THE TRIPLE BORDER AREA: A RE-CONCEPTUALIZATION OF THE PROBLEM AND U.S. POLICY

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By

Michael Patrick Bagrosky, B.S.

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The Triple Border Area (TBA) between Argentina, Brazil and Paraguay is a major hub for international crime that generates billions of dollars annually and is the most important center for financing Islamic terrorism outside the Middle East. The primary criminal activities in the TBA are smuggling and money laundering. The proprietors of these illicit acts include local opportunists, multinational criminal organizations and Middle Eastern terrorist fundraisers. The first argument of this thesis is that the current concept, or view, of the TBA has been too fragmented. There are several different models and theories that address parts of this phenomenon, however, there is no single model that describes how the TBA works and no complete theory that attempts to explain the existence of this phenomenon. The second argument of this thesis is that the U.S.’s policy has been too narrow and the result of this narrowness has contributed to the perpetuation of crime in the TBA. To resolve this problem there needs to be a re-conceptualization of the TBA and U.S. policy.
I would like to thank my thesis advisor Professor Eric A Langenbacher, the professors and staff at the Universidad Nacional de General San Martín (UNSAM) in Buenos Aires, Argentina and Georgetown University in Washington, DC. Finally, I want to thank my family.

Many Thanks,
Michael Patrick Bagrosky
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Introduction

The Triple Border Area (TBA) between Argentina, Brazil and Paraguay is a major hub for international crime that generates billions of dollars annually and is the most important center for financing Islamic terrorism outside the Middle East.\(^1\) The primary criminal activities in the TBA are smuggling and money laundering. The proprietors of these illicit acts include local opportunists, multinational criminal organizations and Middle Eastern terrorist fundraisers.

Geographically, the TBA is located in a remote part of South America and does not have easy access to the sea, however, it is endowed with a vast river system and porous borders that are ideal for criminal commerce. Smuggling started in the TBA during the 1600s and by the early 1980s the TBA became a major transit point for cocaine and marijuana. After the Paraguayan dictator Stroessner was replaced in 1989, the criminal economy in the TBA grew to include corruption (bribes), drug trafficking, arms trafficking, counterfeit products trafficking, document forgery, trafficking in persons, intellectual property rights violations and money laundering. The TBA is

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\(^1\) Estimate of value: United States Department of State Bureau for International Narcotics and Law Enforcement Affairs International Narcotics Control Strategy Report, Volume I Drug and Chemical Control (March 2007)

home to more than 700,000 people including 25,000 people of Middle Eastern
descent.\(^2\)

In response to this epidemic, in 1996, the three nations of the TBA established a
multi-national Tri-border command to improve governmental control in this region.
Three years later, a U.S. State Department report estimated the underground economy
equaled $US 10 billion.\(^3\) In 2002, the U.S. joined the Tri-border command creating the
3+1 Group. This group has a command center located on the Brazilian side of the TBA
and its members share intelligence and resources. Paraguay is the weakest link among
these neighboring countries and is one of primary causes of crime in the TBA.\(^4\)

Argentina and Brazil are considerably more developed, however, since the TBA is

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\(^2\) The TBA is home to approximately 700,000 people with 25,000 people of Syrian, Lebanese, and

\(^3\) “The underground economy, which is not included in the national accounts, may equal the formal
economy in size. The bulk of underground activity centers on the unregistered sale of imported goods--
including computers, sound equipment, cameras, liquor, and cigarettes--to Argentina and Brazil.” Figure
based on a formal economy (GDP) of $10 billion. This same report also stated that Hizballah was active
in the region and was engaged in narcotics, smuggling and terrorism.

U.S. Department of State Background Notes: Paraguay, January 1999, Released by the Bureau of
Western Hemisphere Affairs http://dosfan.lib.uic.edu/ERC/bgnotes/wha/paraguay9901.html

\(^4\) This conclusion is based on research outlined in this thesis and is also supported by the U.S.
Government; Overview of the Congressional Budget Justification, Foreign Assistance and USAID
Operations FY 2008 Budget Request

\(^4\) Concept is an abstract or generic idea generalized from particular instances. "concept." Merriam-
Webster Online Dictionary. 2009.Merriam-Webster Online. 2 June 2009 <http://www.merriam-
webster.com/dictionary/concept>

In other words, concept is how something is perceived and/or defined. Similarly, re-conceptualization is
the process of redefining something.
located far from their major population and economic centers, it has remained low on their domestic agendas. Despite this multinational effort over the past decade the illicit economy in the TBA is still worth billions for international criminals and terrorist organizations.

The first argument of this thesis is that the current concept, or view, of the TBA has been too fragmented.\textsuperscript{5} There are several different models and theories that address parts of this phenomenon, however, there is no single model that describes how the TBA works and no complete theory that attempts to explain the existence of this phenomenon. The second argument of this thesis is that the U.S.’s policy has been too narrow and the result of this narrowness has contributed to the perpetuation of crime in the TBA. To resolve this problem there needs to be a re-conceptualization of the TBA and U.S. policy. Before this re-conceptualization is described further, the following is a quick summary of the current fragmented concept of the TBA.

The concept of the TBA is generally divided into three separate areas; (I) general, non-TBA specific, literature on money laundering, (II) general, non-TBA specific, literature on smuggling, and (III) specific literature on the TBA. First, the

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model most often used to describe the global process of money laundering is the Money Laundering Cycle (MLC). The stages of the MLC are placement (physical introduction of ‘dirty’ money into the system), layering (moving the money through different financial institutions) and integration (reintroduction of ‘clean’ money; e.g. investments). To help explain money laundering, Eric Helleiner proposes a theory based on global forces. Helleiner proposes that the ‘rapid growth’ of money laundering across the globe has been spurred by the globalization of the financial sector, advancements in telecommunication technology and the spread of offshore havens. Next, the Financial Action Task Force (FATF) offers an explanation of the local forces behind money laundering. The FATF propose that money laundering develops in certain locations because launderers seek areas with minimum risks and because of geographical proximity to the infrastructure of the Money Laundering Cycle.

Second, unlike money laundering, smuggling lacks a unifying model or theory. This may be due to the fact that smuggling is vast and can include several different activities or perhaps it is because smuggling lacks sufficient scholarship. One good description of smuggling, however, is given by John Salt and Jeremy Stein.

