatic example of the scope of the problem.⁸

The challenge is to accurately assess the size and meaning of that gap. While the Mexican government estimates the amount at about \$11 billion a year, the financial services firm KPMG estimates the amount at \$25 billion, while the estimates of respected academics range from \$6 billion to \$36 billion.⁹

A second challenge is determining how and why different methods of transferring money are used, and how they shift over time. This is useful particularly in seeking to identify points of vulnerability in the process. Historically much of the money - up to 80 percent by some estimates - generated by the Mexican drug trafficking cartels are used to buy new shipments of cocaine, meaning that the total amount left in Mexico for the traffickers' use is considerably less than the amount of revenue generated by drug trafficking activities. For reasons described below the estimates of 80 percent in outbound payments is likely significantly higher than reality now indicates.

There have been at least two significant and related realignments in the cocaine trafficking world that need to be factored in to the current assessment. The first is that Mexican DTOs, as described below, have significantly displaced the traditional Colombian organizations and because of this are reaping higher profit margins because there are fewer middlemen. This coincides with the Mexican DTOs need for more cash to

⁷ Author interviews in the United States and Mexico.

⁸ Mexican authorities on March 15, 2007, announced the seizure of approximately \$207 million in currency from the Mexico City home of pseudoephedrine trafficker Zhenli Ye Gon. Mexico's Office of the Attorney General (PGR) reported that \$205,564,763 in U.S. currency, €201,460 Euros, 17,306,520 Mexican pesos, \$20,000 in American Express Traveler's Checks, \$180 in Canadian currency, HK\$113,260, 17,000 yen, 9,935 Chinese renminbi (RMB), two Portuguese 20-denomination banknotes, and 53 counterfeit U.S. \$100 banknotes were seized from Ye Gon's residence. For details, see: Paul Duggan and Ernesto Londoño, "Not Your Average Drug Bust: Suspect Wanted in Mexico Found in Wheaton Restaurant," Washington Post, July 25, 2007.

⁹ The government figure was given in interviews with senior members of the Mexican Financial Intelligence Unit, but they declined to provide any methodology for reaching that figure. Mexican Attorney General Eduardo Medina Mora, appearing before the Mexican Congress in October 2007, stated that Mexican banks receive about \$1 billion from their U.S. counterparts annually, but return up to \$16 billion, of which about \$10 billion "does not have an explanation ... and could be attributed to the flow of drug trafficking money." For KPMG information, see: Raúl Sierra, "Evolución y Situación Actual de la Prevención de Lavado de Dinero en el Sistema Financiera Mexicano," KPMG, April 2006. The lower figure comes from interviews and writings by Ricardo Gluyas Millán, in particular, "Ganancia Ilícita: Prevención Contra el Lavado de Dinero, México, 2005," p. 233. The upper-end figure was provided by numerous academic sources in interviews, and is the most generally accepted. According to Samuel Gonzalez of the Mexican Autonomous Institute of Technology (*Instituto Tecnológico Autónomo de México*—ITAM) drug proceeds laundered in Mexico account for as much as four percent of the country's GDP, or roughly \$35.7 billion annually. See: "Marching as to War," Economist.com, January 31, 2008. http://www.economist.com/world/la/displaystory.cfm?story_id=10608676

equip and maintain their growing military-style armed operations that wage war on both the state of Mexico and each other.

The second is that this realignment, and new cyber technologies, have given the Mexican DTOs faster and less risky methods of moving the cash to Colombia to purchase shipments of cocaine. This means that much of the money that used to have to be shipped through Mexico and then onward to Colombia is no longer smuggled into Mexico at all, but shipped through ethnic organized crime groups (primarily Russian and Chinese) directly to Colombia or Ecuador.

The net result is that a higher percentage of the money from cocaine sales stays in the hands of Mexican cartels because they are dealing with fewer middlemen in the Andes and, instead, making purchases directly from producers. This also means that the total amount of money smuggled into Mexico has likely declined because more of the money is flowing directly to the Andes to resupply the Mexican DTOs with cocaine .

There are no reliable and current estimates of exactly how much drug money is flowing back to Mexico given this new way of doing business for the cartels. Nonetheless, available estimates, even if dated, show the amount of money staying in Mexico is significant. If one uses the lowest estimate of \$6 billion that would still leave minimum earning of \$1.2 billion for profits and corruption inside Mexico (based on an assumption of a 20 percent profit margin). Using the conservative Government of Mexico estimates, the approximate earnings for Mexican DTOs would be \$2.2 billion. Using the more generally accepted number of about \$25 billion, the earnings would be \$5 billion, and using the upper estimates would yield at least \$7.2 billion.

A third challenge is data collection. No single entity in the U.S. government collects or consolidates bulk cash seizure figures from national, state and local enforcement efforts. The DHS's offices of Customs and Border Patrol (CBP) and Immigration and Customs Enforcement (ICE), the Drug Enforcement Administration (DEA), the Treasury Department and others all keep a sub-set of the data, and that data is largely separate from what state and local authorities seize. The Bulk Cash Shipment Center, established in December 2009 under the direction of ICE, is an effort to remedy both the reporting aspects and give national, state and local officials a one-shop stop for information, intelligence support and expertise.¹⁰

In Mexico the situation is similar. While the Financial Intelligence Unit keeps statistics on suspicious transactions in the formal sector, there is no consolidated center among the law enforcement, attorney general's office (*Procuraduría General de la Republica - PGR*) and Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público - SHCP*).

¹⁰ See: <http://www.ice.gov/pi/bcsc/index.htm>

Assessing Current Trends

Bulk cash smuggling across the U.S.-Mexico border cannot be viewed in isolation. Rather, the process of illegally moving large quantities of dollars across the border must be viewed as part of the movements in a larger recombinant pipeline that flows across the northern tier of South America, through Central America and Mexico and into the United States.

The pipeline, fed by many smaller feederlines, moves products both north and south. The drug trade and other illicit activities move as a circular flow of goods, rather than linear transactions. A significant portion of the violence in Mexico today, particularly that in Ciudad Juárez and environs, as well as among the *maras* in Central America, revolves around disputes over control of portions of that pipeline, its *plazas* and branches. The primary goods flowing northward are cocaine, human traffic, gang members hired by the drug cartels as enforcers, and marijuana. The primary products moving south are large amounts of cash generated from the illicit activities, stolen cars and other goods, and weapons.

Most of these products move through the same basic architecture and rely on many of the same facilitators to enable the flow of goods and services. This is not to say that the groups engaged in myriad criminal activities work together or maintain stable alliances. Sometimes drug trafficking groups, such as the Zetas, branch out to control other criminal activity such as human smuggling and extortion. More frequent, however, is the use of different criminal groups of the same set of facilitators or gatekeepers to the pipeline, to move their illicit products both north and south.

At the same time, new actors are constantly entering the arena of money laundering activities, leading to new challenges and new inputs for the pipeline. These are driven both by profit seeking and the ongoing shakeups and realignments within the drug trafficking world. Among the most important elements of the new geography of the cocaine trade is the growing strength of the Mexican drug trafficking organizations and the relative weakening of the traditional Colombian structures.

The demise of the Medellín, Cali, Northern Valley cartels and the formal structure of the paramilitary *Autodefensas Unidas de Colombia*-AUC) has atomized Colombian cocaine production and left the *Fuerzas Armadas Revolucionarias de Colombia*-FARC) as the main cocaine producing organization. Recent Colombian police and military reports estimate that the FARC now produces about 70 percent of Colombia's refined cocaine, while smaller organizations, including remnants of the AUC and Northern Valley organizations make up the remainder.¹¹

¹¹ Author interview with Colombian National Police leaders, December 2009. This has not always been the case. During approximately 1990-2003 the AUC was a much more important cocaine producing and shipping organization than the FARC, in part because most of the early Colombia cartel leaders (Gonzalo Rodríguez Gacha, Pablo Escobar, the Northern Valley) had close ties to the AUC.

