

# Drug Trafficking and The Financial Crisis

by Victor Ivanov

*Director of the Federal Drug Control Service (FDCS) of the Russian Federation Victor Ivanov gave this speech, titled “Worldwide Drug Trafficking as the Key Factor of the Escalating Global Financial and Economic Crisis,” at the Center for Strategic and International Studies, in Washington, D.C., on Nov. 18, 2011. The speech has been translated from Russian and sub-heads added.*

Mr. Chairman, dear colleagues,

Thank you for your invitation to deliver a speech at your think tank, a well-known worldwide leader.

Yesterday I came from Chicago, where a regular round of consultations and talks of the [counter-narcotics] working group took place within the Obama-Medvedev Russian-American Bilateral Presidential Commission. Gil Kerlikowske, Director of the Office of National Drug Control Policy in the Executive Office of the U.S. President, and your humble servant are co-chairmen of this group.

For two years we have been engaged in close cooperation on specific projects, planning and implementing joint operations and, certainly, discussing the most burning issues: primarily the need to eradicate opium poppy crops in Afghanistan, whose heroin is actually flooding both Russia and the European Union.

To give you an idea of the scope of this phenomenon, I'll cite only one estimate: just one year's output of Afghan heroin is sufficient to kill 10 million drug addicts.

Taking an opportunity to speak today to a well-prepared audience here, at this think tank, I'd like to draw your attention to my view of one of the most intricate and, probably, key challenges in drug policy.

Analysis has shown that about 10-15% of drugs are intercepted, while the share of drug money confiscated is less than 0.5%. This means that the entire revenue from the global drug economy freely enters into circulation and becomes part of global money flows, taking advantage of the capabilities of the legal financial system.

Meanwhile unscrupulous banks, which practice large-scale financial operations beyond their ability to answer for the liabilities they assume, seek to secure the liquidity they need by resorting to the criminal attraction, or, to be more precise, the absorption of huge amounts of criminal money, the greater part of which is drug money.

Here (**Figure 1**) we have revealing official estimates made by Antonio Costa, former Under-Secretary-General of the UNO and Executive Director of the ODC, that during the global crisis in 2008-2009 about 352 billion narcodollars were injected into major world banks to avoid critical shortages of liquidity; later this money was used for interbank loans. This is not surprising, since, according to the IMF, major American and European banks lost over \$1 trillion due to “toxic” assets from January 2007 to September 2009, and over 200 major mortgage companies, and plenty of other financial institutions, have gone bankrupt.

## The Problem? The Financial System

It is quite symbolic that this high-ranking international official emphasized that it is not a problem with individual banks, but with the general setup of the whole financial system. Mr. Costa knows what he is talking about: he is an experienced international banker who, among other things, for ten years prior to his work at the UNO was Secretary General of the European Bank for Reconstruction and Development.

Assertions about the leading role of criminal “dirty” drug money in the global crisis are also confirmed by abundant other evidence, including data at the disposal of our service.

FIGURE 1



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No wonder more and more experts as well as participants in the “Occupy Wall Street” movement, are beginning to talk about the emergence of so-called “financial terrorism.”

At the same time it should be emphasized that periods of crisis merely aggravate and expose the liquidity problem, making it more evident.

It is also obvious, and analytically confirmed, that the existing financial system, which operates using a great and growing number of financial instruments such as options, futures, swaps, and other derivatives that inflate the so-called “financial soap bubble,” can no longer exist without injections of “dirty” money.

This analysis is fully confirmed by the expert appraisals presented in the research report published one month ago by the UN Office of Drug Control and Crime Prevention, “Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crimes.”

The report states outright that nowadays dirty money can very easily enter into legal financial flows; at the same time “investment” of such money gravely disrupts the real economy and substantially impedes economic growth.

The report estimates the total flows of dirty money of transnational organized crime at over a trillion dollars, or 1.5% of the global GDP, and no less than 70% of this money is laundered through financial institutions. The most profitable sector of this “black” economy, according to the report, is the illicit drug trade that accounts for a minimum of half of all global criminal flows (“accounting for half of all proceeds of transnational organized crime”).