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7 U.S. Government; Overview of the Congressional Budget Justification, Foreign Assistance and USAID Operations FY 2008 Budget Request
Stein describe the illegal smuggling of people as a “global migration business facilitating movement of people between origin and destination countries.” Specifically, these two authors developed a three stage model describing the process of human smuggling: the mobilization and recruitment of migrants; their movement en route; and their insertion and integration into labor markets and host societies of destination countries.

Third, the majority of the TBA literature concentrates on describing the problem and focuses on a few variables as the cause of the problem. For example, the U.S. Government’s view is that the TBA is a major source for terrorist fundraising and believes crime persists mainly because of weak governmental institutions among the TBA countries, with Paraguay being the weakest. These weak institutions are vast and include the police and legislature. This view drives the U.S.’s anti-crime strategy towards improving local governmental institutions.

These are just a few examples of the current debate, however they highlight both the fragmentation of the concept and the dominant trend of reducing the phenomenon to two or three variables that are the key to solving the problem. This


8 Additionally, I lived in Paraguay for one year, Argentina for 2 1/2 years and Brazil for 5 months. These experiences have contributed greatly to my deeper understanding of this topic.

9 Definition based on Merriam-Webster’s dictionary as well as other sources.
thesis recognizes the value of these reductions, especially when considering that governments are managing limited resources; however, this concept is flawed since it has led to fragmentation and over-simplification to a point that each separate view is no longer in-touch with the entire phenomenon.

To re-conceptualize the problem of the TBA, this thesis has two proposals. The first proposal is an Illicit Economic Cycle model that combines the traditionally separate concepts of smuggling and money laundering. This model contains the stages of production (production of products or recruitment of people), shipping, generation (selling products or services), placement, layering and integration. Based on this model, this thesis concludes that the TBA is part of a continuous global cycle of criminal commerce and illicit money flows.
The second proposal is to create one coherent theory that incorporates global, regional and local variables that explain the forces behind the TBA and the Illicit Economic Cycle. This thesis proposes that the TBA is driven by the following variables; *history, culture, geography, flawed institutions, corruption, imbalanced trade policies*; as well as the *criminals’ demand to use their proceeds* and the *consumers’ demand for illicit products*. Furthermore, as the world became more globalized, economic crime became further entrenched by *technological advances in shipping and telecommunications*, the *globalization of the financial system*, *political trends towards integration* and the *spread of offshore havens*.
The U.S. Government needs to develop a coherent policy that address the entire problem outlined above. In recent years the U.S. has made great strides to discuss complex problems with a wide view. For example, the National Security Strategy (NSS) created in the aftermath of the September 11, 2001 attacks addresses diplomacy, defense and development as the key components to national security. The NSS fails, however, to address adequately some key areas such as shipping, demand, history, culture and regional economic policies. Although the NSS makes strides towards a coherent strategy, the reality of the policy implemented in the TBA remains far from addressing the entire problem. Thus, this thesis proposes structuring policy to address each stage of the Illicit Economic Cycle as well as each of the variables outlined in this thesis that are responsible for driving this phenomenon.

To support these arguments this thesis is organized into three main chapters. The first chapter concentrates on the phenomenon of the TBA. The first part of this chapter is a review of the conventional concept of smuggling, money laundering, and the TBA. The first chapter also develops this thesis’s Illicit Economic Cycle and coherent theory. Lastly, the first chapter provides an in-depth case study of the TBA. To facilitate this case study the six stage Illicit Economic Cycle is used as a framework for analysis. The second chapter discusses the case study of Colombia and the related U.S. led war on drugs. After a decades long internal conflict fueled by the drug trade,
U.S. assistance has helped Colombia transition from an almost failed state to a state with a solid democracy, economy, and significantly lower levels of violence.\textsuperscript{10} The goal of this case study is to discuss a similar phenomenon to the TBA and to review the lessons learned. The third chapter of this thesis is an analysis of U.S. policy. The first part of this chapter gives a summary of the historical debate of U.S. policy development in-general and provides a summary of U.S.’s TBA policy. The third chapter then compares this U.S. policy to the entire problem of the TBA as outlined in section one to determine if the policy is addressing each component of the problem. This comparison also offers ways to improve the U.S.’s policy. The end of chapter three includes predictions for the future of the TBA.

Lastly, I want to address the unique challenges I faced during the research for this thesis. The first challenge was the secretive and potentially dangerous nature of my topic. As a Masters student conducting research on an illicit economy I was unable to conduct primary research. I visited the TBA, however I did not attempt to conduct research for security concerns. Therefore, I relied on secondary sources such as

\textsuperscript{10} There are several different examples of products being smuggled. For example, in Indonesia, illegal logging and timber smuggling occurs at a rate of 40 million m\textsuperscript{3} per year. Obidzinski, Krystof “Timber smuggling in Indonesia critical or overstated problem?: forest governance lessons from Kalimantan/by Krystof Obidzinski, Agus Andrianto, Chandra Wijaya. Bogor, Indonesia: Center for International Forestry Research, 2006.

Gas smuggling in Venezuela has reached 27,000 barrels per day and at a cost of $1 billion per year. Reuters, “Venezuela smuggling of world’s cheapest fuel rife” May 21, 2008 6:52pm BST By Enrique Andres Pretel and Brian Ellsworth
government publications and academic articles. I also conducted interviews in Argentina and Paraguay with a wide range of sources. Specifically, I spoke with U.S. officials from the Department of State, Department of Defense and Department of Treasury. I also conducted interviews with local professionals in security, law, and shipping. Due to the nature of my thesis topic all of these interviews were off the record. The second challenge I faced during my research was trying to study a current topic. For the most part, the present day analysis of the TBA occurs between 2002 and 2008. This is notable because this timeframe ends before the recent change in U.S. administration as well as the developing global economic crisis; both of which should have an impact of the current state of the TBA. A third challenge was the fact that I conducted my research from outside the United States. Being overseas has greatly enriched my understanding of this topic; however, since I am relaying on secondary sources, being in South America has also limited my access to research material. Regardless of these challenges I was able to develop a profound understanding of the TBA.11

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11 World Bank Economics of Tobacco Toolkit, “Understand, Measure, and Combat Tobacco Smuggling”
Chapter I. The Triple Boarder Area (TBA)

1a. Smuggling, Money Laundering, and the TBA

As previously stated the current concept related to the TBA is extremely fragmented. The following section describes this conventional view by examining its three main parts; smuggling, money laundering, and TBA specific literature.