But the FARC, the oldest insurgency in hemisphere, has never built up the infrastructure necessary to move the cocaine to the international market. It traditionally relied on local cartel intermediaries to pick up the product and sell it abroad, primarily to Mexican trafficking organizations.

The result is that, for the first time in almost three decades there would appear to be no predominant Colombian drug trafficking organization in the international sales market. Mexican groups are taking advantage of the vacuum to increase their influence by directly buying -- in Ecuador particularly -- cocaine directly from the FARC and other cocaine producers, and moving it to market. Most importantly for this analysis, this has greatly enhanced the financial returns the Sinaloa and Tijuana cartels, primarily, because these groups are taking control of more elements in the production cycle and bypassing Colombian intermediaries.¹² This implies, as noted earlier, that the Mexican DTOs have more cash at their disposal than they historically have.

This chapter will look at three distinct parts of the money structure of the Mexican drug trafficking organizations. One is bulk cash shipment, moved largely by vehicle across the U.S.-Mexican border. Another is the broader issue of how other types of drug money circulate in Mexico's formal and informal economies and the how that is used. A third is how money obtained from the cocaine trade is moved back to purchase more cocaine in order to keep the cartels operational.

Bulk Cash Shipping: How the Money Moves

Like much else in the drug trade, the current situation with bulk cash shipments is the product of adaptation and evolution by the drug cartels to law enforcement efforts. This means that any analysis of the movement is constantly subject to change, and at best we get a snapshot of relatively current conditions in a fluid environment. With this in mind, it is important to first understand the role bulk cash shipments play in the financial architecture of Mexican drug trafficking organizations, how the money is moved, and the efforts to halt that flow.

Using the pipeline analogy, products can be rerouted around whatever law enforcement obstacle is raised, when cartel warfare raises unforeseen risks, or a blockage or bottleneck occurs. Globalization and the "dollarization" of the Mexican economy have opened a variety of new fronts for the movement of profits from drug cartels and other transnational criminal organizations.

However, the money derived from the sale of drugs and other illicit activities, and the need to move and place that cash, are vital to the criminal organizations that generate the

¹² Author Interviews with Mexican and Colombian intelligence officials, December 2009 and February 2010.

revenue. This offers some vulnerabilities that can be exploited by law enforcement and intelligence operations on both sides of the border. The impact of cash seizures is high, in the short term because it deprives the criminal organizations of both profits (their reason for existing) and operating funds (the source of power, weapons and impunity). Over time the impact is lessened if more shipments are delivered and revenue streams are again opened.

According to U.S. and Mexican law enforcement officials, money from regional drug sales are generally taken to a central counting house in one of several major U.S. cities, including Atlanta, Chicago, Boston and Los Angeles.¹³ Either at the centers or in the original cities of sale, the money, usually arriving from the street in the form of smaller bills and is converted to \$100 or \$50 bills. This is done primarily to reduce the bulk of the cash and make it easier to conceal.

Once the cash is converted into larger bills it is vacuum sealed in plastic bags, to further reduce the bulk, and concealed in the wheel wells, panels and spare tire compartments of vehicles that are clean, meaning they have no reason to raise any suspicion if they are stopped. The cash is often concealed in tractor-trailer trucks as well, often the same vehicles that bring cocaine north.

Cartels utilize several tactics in an attempt to minimize the impact of potential seizures by authorities. For example, the cash transport vehicles are rotated often so as not to be detectable or raise suspicion. Most shipments range from \$150,000 to \$500,000, so that if any one vehicle is stopped the loss is not significant to its leader and does not disrupt operations. Typically multiple cars are sent, each carrying a relatively small percentage of any given cash shipment.

Each Mexican organization employs a group of constantly rotating drivers who drive the cash shipments from the city to the designated border town close to the *plaza* or drug trafficking center of that particular trafficking organization. While in the past the cash was often aggregated and vacuum packed in a safe house on the U.S. side of the border before being shipped into Mexico, officials said that the cartels often now have the drivers continue directly into Mexico to deliver the money. This change is likely due to several factors, including a growing U.S. law enforcement emphasis on monitoring the sales of particular equipment such as money counting machines and different types of packing equipment.

¹³ This description of the movement of cash across the United States and then across the U.S.-Mexico border is based on interviews with U.S. and Mexican law enforcement officials.

Crossing the Border

Border crossing times and locations are decided in large part by the flow of traffic across any of the main entry points and the information derived from lookouts, known as *halcones* or hawks. Each *halcón* watches specific lanes of a border crossing to determine traffic flows, patterns of cars being stopped and any unusual signs of searches. In addition to the *halcones*, the drug traffickers employ sophisticated communications networks along the border, often more sophisticated than federal agents have, and more than they can monitor. As the NDIC report stated:

*several Mexican DTOs maintain cross border communication centers in Mexico near the U.S.–Mexico border to facilitate coordinated cross-border smuggling operations. These centers are staffed by DTO members who use an array of communication methods, such as Voice over Internet Protocol, satellite technology (broadband satellite instant messaging), encrypted messaging, cell phone technology, two-way radios, scanner devices, and text messaging, to communicate with members. In some cases DTO members use high frequency radios with encryption and rolling codes to communicate during cross-border operations.*¹⁴

"They shift as the border opens and shuts," said one U.S. official. "They have very good intel on our operations. We are always one step behind. They are willing to lose two of 10 cars. We are only equipped to deal with half the problem (south-north), and we need to add the southbound part."

Those seeking to smuggle goods south start out from a position of distinct advantage. While 10 percent of the vehicles crossing from the United States to Mexico are supposed to be stopped for secondary screening, the number is often less, according to Mexican and U.S. officials. This means that the chances of being stopped and searched are minimal from the start. In addition, only one lane at a time is usually closed to search vehicles. If any enforcement activity is detected, the courier is simply rerouted by *halcones* to another crossing deemed to be less risky.¹⁵

The sheer numbers of vehicles and pedestrians crossing the border each day helps illustrate the magnitude of the problem of identifying and interdicting illicit cargo, akin to searching for the proverbial needle in a haystack.

¹⁴ "National Drug Threat Assessment 2009," op cit., p. 45.

¹⁵ While the figure of 10 percent checks on southbound traffic is often used, in fact, according to U.S. and Mexican officials, the figure is less. There are compelling reasons for not increasing the inspection rate. The most pressing issue is to balance the needs to check cars with the imperative to keep traffic flowing and not cause backups that have a significant economic impact. That tension, between security concerns and trade concerns, is one that will likely grow in coming years as traffic grows.

In 2008, the last year for which complete statistics are available from the Bureau of Labor Statistics, 78,856,542 passenger vehicles entered the United States from Mexico, carrying 157,981,839 passengers. In addition, 4,844,250 freight trucks crossed the border. Unfortunately, no similar statistics are kept for southbound traffic. Pedestrian crossing totaled some 30 million just at the top five border crossings.¹⁶ A recent Texas A&M study estimated that in 2008 27 million vehicles crossed into Mexico from Texas alone.¹⁷

In this vast sea of vehicles and pedestrians, if couriers find themselves in lanes that could prove risky they have several options to avoid getting caught. One is to simply pull out of line and gun through the border point, a risky but viable option as the inspecting officers are protected only by plastic cones, and, according to authorities on both sides of the El Paso-Ciudad Juárez crossing, no one has been apprehended when doing this.