The economic toll of drug circulation on society is truly enormous.

The report’s estimations document that the economic damage from drug trafficking is double or triple the value of the drugs. Thus, while the U.S. cocaine market is estimated at \$35 billion and the market of heroin and other drugs at \$15 billion, direct damage to the U.S. economy from drug trafficking is \$150 billion in monetary terms!

Taking into account the fact that similar drug markets are active in the European Union and China, the major trading and economic partners of the United States, this large-scale adverse effect is reproduced in the form of a negative synergy.

And since Europe is the largest market for Afghan heroin, as well as representing half the market for Latin

American cocaine, the result is that the real sector of the economies of the world’s leading countries is collapsing faster and faster. Dirty drug money, in combination with a speculative “bubble,” are simply exhausting the economy of creation and development.

## The Case of Wachovia Bank

Here it would be appropriate to mention investigations into the financial operations of Wachovia Bank in 2004-2007, which have been widely discussed in the world mass media. According to the *Observer*, in early 2010 the bank signed an out-of-court settlement with American regulators, and paid about \$150 million in exchange for the dropping of charges that it had assisted in money-laundering. This resulted from a 22-month investigation by U.S. Drug Enforcement Agency officers who established that in 2004-2007, Mexican drug cartels made transactions through the bank using electronic transfers, traveler’s checks, and cash. According to federal prosecutor Jeffrey Sloman, “Wachovia’s blatant disregard for our banking laws gave international cocaine cartels a virtual carte blanche to

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FIGURE 2



finance their operations by laundering drug proceeds.”

The most disgusting and essential thing was that the bank was found guilty of transferring \$378.4 billion (the amount is equal to one-third of the Mexican GDP) to dollar accounts at so-called currency exchange offices in Mexico.

There are other, similar cases in which banks did not inform the financial authorities about such operations. Besides the Wachovia case, the U.S. drug police also reported about criminal transactions through another major bank, Bank of America. In one case they tracked transactions related to sales of 22 tons of cocaine, and in a second case, of 10 tons of this drug.

Other banks also came under suspicion and were fined, including the American Express Bank and HSBC.

What is behind this phenomenon? The very nature of the current global financial system.

Today the role of the different types of ersatz money, various derivatives, securitized bonds, futures, etc. that constitute the so-called financial speculative “soap bubble” is already quite obvious.

**Figure 2** clearly shows cumulative registered financial liabilities in the amount of \$600 trillion. Since secured liabilities account for just \$10 trillion of the total amount, it is quite obvious that unsecured liabilities, or the “financial bubble,” are 10 times greater than secured ones. Indeed, these facts have been thoroughly investigated and described many times; unfortunately, they have become commonplace.

It is the increasing volume of unsecured liabilities that underlies the surging crisis we face.

FIGURE 3



FIGURE 4



Naturally in this situation the real economy is extremely weak, since it is affected by the “soap bubble” swelling on top of it. **Figure 3** shows it in the immensely overblown upper part, on top of the rather narrow sector of the real economy.

Almost nobody, however, pays attention to a kind of a paradox: how, under conditions where the economy is slackening and essentially crisis-ridden, banks manage to procure liquidity and service their liabilities.

The problem is even greater, in that the “bubble” is compounded by a heavy encumbrance in the form of unrecoverable military expenses (see **Figure 4**). Studies have shown that the persistent lack of liquidity and attempts to stay afloat during a crisis promote not only tolerance toward criminal money, but also an attitude of

FIGURE 5



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encouraging the availability of such money.

Furthermore, this circumstance, i.e., the possibility of continuously replenishing greatly needed liquidity, is what, in many respects, functions as the moving spring of the ongoing financial and economic, and social, demand for drug production.

Figure 4 is a kind of an X-ray of the mechanics of the current financial crisis. Drug money and the global drug traffic are actually not just valuable elements, but, as donors of liquidity which is so scarce, they are a vital and indispensable segment of the whole monetary system.