Smuggling is the act of secretly importing or exporting goods to avoid custom duties (e.g. taxes), restrictions (e.g. amount) or laws (e.g. illegal).\(^\text{12}\) Smuggling can include the movement of primary products\(^\text{13}\), manufactured products, drugs (legal and illegal), people, documents or just about anything else that someone wishes to move without detection and interception. Under the umbrella of smuggling there are a few further concepts that need to be defined. According to the World Bank, ‘wholesale smuggling’ [occurs when products are sold without the payment of taxes or duties, even in the country of origin].\(^\text{14}\) The World Bank also defines ‘bootlegging’ as the


[purchase of legal goods in one country but consumption or resale in another without paying applicable taxes and duties.] The Merriam-Webster’s Online Dictionary has a slightly different definition of bootlegging; bootlegging is the action of [carrying a product on one's person illegally; the action to manufacture, sell, or transport for sale illegally; and to produce, reproduce, or distribute illicitly or without authorization.]\(^\text{15}\)

Similarly, according the American Heritage Dictionary, ‘trafficking’ means both a legal commercial exchange of goods and illegal commercial activity.\(^\text{16}\) When addressing humans, however, trafficking takes on an entirely illegal definition. ‘Trafficking in persons’ refers to people who are smuggled against their own will. According to the United Nations Convention Against Transnational Organized Crime, ‘trafficking in persons’ means;

> “the recruitment, transportation, transfer, harbouring or receipt of persons, by means of the threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of a person having control over another person, for the purpose of exploitation. Exploitation shall include, at a


\(^\text{16}\) Speech by Michael Prideaux to the 4th Global Congress on Combating Counterfeiting & Piracy Dubai, 4th February 2008; “We estimate that the size of the global illicit trade in cigarettes to be approximately 390 billion sticks annually representing 6% of total world cigarette consumption. This denies governments approximately US$20 billion in annual revenue.” [http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/8E677BB8005B311AC12573F50034D871?opendocument&SKN=1](http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/8E677BB8005B311AC12573F50034D871?opendocument&SKN=1)

David Merriman, Ayda Yurekli, and Frank J. Chaloupka, “We conduct three separate empirical analyses. Our estimates indicate that between 6% and 8.5% of global cigarette consumption is smuggled. “How big is the worldwide cigarette smuggling problem?”
minimum, the exploitation of the prostitution of others or other forms of sexual exploitation, forced labour or services, slavery or practices similar to slavery, servitude or the removal of organs;”

This is in contrast to the ‘smuggling of migrants’, who are people that are illegally traveling under their own free will for residence or employment in another area. According to the United Nations Convention Against Transnational Organized Crime, smuggling of migrants is defined as “the procurement, in order to obtain, directly or indirectly, a financial or other material benefit, of the illegal entry of a person into a State Party of which the person is not a national or a permanent resident.” Examples of this include Mexican citizens who pay to be smuggled unto the United States in order to work.

Another important definition concerns organized crime and criminal organizations. These two terms are frequently used as synonyms to represent the idea of a criminal group involved in criminal activity, however, it is possible to separate these two ideas. A criminal organization is an organized body of people noted for their “criminal sophistication, structure, self-identification, and the authority of reputation, as well as their size and continuity” with a particular purpose to commit organized

17 Wholesale smugglers “account for the vast majority of cigarettes smuggled globally.”; World Bank Economics Of Tobacco Toolkit, “Understand, Measure, and Combat Tobacco Smuggling”

18 World Bank Economics Of Tobacco Toolkit, “Understand, Measure, and Combat Tobacco Smuggling”
Additionally, the goal of criminal organizations is to make money and they are not ideological. Organized crime, however, is a *criminal activity* arranged in a systematic way by a group of people. The groups committing these activities do not need to reach the level of sophistication as a criminal organization and these groups can have explicit ideologies, such as political insurgencies and terrorist organizations. In sum, criminal organizations commit organized crime, however not all organized crime is committed by criminal organizations.

There is no single model that describes the process of smuggling. In general, smuggling depends on what is being smuggled, the amount, and who is doing the smuggling. To fill the void, this thesis proposes three basic phases; obtaining product, transport of product and retail.

![Diagram 2: Smuggling Process (original diagram)]

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19 H.Richard Friman and Peter Andreas “The Illicit Global Economy and State” Introduction: International Relations and the illicit Global Economy
Tobacco/cigarette smuggling spans the globe and represents “6% of total world cigarette consumption.” This process depends greatly on the actors involved (bootleggers or wholesalers) and the type of cigarettes (counterfeit or original), however it follows the basic three step process outlined above. For example, bootleggers legally purchase small amounts then transport the products through simple means such as cars or vans. Similarly, wholesale smugglers, who obtain their supplies largely illegally, but often ship legally, operate on a large scale and their process tends to be sophisticated. According to the World Bank, wholesale smugglers often legally ship tobacco products to or through a tax free zone. There the goods are often temporarily stored as they await onward transfer. At this point, large-scale smugglers often smuggle this tobacco to its final destination.

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Some have argued that smuggling is often committed by members of an ethnically homogenous group. For example, the World Bank, states that “in many countries smuggled tobacco is distributed within tightly-knit cultural and economic communities.” World Bank Economics Of Tobacco Toolkit

In a study on cigarette smuggling in Greece, Georgios A. Antonopoulos argues that “although specific groups within the network are ethnically homogeneous, the particular network [related to Greece] is ethnically heterogeneous.”

21 Luk Joossens, Frank J. Chaloupka, David Merriman, and Ayda Yurekli, “Issues in the smuggling of tobacco products”

22 Washington Post, “Cigarette Smuggling Linked to Terrorism” By Sari Horwitz, June 8, 2004; Page A01
Similar to tobacco smuggling is the smuggling of people. The illegal smuggling of people, also known as migrant trafficking or human trafficking, is a "mutibillion-dollar business with smugglers charging up to $50,000 per head. The specific process of migrant trafficking is complicated and is constantly evolving, however, Salt and Stein developed a simplified model that is divided into three stages: the mobilization and recruitment of migrants; their movement en route; and their insertion and integration into labour markets and host societies of destination countries.