A second option is to simply get out of the vehicle, blend in with the crowd and walk into Mexico. As noted in interviews with border officials, there is essentially a no-man's land between the two countries and, while there is the technical capability to call from one side of the border to the other to alert authorities to a runaway vehicle or driver, this has never actually been done.¹⁸

"We are simply not configured to deal effectively with southbound traffic," said one U.S. official in El Paso. "It is something that is relatively new to us. What we do know is that what we are doing now is not working."¹⁹

The Uses of Bulk Cash in the Cartel Financial Structure

The primary role of bulk cash shipments from the United States into Mexico, largely by vehicle, is to pay the operating expenses of the different drug trafficking organizations, including the expense of bribes to political protectors and law enforcement officials, and allow the senior cartel leaders to enjoy the fruits of their illicit labor. This is a role that has changed over time.

For many years, when Mexican drug cartels were largely dependent on Colombian organizations delivering the drugs to Mexico to be moved across the U.S. border and sold, bulk cash shipments and unregulated money exchange houses were the favorite

¹⁶ "Table 1-45: U.S.-Mexican Border Land Passenger Gateways: Entering the United States," Bureau of Transportation Statistics, accessed at:

http://www.bts.gov/publications/national_transportation_statistics/#front_matter; "Table 1-49a: U.S.-Mexican Border Land-Freight Gateways: Number of Incoming Truck or Rail Container Crossings, accessed at: http://www.bts.gov/publications/national_transportation_statistics/#front_matter.

¹⁷ "Mexican Drug War: Some Cash, Few Guns Found in Southbound Checks," Associated Press, May 15, 2009.

¹⁸ Author interviews in El Paso, Texas and Ciudad Juárez, Feb. 1-3, 2010.

¹⁹ Author interview in El Paso, Texas, Feb. 1, 2010.

ways to remit cash. Most of the money needed to be held in Mexico because the payment to the Colombian providers was usually made in Mexico and in dollars.²⁰

Now, bulk cash shipments, while remaining vital to overall cartel operations, are not necessarily the primary means of moving money to pay for ongoing cocaine shipments from Colombia. Other cartel affiliations with ethnic organized crime structures that span the globe, coupled with the official adoption of the dollar as the currency of Ecuador, Panama and El Salvador and new electronic transfer mechanisms have opened up new avenues for that type of large value movement as the Mexican DTOs have grown in wealth and importance.

The need to move larger amounts of money via bulk cash transfers has developed at the same time as stronger U.S. anti-money laundering regimes, particularly after the 9/11 attacks, have made other electronic methods (smurfing, layering through banks, and other uses of the formal financial sector) more difficult and risky. Greatly increased pressure on U.S. banks to enhance and comply with Know Your Customer protocols have also increased the risks of dealing with U.S. banks, at a time when many new and less stringent banking jurisdictions were becoming more accessible in the Internet age.

At the same time, the cartels need to rely far less on their own money service businesses such as *casas de cambio* and *centros cambiarios* to convert dollars to pesos because Mexico, through the NAFTA agreement, was much more "dollarized" or open to the use of dollars that it had historically been.

The revenue generated from drug trafficking and criminal activity is dispersed throughout Mexican society, including the business community, politicians, law enforcement and military personnel, the media, and scores of other individuals.

Recent political changes in Mexico have also led to a significant change in corruption patterns and how the criminal organizations distribute their cash. Under the one-party rule of the PRI, corruption was largely top down. That is to say that senior officials could be bribed and distributed the money down the chain of command. With the advent of multi-party rule, most states and towns have several parties that must be paid off at the local level, forcing the criminal organizations to pay less to each party but more overall to ensure continued freedom of operations. This has led to the need to buy into the electoral process earlier, as the winner is no longer guaranteed, spreading the corruption further throughout the body politic.²¹

²⁰ This information is based on interviews with counter-drug officials on the U.S.-Mexican border, Mexico City, Colombia and Ecuador.

²¹ In August 2008, *El Universal* reported that Mexican Defense Secretary Guillermo Galvan stated that 500,000 individuals in Mexico are tied to the illegal drug trade. According to Galvan, this includes 300,000 growers, 160,000 small-time drug dealers or transporters, and 40,000 individuals in leadership positions. These figures may be considerably understated, as private security forces, complicit public officials, and willing members of the business or financial community were not mentioned in Galvan's remarks. See

Another unintended side effect of the growing controls, reporting requirements and regulations placed on the *casas de cambio* and *centros cambiarios* is that many of those companies are going out of business. For example, *casas de cambio*, which are allowed to move money internationally and exchange currencies, must now report all transactions above \$3,000 in an effort to detect suspicious activities. Customers must now present identification and register their names for all transactions over \$500 in an effort to end the anonymity that made them so useful for money laundering. *Centros Cambiarios*, which were almost entirely unregulated until 2009, must also identify their customers like the *casas de cambio* and are limited both in the amount individuals can exchange on a daily basis. Leaders of organizations representing both groups said the requirements were so onerous that the businesses could no longer remain profitable.²²

These companies are being replaced by unregulated money remittance houses, including Western Union and other U.S. based companies.²³ In a stark admission of the vulnerability presented by money transfer systems, in February 2010 Western Union reached an historic agreement with four Southwest border states where the company agreed to pay \$94 million to help improve border enforcement of drug money movements and reimburse Arizona for the cost of a lengthy legal battle. In addition, Western Union agreed to grant investigators from Arizona, California, Texas and New Mexico "unprecedented" access to records of transactions to Mexico.²⁴

Other vulnerabilities include the lack of regulation in the registration of used car sales, as well as the purchase and sale of real estate, both favorite ways for drug trafficking organizations to launder and invest cash.

Particularly vulnerable are the 3,603 notary publics in Mexico, where land transactions and other sales are registered. They remain largely antiquated, limited computerization, not searchable and unable to communicate with other registries, meaning that land records are virtually impossible to trace.

This is important because proceeds from the drug trade are flowing directly into land purchases in Mexico. These purchases are highly valued by drug traffickers on a personal level, to enhance prestige and show power. But the expanses of land also allow criminal

Brendan Walsh, "Mexico Estimates 500,000 Tied to Drug Trade, El Universal Says," Bloomberg.com, August 9, 2008; <http://www.bloomberg.com/apps/news?pid=20601086&sid=a2CHFyvjv3gn8>.

²² Author interviews, Mexico, D.F., January 2010. This does not mean these types of companies no longer exist. Because of lax enforcement in Mexico, many of these institutions simply do not register their operations with the government and continue to carry out their business.

²³For an interesting look at the new concerns about Western Union, see:

<http://www.supreme.state.az.us/opin/pdf2009/WesternUnionOpinion%20FINAL.pdf>; and Josh Meyer, "Blood Wires' Over the Mexican Border," Los Angeles Times, June 8, 2009, accessed at:

<http://www.latimes.com/news/nationworld/nation/la-na-western-union8-2009jun08.0.4162344.print.story>

²⁴ Sean Holstege, "Western Union \$94 Million Settlement Broadens Border States' Investigative Powers," Arizona Republic, Feb. 12, 2010. The settlement sets aside \$50 million to establish a Southwest Border Anti-Money Laundering Alliance to investigate international money laundering rings; \$21 million to reimburse Arizona for a decade-long investigation into Western Union; \$19 million to improve Western Union's internal security methods to combat money laundering; \$4 million for an independent monitor to scrutinize Western Union's anti-money laundering efforts elsewhere.

organizations to establish territorial control, set up training camps and safe havens and expand their influence in significant parts of the country.