### The Overlooked 6% of World Trade

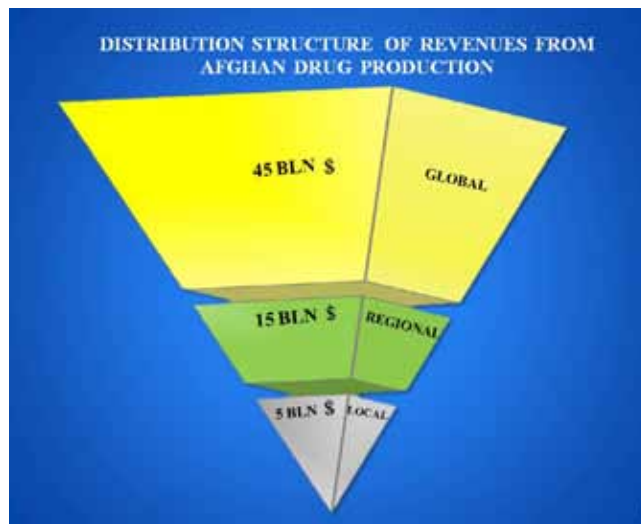
It should be emphasized that the degree of impact of hydrocarbons (oil and gas) on the global economy is common knowledge: They account for about 6% of total world trade. The impact of the narcotics market, which is estimated at approximately the same size, is not looked at by economists and politicians. Yet the development of adequate solutions should be based on a deep understanding of the specifics of global drug trafficking.

So far, unfortunately, anti-drug policies have been dominated by local or, at best, regional or interregional efforts.

To elaborate adequate solutions and understand what is going on, one should have a better idea of global drug streams. Yet the primary capacity of a drug stream is beyond the local and regional levels: It is at the top, global level of drug crime, as shown in **Figure 5**.

This is also confirmed by analysis of the distribution

FIGURE 6



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of the drug mafia's financial proceeds from sales of Afghan drug products, corresponding to these same levels.

This slide of an example, the structure of Afghan drug trafficking proceeds (**Figure 6**), shows that the distribution pyramid for its proceeds by level is inverted, compared with the pyramid for the distribution, by level, of offenders and their criminal transactions.

The structure of distribution of profits from global cocaine production, with total proceeds in 2009 of around \$84 billion, shows the same pattern. While Andean coca farmers earned about \$1 billion, the bulk of the income of \$35 billion was concentrated in North America, with another \$26 billion in Central Europe.

That [North America and Europe] is where, naturally, almost 80% of the illicit proceeds of the cocaine trade are laundered, while just one tenth of the income, a portion of the funds obtained in other regions, are laundered in the Caribbean.

At the present time there are two obvious components of global drug trafficking, or drug streams, as shown in **Figure 7**: Latin American cocaine and Afghanistan heroin.

The direction, intensity, and extraordinary capacity of these two components of the traffic require that they be specified more precisely as "streams."

The impressive, devastating capacity of these drug streams is particularly visible from the situation in the drug transit countries, which, falling under their influence, enter into endless social and political turbulence, since their budgets are smaller than the value of the



FIGURE 7



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drug streams crossing their territories by a factor of two or three, and sometimes by orders of magnitude.

I don't think it is appropriate here to go into the details of the current semi-civil war in Mexico, which is being literally ripped apart by avalanching drug streams.

Let us have a look at Central Asia. The budgets of the nations of Tajikistan and Kyrgyzstan, located on the Northern Route of Afghan heroin, are several times less than the financial capacity of the Afghan drug trafficking that passes through their territories.

Unfortunately, the globalization of drug crime and the emergence of global drug streams that sweep away everything in their path have also become commonplace for the countries of the Balkan peninsula. Suffice it to point out that, as a result of the well-known events, the geographic region of Kosovo has turned into the main drug transit cluster in Europe, an epicenter where, on the one hand, two global drug streams intersect—cocaine coming via Africa and heroin via Turkey; while, on the other hand, there is targeted transshipment of narcotics into the EU countries.

According to UN estimates, about 50 tons of heroin annually comes through this European center of cocaine and heroin distribution, with the annual transit profits amounting to EUR3 billion, i.e., twice the size of the total budget of Kosovo.