Smuggling involves a wide range of actors. These actors can be individuals or groups and vary in legality, sophistication, ethnicity, and motivation. For example, Salt and Stein state that the actors involved in human trafficking include governments, employers, recruitment and travel agencies, transport operators, legal and advisory

Diagram 3: Salt and Stein, Illegal Smuggling of People

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firms and international organized crime.\textsuperscript{24} Criminal organizations and organized crime are major players in global large-scale cigarette smuggling.\textsuperscript{25} The \textit{Washington Post} reported in 2004 that “smugglers with ties to terrorist groups are acquiring millions of dollars from illegal cigarette sales and funneling the cash to organizations such as al Qaeda and Hezbollah.”\textsuperscript{26} For example, in 2000, 18 suspects were arrested in North Carolina for smuggling cigarettes and sending proceeds to Hezbollah.\textsuperscript{27} These criminals would legally buy cigarettes in a state with a low lax, such as North Carolina, then they would smuggle the cigarettes to another state that had higher taxes. The smuggled cigarettes would then be sold below the market value within that state. This smuggling ring produced an estimated multimillion-dollar profit.\textsuperscript{28}

In addition to these criminal organizations some have argued that smuggling of cigarettes has been part of the corporate strategy of large tobacco firms. The World

\textsuperscript{24} National Center for Policy Analysis, Brief Analysis No. 423 Wednesday, October 30, 2002

\textsuperscript{25} World Bank Economics Of Tobacco Toolkit, “Understand, Measure,and Combat Tobacco Smuggling”


\textsuperscript{27} Reported by Maud S. Beelman, Bill Birnbauer, Duncan Campbell, William Marsden, Erik Schelzig and Leo Sisti and written by William Marsden. The International Consortium of Investigative Journalists is a project of the Center for Public Integrity. This investigation was supported by \texttt{www.theRake.com}.

\textsuperscript{28} World Bank Economics Of Tobacco Toolkit, “Understand, Measure,and Combat Tobacco Smuggling”
Bank states, “there is considerable evidence and many claims that tobacco producers themselves assist, both tacitly and explicitly, wholesale smugglers in transporting tobacco products.”

Some of the goals of this corporate strategy are to enter closed markets, gain market share, undermine regulation, undercut rising government taxes and obtain high profit margins. Due to the clandestine nature it is difficult to clearly describe the level of tobacco firms’ involvement in smuggling, however a study by the International Consortium of Investigative Journalists into British American Tobacco shows that the firm directed and controlled smuggling, “funneled massive amounts” of their cigarettes into smuggling networks and even ran legal business to support their contraband trade.

Once the tobacco reaches its retail destination, the actors involved tend to be local actors. For example, the World Bank, states that “in many countries smuggled tobacco is distributed within tightly-knit cultural and economic communities.” In a study on cigarette smuggling in Greece, Georgios Antonopoulos echoes this and states

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30 World Bank Economics Of Tobacco Toolkit, “Understand, Measure, and Combat Tobacco Smuggling”


that cigarette smuggling also includes “smaller local smuggling ‘groups’ and/or individuals that operate in cooperation (and sometimes in competition), and connect to each other through individuals, who are reciprocally linked in some way or another, strongly or weakly, to more than one individual and group. Although the global implications of cigarette smuggling, and organized crime in general are clear these, groups largely operate on a local/regional level.”

The actors involved in smuggling can also be described by the type of smuggling they perform. According to the World Bank, bootleggers represent a small percentage of the total amount of smuggled cigarettes and they follow a simple low cost smuggling process and wholesale smuggling is typically driven by sophisticated actors such as organized crime syndicates. Georgios Antonopoulos also proposes the roles of wholesaler, procurers, pushers, street-sellers, scouters/look-outs, ‘house guards’, legitimate shop owners, thieves/burglars, and corrupt public officials. In sum, there are a wide range of actors involved in smuggling with different motives. This complexity makes it difficult to summarize easily, however these actors still

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33 World Bank Economics Of Tobacco Toolkit, “Understand, Measure, and Combat Tobacco Smuggling”

34 The weight of his speech focused on tax/price differences. Speech by Michael Prideaux to the 4th Global Congress on Combating Counterfeiting & Piracy Dubai, 4th February 2008; http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/8E677BB8005B311AC12573F50034D871?opendocument&SKN=1

35 L. Joossens, M. Raw, “Turning off the tap: the real solution to cigarette smuggling”, International Union Against Cancer
follow the basic process of *production* (obtaining product), *shipping* (transport), and *generation* (retail).

In general, the theories that attempt to explain the forces behind smuggling are centered on market forces (supply and demand) and governmental controls (transparency, corruption, enforcement). The debate on the driving forces behind tobacco smuggling largely depends on who is making the argument. Generally speaking, the tobacco companies tend to blame market forces (demand) caused by high taxes as the main cause for smuggling. For example, in 2007 company statement, Philip Morris USA stated that;

“...We believe cigarette excise tax increases can cause more problems than they solve because they often yield lower than expected revenue and create an additional incentive for tobacco users to seek alternative avenues to purchase tobacco products - such as the Internet - and create increased incentives for smuggling.”

This argument makes logical sense, however, the common argument against this tax/price cause is the fact that several countries with high tobacco taxes/prices have low levels of smuggling and counties with low taxes have high levels of smuggling. “For example, in countries with the highest taxes in Europe, such as the Scandinavian countries, there is little evidence of smuggling, while in Spain, Italy and many Central and Eastern European countries, where taxes and prices are much lower,

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36 Joossens and Raw, “How can cigarette smuggling be reduced?” 2000; 321: 947-950
the illegal sale of international cigarette brands is widespread. (Joossens 1998 p. 146.) Thus, there is an obvious paradox between taxes and smuggling.

In 2008, in an apparent effort to explain this paradox, British American Tobacco’s Michael Prideaux agreed with the Philip Morris USA tax/price argument but also cited low detection rates and penalties as a cause for smuggling. Thus, Prideaux added the variables of enforcement and border controls. The other side of this argument is the belief that tobacco companies themselves are actors in smuggling. For example, Joossens and Raw state that;

“At the heart of cigarette smuggling is large scale fraud: container loads of cigarettes are exported, legally and duty unpaid, to countries where they have no market, and where they disappear into the contraband market. They are often smuggled back into the country of origin, where they are sold at a third to half price. It is therefore profitable because duty has been illegally evaded. They key to controlling cigarette smuggling is not lower taxes, it is controlling the tobacco manufacturing industry and its exporting practices.”