Another vulnerability was outlined by a senior Mexican agricultural official, who warned that drug traffickers had become the principal source of credit for many farmers in rural Mexico who were cut off from the formal credit market. According to Ricardo García Villalobos, president of the Superior Agricultural Court (*Tribunal Superior Agrario*), some 30 percent of Mexico's agricultural land is now dual use, with both licit and illicit crops, primarily marijuana and poppy for heroin, being planted together.

"They [the narcos] provide seeds and the illicit plants, and that allows the campesinos to buy other types of seeds, so that is why I call it dual use," he said. "They are not purely marijuana or poppy, they are always mixed with legal crops."²⁵

Among the most significant uses of bulk cash shipments for Mexican drug trafficking organizations are believed to be:

- Money to pay gangs that act as muscle for the cartels, particularly those engaged by the different sides in the Ciudad Juárez plaza. These include the Barrio Azteca, working for the Juárez organization and the Artistas Asesinas (AKA AA or *doblados*), working for the Sinaloa cartel. Both gangs have developed relationships with the respective organizations to take over street corners for local sales enforce control of the *plaza*, in addition to providing manpower for specific jobs such as guarding safe houses, executions, and transportation of cash or personnel;²⁶
- Money for bribes to political, military and police structure in order to move goods through the *plaza* unimpeded and insure the protection of the political structure.
- Drug trafficking organizations in Mexico prefer to hold onto their cash in U.S. dollars, as U.S. dollars are considered more stable than the Mexican peso;
- Due to generational differences, while some of the younger drug traffickers are accustomed to using alternative forms of value transfer, many of the old guard, older generation leaders still only feel comfortable dealing with cash, and demand that their illicit proceeds be paid in a tangible form;
- Most weapons purchases, both in the United States and elsewhere are made with dollars, not local currencies. This is particularly true in the United States, but weapons purchases from Guatemala and further afield also are dollar transactions;
- Many legitimate businesses in Mexico accept U.S. dollars, thus providing an easy means for drug trafficking organizations to place their illicit proceeds into the formal economy. Among the favorite places to place the dollars are in real estate, luxury vehicles, construction and other cash-intensive businesses. Hoarding cash is also common, to hedge against lost drug shipments or cash seizures.

²⁵ Carlos Avilés, "Cárteles Financian al Campo: Tribunal," *El Universal*, Feb. 17, 2010.

²⁶ Author interviews in El Paso, Texas and Ciudad Juárez, Feb. 1-3, 2010.

The cumulative cartel expenditures amount to millions of dollars a month, underscoring the importance of bulk cash shipments in keeping the cartel machinery running. One U.S. government analysis estimated that in 2007 one Mexican group, the Gulf cartel, paid about \$2.5 million a week in bribes and smuggled \$30 million to \$50 million per month through each major plaza such as Nuevo Laredo, Matamoros and Reynosa.²⁷

While extrapolation of inexact figures does not lead to definitive conclusions, it might be useful to help illustrate the magnitude of the problem. While the Gulf Cartel has fragmented and weakened, one could safely estimate that the Sinaloa cartel now operates on an even larger scale. If one adds the Juárez organization, which recently was estimated to handle up to 60 percent of the cocaine heading to the United States, the *Zetas*, the *Familia Michoacán*, Tijuana and other groups, one could conservatively estimate that at least \$250 million in bulk cash is shipped to Mexico each month (\$3 billion per year) and \$2 billion a year paid out in bribes.

The expenses of the cartels are also rising in the face of the sustained efforts by the Calderón administration to attack the drug trafficking organizations militarily, coupled with the intra-cartel wars that inflict an enormous human and social cost.

In addition to the costs associated with using the gangs as muscle (and the gangs are often paid in cocaine rather than cash), the cartels have expanded their military training programs and recruitment of outside groups from Central America to help them gain the upper hand against their rivals.

This could significantly impact the profits the cartels and their associated criminal organizations earn. The cartels are faced with escalating purchases of ammunition, sophisticated weapons, surveillance equipment, armored vehicles, and bulletproof vests, as well as the recruiting and training of security forces.

This includes training camps and active recruitment campaigns, even among young men enrolled in the U.S. military and living on bases near the border.²⁸ As one U.S. official told the Dallas Morning News, "Traffickers go to great lengths to prepare themselves for

²⁷ While the total value of the current U.S. cocaine market is not known, some guess work is possible based on official government estimates. Official U.S. figures for 2008 estimate that a total of 295 tons of pure cocaine could be produced from the available coca, and that 40.5 tons had been interdicted, leaving 254.5 tons available. Of that, some 200 tons were destined to the U.S. market, and the average price was \$120 per gram or \$120,000 per kilo, or \$120 million per ton or \$24 billion dollars in total sales. This does not include sales in Europe and elsewhere, or the income from the marijuana and heroin sales. These numbers were taken from: National Drug Threat Assessment 2010, National Drug Intelligence Center, U.S. Department of Justice, January 2010.

²⁸ Numerous U.S. officials expressed their concern that the Mexican gangs such as Barrio Azteca were successfully recruiting among young enlisted men in Ft. Bliss, near El Paso, and that such recruitment could increase as the base was expanded by up to 30,000 people in coming years. For a look at the cartel recruitment and training tactics see: Alfredo Corchado, "Drug Cartels Operate Training Camps Near Texas Border Just Inside Mexico," Dallas Morning News, April 4, 2008; and

battle. Part of the preparation is live firing ranges and combat training courses... and that is not something we have seen before."²⁹

All of these activities and purchases require payments to be made, and the vast majority of those payments must be made in dollars. This internal dynamic could mean that, at least in the short to mid term bulk cash smuggling will increase and be even more important to the cartels' financial structures because their internal costs of doing business have risen.

Measuring Interdiction of Bulk Cash Shipments

Given the paucity of data on either side of the border it is difficult to determine with any precision how much bulk cash is being shipped or interdicted. While the rough calculations made above seem reasonable to numerous U.S. officials monitoring the process, they are simply ballpark figures that can fluctuate significantly to meet the drug traffickers' needs. Without even baseline data it is difficult to envision meaningful metrics for measuring success or if progress is being made. For example, even if seizures were to increase significantly, one would not know if it is because of enhanced enforcement techniques or because significantly more amounts of money were being shipped and the amount seized was a smaller percentage of the whole.

By their admission, U.S. and Mexican officials are getting only a small fraction of the money that flows across the border. How much is seized and how much flows through remains unquantifiable in any meaningful way. U.S. officials dealing with bulk cash transfers estimated that total seizures related to drug trafficking had risen from about \$19 million in 2006 to about \$30 million in 2008 due to increased focus. The officials said the large majority of seizures were intelligence-driven, meaning they had information on specific vehicles carrying cash, and had the vehicles stopped knowing it was likely to have money onboard. This is in contrast to detecting cash in a car that is randomly stopped at a border checkpoint.