The same trends are seen in global cocaine trafficking through the territories of Niger, Guinea Bissau, and other African countries.

Furthermore, analysis of the global cocaine trafficking shows that, in the past decade, it has drastically shifted towards Europe, while establishing hundreds of new transit routes from Latin America to Europe via West Africa.

Meanwhile there is an absolutely evident process, which is typical of such situations, and is especially clear in the example of the western Sahel countries, whereby drug trafficking is rapidly becoming a dominant, criminal geopolitical factor, one possessing huge financial, technological, and human resources, which have been mobilized to reformat the global political and economic space.

### Destabilizing Region After Region

The most conspicuous examples are the upheavals in Guinea Bissau, Mauritania, and Niger, as well as current riots in the Ivory Coast. Drug trafficking has also contributed a lot to the destabilization of the situation in the Arab countries.

These examples of destabilization in transit countries is another revealing characteristic of the global scale of drug trafficking. Only a comprehensive and integrated understanding of the nature and dynamics of these global drug streams will allow us to grasp the essence of the threat posed by drug crime.

It is encouraging that the G-8 Summit in Deauville gave consideration to the problem, thus making it quite a promising area for cooperation aimed at strengthening international security.

But that is definitely not enough.

There must be a resolute consolidation of the governments of leading countries to set up a global anti-drug coalition, which would combat drug trafficking at the global level, in close cooperation with politicians, economists, and financiers.

### Transforming the Financial System

Drastic transformation of the international financial system will be obviously required to liquidate global drug trafficking.

Initial steps are already being taken in that direction.

Thus, precisely two weeks ago the Big 20 adopted a resolution on mandatory monitoring of financial flows.

To a certain extent we are observing a revival of the logic of the Glass-Steagall Act, adopted in the U.S. in 1933 at the height of the Great Depression, which sepa-

rated the deposit and investment functions of banks.

But tough restrictions to prevent the attraction of criminal money are required even more.

In other words, liquidation of the financial bubble alone will not be enough.

I kindly ask you to focus your attention on the basic outline once again (Figure 4).

It is quite obvious that liquidation of the “bubble” must be backed up by the elimination of the ability to sustain drug production, which is based on renewable bioresources: coca bushes and opium poppy as the primary source of the basic drug money supply.

Repressive measures alone, however, are insufficient.

The key way to liquidate global drug trafficking is to reformat the existing economy and shift to an economy that excludes criminal money and guarantees the continuing generation of clean liquid assets, i.e., to an economy of development, in which decisions are based on development projects and long-term targeted credits.

A sample of such an approach could be Russia’s “Rainbow 2” Plan for the Liquidation of Afghan Drug Production, presented last March to the Russia-NATO Council.

Its Paragraph 2 was titled, “Elaboration and Implementation of a Program for Afghan Economic Revival and Development through Infrastructure Development.”

The case of Afghanistan is the most visible and demonstrative in terms of the problem.

The more this long-suffering country is destroyed, the more hostilities take place there, and the more that utmost geopolitical tension persists, the longer Afghanistan will be the global center and monopolist of opiate production and, since 2010, also of cannaboids and hashish.

In this respect I find promising the statement made by Mr. Rasmussen, the Secretary General of NATO, on Nov. 3, where he fairly pointed out that “mere eradication” of poppy fields in Afghanistan is insufficient; it is necessary to provide Afghan peasants with alternative crops to grow, i.e., to provide them with means of existence.

The Secretary General emphasized that he counts here on the “expansion of cooperation between Russia and NATO.”

These are inspiring words. And I believe that this position could be among the key ones at the jubilee summit of the Russia-NATO Council next May in Chicago.

Thank you for your attention.

## Lyndon LaRouche on Glass-Steagall and NAWAPA:

“The greatest project that mankind has ever undertaken on this planet, as an economic project, now stands before us, as the opportunity which can be set into motion by the United States now launching the NAWAPA\* project, with the preliminary step of reorganizing the banking system through Glass-Steagall, and then moving on from there.”

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