37 “When similar products are sold at substantially different prices in different locations, there is an incentive to transport the product from the lower-priced to the higher-priced market. Therefore, smuggling can be defined as the evasion of excise taxes on goods by circumvention of border controls.” World Bank, “Smuggling; Understand, Measure and Combat Tobacco Smuggling”


39 2007 National Money Laundering Strategy (USA)
Joossen and Raw also state that “cigarette smuggling is not caused principally by market forces. It is supply driven, caused mainly by fraud through the illegal evasion of taxes.”\textsuperscript{40} If this is true, the tobacco companies’ explanation of the forces behind smuggling should be taken with caution. Taking an arguably more balanced approach, the World Bank agrees with the importance of market forces, however it recognizes the tax/smuggling paradox and argues that border controls determine the actual level of smuggling and not the level of taxes.\textsuperscript{41} The World Bank accounts for this paradox by explaining that often countries with low levels of taxes also have lower controls and higher levels of corruption and are less transparent, thus these countries are more attractive to smugglers. In sum, smuggling is driven by geography, flawed institutions, corruption, imbalanced trade policies; as well as the criminals’ desire to use their proceeds and the consumers’ desire for illicit products.

Like smuggling, money laundering has occurred for centuries, however, over the past few decades it has experienced incredible growth. For example, in 1998 the amount of money laundered was estimated to be between $300-$500 billion (USD)\textsuperscript{42},


while today the annual estimate is between $800 billion and $2 trillion dollars, or 2-5% of annual global GDP. Since money laundering is often viewed as a white-collar crime, this phenomenon many not seem that threatening, however, money laundering is not a ‘faceless’ crime. Money laundering supports international drug trafficking and smuggling. It also has an adverse affect on local development, “fuels corruption, and erodes confidence in the rule of law.” Lastly, money laundering threatens the overall stability of the world’s financial institutions.

There is little debate over the basic definition of money laundering. At the core of the definition most sources focus on the process of turning ‘dirty’ money into ‘clean’ money. Other sources, however, also include the criminal activity that generates the ‘dirty’ money into their broader definition. Here are two examples;

“Money laundering is the criminal practice of filtering ill-gotten gains or “dirty” money through a series of transactions, so that the funds are “cleaned” to look like proceeds from legal activities. Money laundering is driven by criminal activities and conceals the true source, ownership, or use of funds.”

US Office of the Comptroller of the Currency

Money Laundering

44 Reuter/Truman, 2006; Huisman/Sander, 2006
45 Email received from FATF (25 April 2008), Contact@fatf-gafi.org
“The goal of a large number of criminal acts is to generate a profit for the individual or group that carries out the act. Money laundering is the processing of these criminal proceeds to disguise their illegal origin. This process is of critical importance, as it enables the criminal to enjoy these profits without jeopardizing their source. Illegal arms sales, smuggling, and the activities of organized crime, including for example drug trafficking and prostitution rings, can generate huge amounts of proceeds. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to “legitimize” the ill-gotten gains through money laundering.”^47 **Financial Action Task Force on Money Laundering (FATF)**

Measuring money laundering is much more problematic than reaching a standard definition because the nature of this activity is secretive. Efforts to quantify money laundering are only general estimates and are mostly generated for political purposes to “warrant public policy attention.”^48 For this reason the use of these ‘statistics’ as guidance for policy should be taken with great care.^49 For example, the Financial Action Task Force on Money Laundering (FATF) does not even maintain a comprehensive global database of money laundering estimates.^50 Nevertheless, the most common approach used for estimating money laundering is a microeconomic

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^48 Based on: Spremann, K. “Money Laundering Course.” WS 2000/2001. Washington, DC, United States: Inter-American Development Bank. (I was unable to find an original Zund document in English or Spanish)


approach which is based on estimating the income of the ‘feeding activities.’\textsuperscript{51} The feeders include criminal activities (such as drug smuggling), the underground economy (such as informal employment) and tax evasion.\textsuperscript{52} This approach is imperfect since information on these generating activities is also an approximation.

The most common description of the money laundering process is the Money Laundering Cycle (MLC). Although the stages of the MLC vary depending on the source, the most common stages are placement, layering and integration. Placement occurs after the collection of the ‘dirty money’ and involves the introduction of the money into a physical part of the legal financial system such as a bank, money-wiring office or retail store. Next, during the layering stage, the goal is to move the money through several different financial institutions in order to make it difficult for authorities to trace the origins of the money. Once the funds have been disguised sufficiently the money enters the integration stage where it appears to be legitimate and thus can be used as if it were legal. At this point, criminals can purchase real estate, luxury assets, make financial investments, or reinvest into the activity that generated the original ‘dirty’ money. Keeping the main elements of the three-stage model intact, Zünd (1990) proposed an expanded ten-stage cycle that includes one additional main

\textsuperscript{51} Huisman, Sander 'Chasing Dirty Money', Global Crime (2006)

\textsuperscript{52} UN General Assembly Special Session on the World Drug Problem (June 1998), accessed on 26 May, 2008; http://www.un.org/ga/20special/featur/launder.htm
phase, *Generation*, as well as additional stages within placement, layering and integration.\textsuperscript{53}

![Diagram 4: Money Laundering Cycle (MLC)](image)

The MLC is not without controversy since some critics believe this model is too generic and simplified to describe such a complex and dynamic process. For example Levi and Reuter (2006) believe that “not all money-laundering transactions involve all three distinct phases, and some may indeed involve more.” Similarly, Huisman (2006) states that “different methods are used for laundering the proceeds from different predatory crimes.”\textsuperscript{54} Regardless of the debate on the exact stages, the three-stage model is the most common description of the money laundering process.

\textsuperscript{53} All quotes from this section are taken from; Friman, Andreas, “The Illicit Global Economy & State Power”, Chapter 3: State Power and the Regulation of Illicit Activity in Global Finance, by Eric Helleiner.(1999) Helleiner defines three illicit financial activities that have grown with financial globalization: money laundering, tax evasion, and capital flight.

\textsuperscript{54} The following theory of where money laundering occurs is distilled the FATF’s Policy Brief on Money Laundering (July, 1999).
There has also been a debate concerning the actors involved. At the root of this debate are the actors’ level of sophistication and organization. For example, a common discussion involves the relationship between criminal organizations and organized crime with money laundering. According to Spremann (2000), some people believe the analysis of money laundering should be restricted to the more sophisticated services provided by large criminal organizations, however, he argues that money laundering should be viewed as being connected to the larger pool of actors behind organized crime.\textsuperscript{55} Reuter and Truman (2005) also take this less restrictive approach. According to these authors, launderers tend not to be professionals, but rather are people who generate the dirty money or are people who provide “ad hoc assistance to the person or group that was involved in the predatory crime. So quite often money laundering is opportunistic, and self-laundered.”\textsuperscript{56} Besides this criminal organization versus organized crime debate, money laundering involves a wide range of additional actors such as lawyers, multinational corporations, bankers and governments.\textsuperscript{57} In sum, the possible actors involved in money laundering cover a wide range of sectors with

\textsuperscript{55} All quotes related to the GATF are taken from: OCED, Financial Action Task Force (FATF), Policy Brief, Money Laundering (July, 1999)


varying degrees of organization, professionalism and motivation. Regardless of this ambiguity all these actors follow the basic process of placement, layering (shipment of money) and integration.