Perhaps the most telling information came from Mexican border authorities who are monitoring an important border crossing area where two Gamma ray machines were installed in October for non-intrusive inspections vehicles, including southbound vehicles. The inspections are part of the broader effort to install modern technology along the border to record license plates, vehicle weight and other data to detect anomalies and specifically installed to help detect the flow of bulk cash and weapons. Since the system was installed in November, it has led to no bulk cash seizures and had a limited impact on detecting weapons in that area. The system, *Sistema Automático para la Revisión y*

²⁹ Corchado, op cit. It should be noted that only an elite cadre of cartel hit men are trained in this fashion. U.S. and Mexican officials and members of civil society said repeatedly that the gang members on the street, tasked with street sales of cocaine, heroin and marijuana, are "disposable," and that they received little if any training at all. There seems to be a significant distinction in training and operational capacity between squads that are directly tied to the cartels and those in loose alliance with the cartels through the gangs.

Control Vehicular-SIAVE, remains unconnected to other data bases either geographically or with agencies outside the Mexican Customs service (*Aduana*). "We really cannot say SIAVE has helped us at all with bulk cash," said one Mexican official.

Other Factors in the Shifting Money Laundering Structures

There are several new factors in the money laundering and financial structure of the Mexican drug cartels and their rapidly shifting relationships with the Colombian suppliers that have changed the way drug money is moved and used.

As noted above, the growing dominance of the Mexican drug trafficking cartels has allowed them to extend their reach into Colombia, Ecuador, Bolivia and Peru. Given these new revenue streams, it is reasonable to assume that the revenues generated by these organizations has grown considerably in the past two years.

The primary reason for this assumption is that Mexican organizations, particularly those associated with the Sinaloa syndicate, are gaining control of cocaine factories that produce cocaine hydrochloride (HCL), the finished powder that has the greatest value. This is particularly true in Bolivia and Peru, where the Colombian organizations had long kept local organizations from manufacturing HCL, preferring to control that high end production themselves in Colombia.

Another primary reason for this assumption is the widely-espoused view on both sides of the border that several of the major Mexican drug trafficking organizations, particularly the Sinaloa cartel and *Los Zetas* have moved beyond the illicit drug trade as a source of income and have diversified into human trafficking, extortion, kidnapping and other criminal activities that also generate significant amounts of income.

A secondary reason for this assumption is the growing intelligence indications that cocaine (HCL) can be shipped directly to Mexican waters from Ecuador and Colombia via semi-submersible crafts that can carry loads of several tons of cocaine. Not only does this lower transportation costs, but also the protection costs of moving the product through the various borders and checkpoints across Central America.³⁰

The Growing Dominance of the Mexican Drug Trafficking Organizations

With the demise of large-scale Colombian operations, Peru and Bolivia are again producing significant amounts of HCL and selling the product directly to Mexican buyers.³¹ The integrated supply of HCL from these regions has greatly increased the

³⁰ For a look at the growing use of semi-submersibles in cocaine transportation, see: Douglas Farah, Ecuador at Risk: Drugs, Thugs, Guerrillas and the Citizens' Revolution, International Assessment and Strategy Center, January 2010.

³¹ For a look at Mexican penetration of the Andean market see: Eliot Brockner, "Mexican Cartels' Andean Stronghold," ISN Security Watch, Nov. 18, 2009; and Douglas Farah, Into the Abyss: Bolivia Under Evo Morales and the MAS, International Assessment and Strategy Center, July 2009.

profitability of the Mexican groups, who no longer have to rely on Colombian intermediaries to receive the cocaine.

Perhaps nowhere is the change more noticeable and more important than in the Mexican organizations' ability to directly buy HCL from the FARC in Colombia, which now produces an estimated 70 percent of the Colombian cocaine.³²

The transactions take place along the porous Ecuador-Colombia border region near the town of Lago Agrio. The region has long been under the control of the FARC's 48th Front, a military unit that has grown increasingly because of its control of cocaine shipments out of Colombia and the importation of precursor chemicals and cash into the FARC. According to Colombian, Mexican and Ecuadoran authorities, for the past several years the person in charge of handling the FARC's ties to Mexican drug trafficking organizations has been Oliver Solarte, a one-time petty criminal who has grown into the Front's chief cocaine handler.³³

Further adding to the attractiveness of Ecuador is that its economy is dollarized, meaning that transactions in dollars draw no scrutiny, and it has one of the least regulated and most secretive banking systems in the hemisphere. In February 2010 the multi-lateral Financial Action Task Force (FATF) placed Ecuador on its blacklist as an "Uncooperative Jurisdiction," along with Iran, North Korea and Ethiopia for failure to take meaningful action against money laundering.³⁴

The implications of this alliance with the FARC for money laundering in Mexico are important beyond the increased profits the trade has generated. For many years the Colombian cartels would collect their money -- both profits and money to purchase more merchandise -- in Mexico then use a variety of methods, from couriers to the Black Market Peso Exchange, to move the money back into Colombia. That routing is no longer essential.

Money can now be "smurfed"³⁵ directly from accounts in the United States to accounts in Ecuador, with no currency conversion necessary. With virtually unfettered access to the Ecuadoran banking system through accounts, ATMs and front companies, the FARC or any other HCL producing organization can presumably withdraw its payments with little risk and few fees.

³² "Las FARC se Fortalecen Como Cartel de Narcotráfico, revela Informe de la Policía," Caracol Radio, Feb. 18, 2010.

³³ "Colombian Rebels Linked to Mexico Drug Cartels," Associated Press, Oct. 7, 2008. For more details on the growing Mexican connection to the FARC and the role of Oliver Solarte see also: Douglas Farah, Ecuador at Risk: Drugs, Thugs, Guerrillas and the Citizens' Revolution, International Assessment and Strategy Center, January 2010; ; Arturo Torres, El Juego del Camaleón: Los Secretos de Angostura, Eskeletra Editorial, Quito, 2009, pp. 63-105.

³⁴ "Group Lists Iran on Money Laundering Blacklist," Reuters, Feb. 19, 2010.

³⁵ Smurfing is a term used by law enforcement to describe an operation of breaking up a large amount of cash and depositing the cash in multiple accounts, with all deposits being just under the \$10,000 reporting threshold, thereby not raising alarms.

Money can also be routed through other dollarized economies in the region, none of which have significant money laundering enforcement. These include El Salvador and Panama and other countries in Latin America use the U.S. dollar as an acceptable parallel currency. Of particular concern are Panama (especially the Colón Free Trade Zone) and El Salvador, which have some of the most rapidly growing banking systems in Latin America, while having little visible legitimate means to support such growth. In addition, multiple new electronic ways to move money outside the regulated financial structures are now readily available to the Mexican organizations, and will be discussed in more detail below.

There is growing evidence (part of which was made public in recent Colombian and U.S. statements) that Hezbollah is using the FARC/Venezuelan connection to raise and move money. The importance of this link is the subject of debate within the U.S. government, with some viewing it as a paradigm shift with significant implications going forward and some viewing it as only a limited, short-term business transaction.

The clearest example to date of the potential breadth of this phenomenon was hinted at in Operation Titan, executed by Colombian and U.S. officials in 2008. Colombian and U.S. officials, after a 2-year investigation, dismantled a drug trafficking organization that stretched from Colombia to Panama, Mexico, the United States, Europe and the Middle East.

Colombia and U.S. officials say that one of the key money launderers in the structure, Chekry Harb, AKA "Taliban" acted as the central go-between among Latin American cartels and Middle Eastern radical groups, primarily Hezbollah. Among the groups participating together in Harb's operation in Colombia were members of the Northern Valley Cartel, right-wing paramilitary groups and the FARC.³⁶

The Introduction of New Factors in the Laundering Process

While it is likely that bulk cash shipments will remain important and perhaps of primary method for the drug trafficking organizations to move money from the United States to Mexico, it is likely that new patterns in money laundering and bulk cash movement will emerge and could already be underway. Because these factors are relatively new, there is little academic literature examining them. However, law enforcement officials on both sides of the border and anecdotal evidence suggest that, though hard to quantify, they are in use and of growing importance.

The Chinese Trade Model

³⁶ While much of Operation Titan remains classified, there has been significant open source reporting, in part because the Colombian government announced the most important arrests. See: Chris Kraul and Sebastian Rotella, "Colombian Cocaine Ring Linked to Hezbollah," Los Angeles Times, Oct. 22, 2008; and "Por Lavar Activos de Narcos y Paramilitares, Capturados Integrantes de Organización Internacional," Fiscalía General de la Republica (Colombia), Oct. 21, 2008.

One is the reported growing use of over invoicing or under invoicing of products that are bought in China and shipped to Mexico. This makes sense in the context of the rapidly expanding trade between the two nations. Between 2000-2008 bilateral trade between Mexico and China grew from less than \$1 billion to \$17.56 billion. This is second in Latin America only to Brazil (\$48.5 billion).³⁷

There is credible anecdotal evidence that Mexican drug trafficking organizations are buying container loads of cheap plastic products in China, which are shipped to Mexico at a substantially inflated declared value. Many of these containers are never claimed in Customs, but the person or company that ordered goods will most likely have successfully laundered the declared value of the products. This means the laundering organizations have moved their money from the point of origin, primarily the United States, to a bank outside of Mexico, and can now move it back through the banking system as clean money. The risk mitigation of this method, if it continues and is unchecked, could lessen the importance of bulk cash shipments for some cartel activities.

This system can also be used to justify the holding of large amounts of cash by cartel front companies, who can show a paper trail showing the "origin" of the money in the procurement and sale of fictitious Chinese goods. Due to the volume of legitimate trade, detecting and following through in tracking down the origin of the valueless shipment is not deemed by either side to be useful or cost efficient.³⁸

Russian Money Laundering Activity

A second important shift is the growing presence of Russian organized crime in Mexico. These organizations, buying up large amounts of properties on Mexico's west coast--particularly hotels and casinos because they are cash intensive businesses--offer new opportunities for Mexican organizations to launder and move their funds through the formal financial system as cash. Gambling in casinos is technically illegal in Mexico, but in fact is widespread. Casinos are not regulated by any government entity.³⁹

If money can be placed into the Russian laundering structures outside of Mexico, they can be delivered in Mexico again as clean cash via the casinos, hotels or other cash-intensive businesses. Alternatively, if Mexican organizations have large amounts of cash on hand in country, they can launder those funds through the Russians' structures and have those funds delivered either inside or outside the country as clean funds. Finally, if the money is needed elsewhere to pay for resupplying to cocaine pipeline, particularly Ecuador or Panama that are dollarized and have growing casino industries, the money can be moved there as well.

³⁷ "Growth Rate of China's Trade with Latin America and Caribbean Decreased in 2008," People's Daily Online (English Version), April 3, 2009.

³⁸ Author interviews in Mexico City, February 2010.

³⁹ "Mexico: Detailed Assessment Report On Anti-Money Laundering and Combating the Financing of Terrorism," op cit., p. 28.

Inroads by Russian organized crime, particularly in the field of money laundering, have been noted by U.S. and Mexican academics studying drug trafficking, but has been largely ignored by government reporting. The primary area of operation of the Russian groups is reportedly the San Diego-Tijuana corridor, and the primary activity is to aid in money laundering activities through hotels and other cash-intensive businesses.

In return for their cooperation Russian groups are allowed to operate unmolested in the area. The opening for the Russian groups came in 2002, following the arrest of Benjamín Arrellano Félix and other leaders of the Tijuana DTO. The cartel then fragmented into far weaker "cartelitos" or "small cartels," who lacked the operational capability necessary to control their tradition pieces of the pipeline.⁴⁰

The University of Miami's Bruce Bagley, a well-know drug trafficking expert, wrote in 2005 that:

*The linkages or "strategic alliances" between various Russian organized crime groups and major transnational criminal organizations in Latin America and the Caribbean in the early 2000s were already substantial and expanding rapidly. Moreover, it raises the specter that, at least in some key countries in the region (e.g., Mexico, Colombia and Brazil), the alliances between home-grown and Russian criminal organizations may provide domestic criminal and/or guerrilla groups with access to the illicit international markets, money-laundering facilities and illegal arms sources that could convert them into major impediments to economic growth and serious threats to democratic consolidation and long-run stability in the Western Hemisphere.*⁴¹

Regarding Mexico specifically Bagley found that:

a variety of Russian criminal organizations, operating through literally hundreds of small cells, are engaged in a wide range of illegal activities in Mexico. Russian mafia groups such as the Poldolskaya, Mazukinskaya, Tambovskaya and Izamailovskaya, all linked to one of Russia's major transnational criminal organization -- Vory v Zakone (or "ladrones de la ley") -- are among the most active. The Moscow-based Solntsevskaya gang is also reported to be present in Mexico as are other mafia gangs from Chechnya, Georgia, Armenia, Lithuania, Poland, Croatia, Serbia, Hungary, Albania and Romania. Their major activities include drug and arms trafficking, money laundering, prostitution, traffic in women from Eastern and Central Europe and Russia, emigrant smuggling, kidnapping,

⁴⁰ Susana Hayward, "Russian Mafia Worms Way Into Mexican Drug Cartels," Miami Herald, Aug. 11, 2003.

⁴¹ Bruce Bagley, "Globalization, Ungoverned Spaces and Transnational Organized Crime in the Western Hemisphere: The Russian Mafia," paper prepared for International Studies Association, Honolulu, Hawaii, March 2, 2005.

*auto theft, and credit card fraud.*⁴²

These external influences are seldom factored into the current analysis of border flows for both drugs and money, and are not exclusively tied geographically to the border area. However, they are likely to have enormous implications in several important areas, with unintended consequences that will not be discernible for some time.

One of the impacts that is already being seen is that less money derived from drug proceeds are being laundered through the Mexican financial system, where such activity is cumbersome, vulnerable and expensive. Now the dollars can simply flow out through the Russian networks that route the money from Mexico to the Caribbean, Europe and Russia. This will make the money ever harder to trace.

Another, as Bagley notes, is to greatly increase the access of the cartels to weapons and money laundering facilities on the world market. This is particularly useful to the Mexican cartels as they wage war against each other and against the Mexican state. While there is only anecdotal evidence at this time, it seems reasonable to think that sophisticated weapons from Russia and the former Soviet bloc will also make the Mexican cartels more lethal.

A third consequence could be an increased presence of Russian organized crime in the United States, as they take advantage of the same routes as cartel operatives to enter the United States. Given the proximity to the border of many of the Russian mafia cells and the vast resources at their command, it would be a logical step in their expansion.

The New Electronic Age

While the involvement of Russian mafia in money laundering for other criminal organizations is relatively new in Mexico, it is an activity that has been ongoing since the fall of the Berlin Wall. The China trade model follow established methods of over invoicing and under invoicing for laundering purposes, similar to other schemes seen elsewhere. But there is also a series of new challenges posed by the rise of the Internet and electronic cash that have no historic precedent.

U.S. officials stressed the growth of whole new methods of money laundering by drug cartels whose contours are only vaguely understood and, if understood, are virtually impossible to combat because the regulatory and legal framework does not exist to criminalize the activities.