Although the majority of money laundering analysis focuses on describing ‘how’ the process of money laundering works, there are also a few theories that attempt to explain ‘why’ it works. The theory that best explains the development of money laundering at the ‘macro’ level is Eric Helleiner’s theory based on globalization. Helleiner proposes that the recent ‘rapid growth’ of money laundering across the globe has been spurred the globalization of the financial sector, advancements in telecommunication technology, and the spread of ‘offshore havens.’ More specifically, the rise of money laundering due to the globalization of the financial sector is caused by economic liberalization and the “reduction of the regulatory authority.” Consequently, state governments have lost control over their own financial markets and thus criminal organizations have found it easier to hide their money laundering activities. Second, advancements in telecommunication technology have helped increase money laundering because this technology has “enhanced the ease and speed with which assets can be moved from place to place to escape state regulation.” Lastly, the spread of ‘offshore havens’ has had a positive effect on money laundering

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because the secret nature of these areas make it difficult for anti-money laundering efforts.

Although Helleiner’s globalization theory gives a good explanation of why money laundering has grown due to the forces of globalization, it does not address the forces that determine where money laundering occurs geographically. The Financial Action Task Force (FATF) gives an explanation of these forces. First, since illicit profits can be generated just about anywhere, the phenomenon of money laundering can “occur practically anywhere in the world.” Nevertheless, the two main factors for determining where money laundering occurs are the desire of launderers to seek areas with minimum risk and a geographic connection to the Money Laundering Cycle (MLC). More specifically, money laundering tends to flow towards areas of low risk and there are two types of risks to money launderers; risk of apprehension and risk of losing proceeds. First, criminals seek to reduce the risk of apprehension by working in areas where there are “weak or ineffective anti-money laundering programs. Similarly, criminals are particularly drawn to exploiting developing economic centers where controls are inadequate compared to other countries. Secondly, criminals are also drawn to areas with stable financial systems to help protect against the risk of losing their profits. The geographic location of money laundering can also be associated with

the specific stages of the Money Laundering Cycle. First, the initial stage of money laundering, *placement* tends to occur close to where the funds are *generated*. Next, during the *layering* stage, layering is more likely to occur in areas with sufficient financial infrastructure such as an offshore financial center, a large regional business center or a world banking center. Lastly, during the *integration* stage, launderers can invest in locations were the money was generated or in other areas that are more appropriate for investments.60

To review, the conventional view of the forces behind money laundering are geography, flawed institutions, corruption, imbalanced policies; as well as the criminals desire to use their proceeds and the consumers desire for illicit products. Furthermore, the forces behind money laundering are closely linked with the same forces that are behind globalization and these forces are largely connected to advancements in technology. Since the conventional concepts of smuggling and money laundering have been outlined, it is now time to review the TBA’s geography, history and introduce forces that have been driving the TBA’s development.

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History of the TBA

There is no authoritative definition of the geographical boundaries that encompass the TBA. Historically, the borders between the colonies of Spain and Portugal (and later the countries of Argentina, Brazil and Paraguay) have always been difficult to define and harder to enforce. Furthermore, the borders have undergone an almost constant evolution. Today, the TBA can be described in broad terms and include the entire southern part of Paraguay, the Argentinean provinces of Misiones and Corrientes; and the southwestern portion of Brazil that includes the states of Paraná, Santa Catarina, and Rio Grande do Sul. Alternatively, the TBA can also be defined as being more focused. This focused area has an approximate 15 mile radius extending from the friendship bridge and includes the cities of Ciudad del Este (CDE), Puerto Iguazú, and Foz do Iguaçu; as well as the Iguazu Falls and the Itaipu dam. The population of the focused TBA is estimated to be more than 700,000 people, about the same size as San Francisco, California USA.\(^6\) Regardless of where the TBA's outer limits are drawn, the heart of the TBA is located perfectly for illicit commerce.

The post-Colombian TBA started on the edge of the Spanish and Portuguese Empires in the mid-1500s. One of the first attempts to establish a border between these empires occurred with the Treaty of Tordesillas in 1494. Since this treaty placed the present day TBA within the sphere of Spanish America, the colonialization that started in the mid-1500s was comprised mostly of Spanish settlers. Although the absence of gold and silver kept the migration of European colonists to a minimum, the Europeans that did find their way to the TBA peaceably intermarried with the local Guarani Indian population and developed an agricultural economy. In the early 1600s, Jesuit missionaries arrived and established autonomous communities in the area near the
present day TBA. Over the next 150 years they developed quasi-independent states with their own military and economic systems.

The people of Guaraní and mixed ancestry who lived in these borderlands became “intermediaries” in the flourishing contraband trade between these the Spanish and Portuguese colonies. One of the principle products smuggled was yerba mate (also known as mate tea or mate). Mate grew in the remote forests that were controlled by the Jesuit missions of Paraguay and was harvested by the missions’ Guaraní population. Although mate was difficult to harvest, it remained extremely popular with the colonists. Thus, mate was the “source of wealth for a complex network of middlemen, merchants and money lenders.” Ultimately, the Jesuits were expelled from South America in 1767 and the mission’s population dispersed.

After independence in the early 1800s, Paraguay plunged into a doctrine of extreme isolation, government ownership and self-sufficiency while both Brazil and Argentina jockeyed for regional power, land and control of resources. Conflict between these countries occurred in 1864 when the dictator of Paraguay led his country against

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the combined strength of Uruguay, Brazil and Argentina. This conflict became known as the War of the Triple Alliance (1864-1870) and was war the bloodiest in Latin American history which resulted in the loss of half of Paraguay’s population.65 Following the War of the Triple Alliance, both Brazil and Argentina acquired large tracks of land from Paraguay while Paraguay struggled to recover and fell under the control of foreign influences.

After the United States Civil War (1861-1865), the U.S.’s international involvement rapidly expanded. For example, the U.S. purchased Alaska from the Russians in 1867, established several diplomatic missions throughout the world and its military became increasing involved in protecting the country’s economic interests.66 This expansion was also felt by the countries of the TBA. For example, in the aftermath of the War of the Triple Alliance, U.S. President Hayes acted as the arbitrator in a boundary dispute between Paraguay and Argentina.