Among those methods identified in author interviews and law enforcement literature as most troublesome are:

- Open System prepaid cards, which are cards that allow their holders to access global credit and debit payment networks. Officials say the regulations governing

⁴² Bagley, op cit.

these prepaid cards are unclear and poorly defined, often allowing the cardholder to use the product without forming a traditional account relationship with the depository institution. This allows the users of the cards to hide their identities and the proceeds of their money. As one law enforcement study noted, "this lack of accountholder relationship could enable the cardholder to anonymously transfer unlimited amounts of money across global payment networks."⁴³

- Digital currencies, which can be used by traffickers to anonymously fund digital currency accounts and send those funds, often in unlimited amounts, to other digital currency accounts worldwide, bypassing international regulatory oversight.⁴⁴
- Mobile payments through cell phones that provide traffickers with remote access to existing payment mechanisms such as bank and credit card accounts and prepaid cards.
- The more than 200 systems like PayPal that allow payment to be made through secure servers over the Internet. While PayPal wins high praise for its cooperation with law enforcement and strict monitoring of suspicious transactions, most of the hundreds of other similar services operate in a much more opaque manner, meaning that unlimited amounts of money can flow from one account to another with no regulation or oversight.⁴⁵
- Online role-playing games or virtual worlds, where in-game currencies can be bought and exchanged for real world currencies. This can allow drug traffickers to "legitimize their income through accounts established online game companies in various ways, such as accepting virtual money in exchange for illicit drugs or buying and selling game items between multiple accounts controlled by them or their associates in a cyber version of trade-based money laundering."⁴⁶

What law enforcement officials say is most frustrating about these new methodologies is that they are almost totally beyond the reach of traditional anti-money laundering measures. Not only are there few laws and regulations that would make money laundering by those methods prosecutable, there is no need for any of the activity in the cyber world to pass through the United States, meaning that even if there were ways to monitor the new methods, there would be little U.S. officials could do.

In addition, while understanding in some cases how they work, they acknowledge they have no idea of the scope of the money being shipped through these electronic methods. While they believe there are billions of dollars, there are no quantifiable ways of measuring the flow of something one cannot see or trace.

"Drug traffickers have always been several steps ahead of law enforcement in acquiring and using technology," one U.S. official said. "They can buy off the shelf and hire the best help. We have procurement processes we have to go through and very limited

⁴³ "National Drug Threat Assessment 2009," op cit., p. 50.

⁴⁴ "National Drug Threat Assessment 2009," op cit., p. 51.

⁴⁵ Presentation of Tom Kellerman, vice president of security awareness, Core Security Technologies, "Criminal Networks, Smuggling and WMD Conference," sponsored by the Terrorism, Transnational Crime and Corruption Center and Defense Threat Reduction Agency, George Mason University, Feb. 25, 2010.

⁴⁶ "National Drug Threat Assessment 2009," op cit., p. 53; author interviews with U.S. officials.

personnel that can deal with this. So we really have no idea what they are doing on the cyber front. And that is what should scare us."⁴⁷

Facing the Threat

The multiple and constantly evolving options available to drug trafficking and transnational criminal organizations to move and hide their funds highlights the extreme difficulty in combating the flow of illicit funds. As with the movement of drugs, people or weapons, the specific routing and methodology of movement of the commodity can be changed, concentrated or diversified as needed.

On the U.S. side of the border, combating the versatile organizations with rapidly shifting methods are primarily state and law enforcement officials. While receiving some federal aid and training, the local law enforcement units are often operating on their own, with little communication or information sharing with other units. On a federal level, resources and talent in the Treasury Department, particularly FinCen and OFAC, have been taken from the tracking of drug money to trying to track terror finance.

In the intelligence community the same trend has prevailed. Only the DEA has managed to keep a sustained focus on drug trafficking organizations, and is now in ongoing turf battles with the Department of Homeland Security (DHS) and other parts of the government. While the trend has reversed slightly in recent months, money movements of organized criminal organizations, unless they are directly linked to terrorism (and more and more are), have been a far lower priority than prior to 9/11.⁴⁸

There are some important signs this imbalance is being corrected. In January the Obama administration issued the first National Intelligence Estimate (NIE) on Organized Crime. The all-agency report remains largely classified but, given that it is the first NIE to focus on organized crime since 1995, it is an important step in recognizing the need to broaden the national security focus beyond radical Islamist terrorism.

On a smaller scale, the U.S. Embassy in Mexico City is coordinating a multi-agency baseline study of drug money movements in an attempt to create a baseline study that will help determine reasonable parameters of phenomena. Again, this will be the first study of its kind in more than a decade and shows a growing recognition of the need for a far broader understanding of the problem in order to develop more effective policies.⁴⁹

On the Mexican side, significant strides have been made in creating the legal framework that will allow the Mexican government to more aggressively pursue the illicit proceeds of the drug gangs, but much of the implementing legislation remains to be written, and the governmental and judicial infrastructure is lacking.

⁴⁷ Author interview, February 2010.

⁴⁸ Author interviews with numerous U.S. money laundering officials.

⁴⁹ Author interviews in Mexico City, Feb. 8, 2010.

The primary tools are preventative detention (*arraigo*) and asset forfeiture (*extinción de dominio*), which were part of a broad package of constitutional reforms that has passed both houses of the Mexican Congress in 2008. The reforms, after passing the needed 16 of 31 Mexican state legislatures, were signed into law by president Calderón on June 17, 2008, giving the president a significant political victory. The reforms, which offer sweeping judicial reforms and anti-corruption measures, were hailed by Calderón as historic, saying: “What is at stake is not the liberty, security or integrity of the government, but above all the security and integrity of the governed.”⁵⁰

Previously, Mexico did not have a civil forfeiture regime and could seize assets only upon a final criminal conviction; it could also seize assets administratively if they were deemed to be “abandoned” or unclaimed.⁵¹ Under the new laws, the right to seize assets before trial solely in organized crime cases gives law enforcement officials the ability to seize any proceeds or property that are the result of, product of, or used in organized crime cases.⁵²

Funding for Mexico’s Financial Intelligence Unit (*Unidad de Inteligencia Financiera*—UIF) has been far from adequate. In 2006, the UIF received just 0.3 percent, or \$7.1 million, of the budget allotted to the Ministry of Finance and Public Credit (*Secretaria de Hacienda y Crédito Público*—SHCP), less than the ministry's public relations department.

There are indications the situation may be changing. Under the Mérida Initiative the UIF is to receive \$5 million in IT assistance and FinCEN has begun a more intensive relationship with the UIF to modernize and improve its capabilities. Personnel to monitor cash flows are being exchanged in numerous entities, with FinCen and the UIF placing people in each other's headquarters to enhance cooperation.

But there is a significant distance to travel. The number of actual cases investigated remains very low and the ability to share information across institutional lines, particularly the UIF and PGR is minimal. The IMF report noted that the UIF and PGR often fail to communicate on cases and the UIF cannot automatically obtain information on its investigations from prosecutors. While UIF personnel can request information, the PRG does not have to respond and often does not.

The IMF report noted that the “insufficient resources allocated to investigation units of the Deputy Attorney General's Office for the Investigation of Organized Crime (SIEDO) have impeded Mexico's capacity to conduct investigations and prosecutions of ML offenses in an effective manner.”⁵³

⁵⁰ Manuel Roig-Franzia, “Mexico Revises Its Justice System,” *The Washington Post*, June 18, 2007, A07.

⁵¹ U.S. Department of State, Bureau of International Narcotics and Law Enforcement Affairs, *2008 International Narcotics Control Strategy Report, Volume II: Money Laundering and Financial Crimes*, March 2008, p. 330.