65 Caudillo; “Latin American military dictator. In the wake of the Latin American independence movement in the early 19th century, politically unstable conditions and the long experience of armed conflict led to the emergence in many of the new countries of strongmen who were often charismatic and whose hold on power depended on control over armed followers, patronage, and vigilance. Because their power was based on violence and personal relations, the legitimacy of the caudillos' rule was always in doubt, and few could withstand the challenges of new leaders who emerged among their own followers and wealthy patrons.” caudillo. (2009). In Encyclopædia Britannica. Retrieved April 12, 2009, from Encyclopædia Britannica Online: http://0-www.search.eb.com.library.lausys.georgetown.edu/eb/article-9471991

66 The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo , Andrew Nickson ; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209
The importance of mate in the TBA lasted until the end of the 1800s when it finally became domesticated. As the value of mate ebbed, Brazil and Argentina continued to insert their presence and sought other ways to profit from this border region. During the first half of the 20th century Argentina showed the most interest in the TBA. Agriculture was slowly established, however, due to the Iguazu Falls which lies between Argentina and Brazil, tourism became the main engine for growth. The city of Puerto Iguazu on Argentina’s side (and to a lesser extent Foz do Iguacu in Brazil) developed hotels, highways, telecommunications and airports. During this time, Paraguay’s presence in the TBA was much less pronounced compared to its two neighbors because it was occupied with the Chaco War against Bolivia (1932-1935) and internal conflicts.

After the end of the Chaco War, the globe was on the verge of World War II. This time marked the start of a new phase for the TBA. Led by Paraguay, the TBA started to transition from an isolated backwater to a center of illicit commerce. At the start of this period the United States sought more influence in the region in an effort to counter the threat of Nazism. After World War II, Paraguay plunged into a Civil War (1947-1954) and the U.S. “maintained a neutral position during the civil conflict.”


68 Power Concept From: US Navy, Division Officer At Sea Training Leadership Handbook
Finally, the Paraguayan Civil War ended in 1954 when General Alfredo Stroessner (1954-1989) seized power with the support from both the Colorado Political Party and the Military.

Although Stroessner did not invent the Colorado-Military alliance, he transformed it from a loosely connected series of relationships to a sophisticated hierarchical regime in the shape of a pyramid. The Stroessner-Military-Colorado pyramid created a regime that blended authoritarianism and totalitarianism with a bit of sultanism. First, the regime’s leadership style was mostly totalitarian since Stroessner was firmly in power and he decided policy.\(^69\) The regime’s leadership also possessed considerable elements of authoritarianism since the Colorados and the Military carried influence. The blend of totalitarian and authoritarian leadership styles also produced small elements of a sultanistic leadership style. Although Stroessner was glorified at the center of a personality cult, his lack of a genuine “caudillo”\(^70\) personality diminished his sultanistic style. Stroessner’s weak “caudillo” personality might be explained by his need to give importance and emphasis to the Military and Colorado


Pluralism within the Stroessner regime was also limited. The regime had a few weak parties, however, in reality, it was a totalitarianism regime controlled by the Colorado Party with no political or economic pluralism outside the power establishment. The regime had a strong sense of nationalism and anti-communism, however it lacked any guiding ideological principles. Lastly, mobilization within the regime was controlled by the Colorado party since party membership was mandatory for all state employees.

To maintain the integrity of this pyramid, Stroessner required a series of linkages or power-bonds. Herbert Kitschelt describes linkages between citizens and politicians in democratic polities in terms of clientelist, charismatic, and programmatic. These linkages can apply to the Stroessner regime, however, I will amplify Kitschelt’s linkages and include them within a series of power-bonds. The power-bonds consist of coercion, reward, referent, expertise, and legitimacy. These power-bonds are normally used in hierarchical organizations and generally originate from an authority figure and are received by a subordinate. In a broader sense, however, they are simply forms of power that can be used to influence others.

71 The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209

72 The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209

power-bond of coercion is based on fear and has the ability to punish and deny rights, liberties or privileges. The power-bond of reward is based on the ability to provide something of value. The referent power-bond is based on personality and admiration. The power-bond of expertise is based on technical and tactical proficiency. Lastly, the power-bond of legitimacy is the connection based on legal, moral, or earned authority.

Stroessner relied heavily on the power-bonds of coercion to maintain his position. Shortly after Stroessner assumed power, he administered a series of crackdowns on both the Colorado Party (1959) and the Military (1962). This solidified his base from which he deployed a network of spies and violence to “established a culture of fear due to arrest, torture, and death or exile.” Next, Stroessner used the power of rewards. Similar to Kitschelt’s clientelist linkage, Stroessner used the Colorado Party as a nationwide web of “economic and political incentives under the patronage system that tied people to the regime at all social levels.” Using rewards he also pacified the Military by giving them land grants and control of the growing contraband trade. Stroessner also used the power-bonds of referent and expertise.

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76 The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209
These two power-bonds are comparable to Kitschelt’s charismatic linkage. Stroessner possessed bureaucratic expertise and is often credited as being a savvy diplomat. However, his referent power was less dynamic. Like most Latin American dictators of the era, a strong personality cult developed around the figure of Stroessner. For example, his photograph was a common site in public areas and his name was given to buildings, schools, and even a city. That being said, he was described as being “uncharismatic”.  

Lastly, Stroessner effectively used the bond of legitimacy to maintain the structure of his regime pyramid. He used legitimacy in the form of constitutional law and presidential elections. Although Stroessner ruled for 35 years as a dictator, he was elected eight times. Initially, Stroessner was the only candidate for the first two presidential elections, however the electoral process was symbolically opened in the 1960s to additional parties. Even with additional parties, Stroessner and the Colorado Party never lost. The constitution also gave Stroessner the power of legitimacy. When he became ruler in 1954, the constitution already granted the winning party 67% of the congressional seats. In 1967, Stroessner further strengthened his control when he


amended the constitution to give him total power over the Congress and the judiciary.⁷⁹ Although using legal legitimacy created a democratic façade, it effectively gave all policy control to Stroessner and his close circle of advisors within the pyramid.⁸⁰