⁵² Interview with César Camacho, chairman of the justice committee of the chamber of deputies, member of the PRI, and the lead author of the legislation.

⁵³ “Mexico: Detailed Assessment Report On Anti-Money Laundering and Combating the Financing of Terrorism,” op cit., p. 30.

From 2005-2009, according to UIF statistics, there were 248,625 "unusual" financial activities reported, meaning activities of more than \$10,000 that can not be accounted for by normal, declared economic activities. Of these, only 741 were deemed to be "worrisome" and meriting further investigation.⁵⁴ As noted earlier, this has led to only a handful of successful prosecutions.

The Road Ahead

It is not realistic to think in terms of eliminating or completely blocking bulk cash shipments and other forms of money laundering. Rather, policy options must examine ways of raising the cost of doing business to the cartels and other criminal organizations and creative ways of targeting their most successful types of operations. This requires an understanding that if one method is successfully tackled the cartels will already have several new ones operational.

This is particularly true in the case of new cyber methods of moving and laundering large sums of money through methods previously unknown to or outside the reach of law enforcement. Entirely new methods will likely require entirely new counter-measures. This will require understanding that does not currently exist, training, regulatory and legal remedies that balance personal freedoms with the dangers of multi-billion transnational criminal enterprises and host of other issues that are now only in the preliminary discussion phase.

There are daunting challenges in the rapidly evolving world of illicit money movements and it will take significant time to understand and disrupt the new cyber challenges. The amply-demonstrated abilities of the DTOs to adjust their strategies to law enforcement actions means that these new challenges must be addressed as soon as possible. There is virtually no regulatory framework to deal with these new issues, and, in order to be even moderately effective the framework must be multi-jurisdictional and enforceable. If the first step to dealing with a problem is to identify it, the U.S. law enforcement has barely taken the first step.

However, this paper's recommendations will focus on the immediate challenges of disrupting the flows of bulk cash shipments, because successfully doing that will impair the cartels' ability to maintain the level of violence and corruption in Mexico.

Key to any success is the effective use of human intelligence and financial intelligence, meaning the ability to sift through significant amounts of data for the anomalies that indicate illicit gain. The danger of over-relying on data extraction at the expense of human intelligence is the sheer volume of data makes it impossible to make significant

⁵⁴ "Inteligencia Financiera en Mexico," Unidad de Inteligencia Financiera, Secretaría de Hacienda y Crédito Público Informe 2009. For a broader interpretation of this data see: José de Jesús González, "El Lavado de Dinero En Mexico: Escenarios, Marco Legal y Propuestas Legislativas," Centro de Estudios Sociales y de Opinión Pública," April 2009.

determinations in a timely fashion. Human intelligence is also the key to understanding the new methodologies and the potential vulnerabilities in those systems.

Of primary importance (and one of the keys to the more successful targeting the FARC and other Colombian drug trafficking organizations) is the creation of vetted units on both sides of the border that can communicate with each other in real time. Only with the ability to compare and share information can the financial side begin to be addressed.

The Mexican experience in this is not good, with supposedly vetted units often turning into particularly sophisticated drug trafficking organizations. The premier example of the recruitment of elite military units by the cartels is the formation of the Zetas by the Osiél Cárdenas organization. The original 30 Zetas deserted en masse from the elite, U.S.-trained Airborne Special Forces Group (*Grupo Aeromóvil de Fuerzas Especiales*, known by their Spanish acronym GAFES) to the Gulf cartel in 2000. Leaders of Zetas, among the most feared of cartel enforcers, have now taken operational control of some fragments of different drug trafficking organizations. The total number of trained Zetas has grown to several hundred.⁵⁵

The DEA (and recently in Iraq, SOCOM in the Pentagon) have worked, with some success, to track financial structures of criminal and terrorist groups. They have done this by maintaining a concerted focus on finances, including successfully exploiting "pocket litter," telecommunications, and exploiting human intelligence. These lessons need to be studied and applied to the Mexico-U.S. border situation.

On the U.S. side, it is imperative that local and state law enforcement forces be given the training and tools to follow the money. Because the movement of money is often a multi-jurisdictional challenge, coordination among these groups across state lines and with the federal government is imperative. Most border police forces do not have the resources to do more than try to keep from being overrun by the flow of drugs, guns and illegal immigrants. Tracing finances is often only done when cash is seized coincidentally as part of an operation. There is not the training or the personnel to do more on the financial front.

Coordination among the federal government is not a small task. The DEA, FBI, FinCEN, DOD, intelligence community and DHS (ICE, CBP and other offices) all have equities in tracking illicit finances, particularly if a designated terrorist entity is involved. This comes into play in the Mexico situation because the Mexican cartels deal directly and indirectly with two designated terrorist organizations, the FARC and the United Self Defense of Colombia (AUC). The territorial disputes, lack of clear jurisdictional guidelines, and inter-agency rivalries make intra-governmental and inter-governmental coordination a daunting task.

⁵⁵ For details, see George W. Grayson, "Los Zetas: The Ruthless Army Spawned by a Mexican Drug Cartel," Foreign Policy Research Institute, April 30, 2008; and Alfredo Corchado, "The Mexican Drug Cartel Enforcers Known as Zetas Are Growing in Strength," *The Dallas Morning News*, September 29, 2006.

On the Mexican side, the endemic corruption, the deep roots already laid down by the drug trafficking organizations, lack of technical training in police and military units and the lack of vetted units all make combating the financial flows particularly difficult. In addition, as describe above, the illicit money seeps into virtually every part of the Mexican national and local state structures, making executing existing laws a daunting task and the effective implementation of the new constitutional reforms on confiscation of properties and other important aspects even more challenging.

The entire process is further hampered by the lack of coordination among the UIF, prosecutors and law enforcement investigators. While information on transactions or suspicious activities can be requested by the UIF, it cannot be required. Requests must still be hand delivered and there is no mechanism to allow the immediate sharing of information that could lead to action.

In order to significantly increase the cost to the drug cartels of moving bulk cash across the U.S. -Mexico border both nations will need to take several steps together. The opportunity to take these steps in coordination with Central American nations exists because of the joint participation in the Mérida Initiative. These are:

1. Make combating the illicit financial flows a central part of the counter-drug and fight against organized crime on both sides of the border;
2. Create vetted units where language is not an obstacle and where information can be shared freely. This would allow law enforcement to jointly exploit what each side knows about personnel, routes and methods and coordinate activities in real time;
3. Substantially increase the financial and technical resources available to trace financial networks. This is particularly true in Mexico and at the state and local levels in the United States. This includes modernizing the way the UIF and other organizations in Mexico exchange information, access information and deal with law enforcement;
4. Develop human intelligence within the drug trafficking organizations specifically targeted at the financial structure with the goal of both identifying routes, but also key facilitators and exploitable weaknesses along the financial pipeline and anticipating future vulnerabilities;
5. Develop joint regulations on wire and other unrestricted money transfer systems, recognizing that such services are often an important financial lifeline to significant numbers of people, particularly in rural areas. Simply cutting the services or making them unviable would create significant hardship and generate sympathy for the drug traffickers;

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6. Monitor and trace the purchase of land, particularly near the border, in order to anticipate where the cartels are likely to be able to exert significant pressure.

All of these steps would increase the cost of doing business for the organized criminal organizations. The more money they have to spend to move money, the less they have for other activities. Money that is seized deprives the criminal organizations of the final payoff for their activities, and hurts them more than interdicting the drugs or other products. Targeting cash remains one of the most effective ways of significantly hurting criminal organizations, so creative and flexible approaches to doing so are imperative.

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