The Stroessner-Colorado-Military power pyramid was a stable and self-sufficient structure, however there were additional sub-players that strengthened the regime. These players were the international community, the local church, and the national economy. The international community was a source of legitimacy and support for the Stroessner regime and Argentina was one of the regime’s earliest supporters. For example, in 1947 during the Paraguayan Civil War, the struggling Colorado Party received military supplies from Peron of Argentina.⁸¹ At the same time, 44.4% of foreign investment originated from Argentina.⁸² The United States was also an important international supporter of the early regime. For example, the financial support from the United States helped stabilize the Paraguayan economy and

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⁷⁹ The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson ; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209

⁸⁰ The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson ; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209


currency.\textsuperscript{83} In return, the U.S. received an ally in its campaign against communism. For example, in 1965 Paraguay sent troops in support of U.S. operations in the Dominican Republic and in 1968 offered to send troops to Vietnam.\textsuperscript{84} The local Catholic Church provided passive support for the regime and in return Stroessner passed a tax exemption for the Church, gave them a portion of the national budget, and installed the archbishop on the Council of the State.\textsuperscript{85}

The economy during the initial years of the regime was feeble. Throughout the 1950’s the average GDP growth was below 3% and between 1946 and 1955 the cost of living increased 20 times.\textsuperscript{86} During the 1950s, there was evidence that Paraguay was quickly institutionalizing the smuggling industry that would soon define the TBA. Although historical empirical evidence related to smuggling is almost nonexistent before World War II, some evidence as far back as the early 1950s states that

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\textsuperscript{86} For example; “By the late 1960s, the U.S. Department of Agriculture reported that Paraguay had become one of the world's leading importers of U.S. cigarettes. These cigarettes were actually coming into Paraguay for sale to "re-exporters," as the low "in-transit" tax levied by the Paraguayan government was substantially below the protectionist or prohibitive tariffs of its more developed neighbors, Argentina and Brazil.” Dominguez, Jorge, “Smuggling” Foreign Policy, No. 20. (Autumn, 1975), pp. 87-96+161-164.
\end{flushright}
smuggling accounted for around 12% of Paraguay’s trade.\textsuperscript{87} Although Paraguay initially had a weak economy, this weakness was not a liability to the regime. One reason it was not a liability was because the economy prior to Stroessner might have been even bleaker. Although economic data collection only started in the late 1940s, it can be assumed that the years of war and political upheavals crippled the economy.

In contrast to Argentina, Paraguay’s ties to Brazil were almost non-existent prior the 1960s. For example, in 1960 Brazil received 0.2% of Paraguay’s exports and accounted for 0.8% of Paraguay’s total imports.\textsuperscript{88} This relationship slowly started to strengthen when Paraguay established the city of Puerto Stroessner (present day Ciudad del Este) in 1957 and the construction of first bridge linking the two countries (Friendship Bridge or Puente de la Amistad, 1967). During the 1960s Paraguay’s economy began to improve slowly with the help from loans, a fixed exchange rate, and

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{88} The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson ; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209
\end{itemize}
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conservative fiscal policies. These combined elements kept inflation to an annual rate of 2% and a GDP growth rate of 4.2%.

The smuggling of manufactured products grew in the 1960s. This was due to the fact that Paraguay could easily import products with its overvalued currency and since there was a high demand created by the import substitution policy of Paraguay’s neighbors. In the late 1960s and early 1970s Paraguay also got involved in the transshipment of heroin. During this time, 50-75 percent of the entire heroin that entered the US was smuggled by Frenchman August Ricord’s organization, through Paraguay, with help from Paraguayan authorities. The heroin trade was eventually shutdown in 1972 after enormous pressure from the U.S. led to the extradition of Ricord. Smuggling, however, remained since Stroessner had pacified the Military and

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elites by giving them land grants and control of the growing contraband trade\textsuperscript{93} and instituted trade policies that stifled legal trade such as a cumbersome bureaucracy.\textsuperscript{94}

The Itaipú dam project (1975-1982) has its roots in the 1950’s when Brazil realized the hydroelectric potential of the Paraná River. In 1964, after a tense period of military buildups and diplomatic conflicts, Stroessner and President Goulart of Brazil reached an agreement to research the possibility of constructing a joint hydroelectric project along their shared boarder. After nine more years of border disputes, joint commissions and surveying, the Itaipú Treaty was signed in 1973. On the Paraguayan side, the treaty was negotiated by only four regime officials and there was no public debate.\textsuperscript{95} Since Paraguay did not have the assets to finance its 50\% share of construction costs, Brazil provided Paraguay with a loan. As a result of these factors the treaty and resale price of energy was heavily in Brazil’s favor.\textsuperscript{96}

Construction started on the Itaipú hydroelectric dam in 1975. During the construction of the Itaipú dam, Paraguay experienced a huge economic boom and


During the economic boom, employment in the public sector also increased dramatically. Between 1970 and 1978, public sector jobs rose from 56,500 to 118,200.\textsuperscript{102} Although the contracts for these jobs were given to those loyal to the

regime, the wealth attracted a new type of Colorado Party member. This new party member represented a growing bourgeoisie that was not tied to the land.103

In addition to construction and public sector jobs, the traditional agricultural sector also experienced a boom. This boom was due to an increase in land cultivation and a switch to the cash crops cotton and soybean. Prior to Itaipú dam construction, the two most important products for export were wood and cattle products. In 1970, cotton represented only 6.3% of the export commodity composition and soybean were negligible. By 1981, cotton represented 43.7% of the export commodity composition and soybean 16.1%.104 The agricultural boom was reinforced by favorable world commodity prices.

During the Itaipú dam economic boom, Paraguay had the opportunity to change its economic institutions and plan for long term-development. The country, however, was unable to lay the foundations for sustainable growth because of the regime’s

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103 When the dam was completed in 1982 it was the largest hydroelectric project in the world. Today, Itaipú, although physically smaller than the Three Gorges dam in China, is rated as the largest producer of hydroelectric energy in the world. The energy produced is evenly divided between Brazil and Paraguay, however Paraguay only takes an average of 15% and sells its remaining 35% share back to Brazil. In 2005, the energy provided by Itaipú represented 93% of the Paraguayan energy consumption market, while it represented 20% of the Brazilian consumption market. [http://www.itaipu.gov.py/](http://www.itaipu.gov.py/)


104 Economic Growth in Paraguay. Carlos G. Fernández Valdovinos Gerencia de Estudios Económicos, Banco Central de Paraguay, Alexander Monge Naranjo, Department of Economics, Northwestern University, August, 2002
structure, fiscal policy, and its fear of being replaced. This failure led to Paraguay’s continued economic backwardness and the institutionalization of smuggling.

The most dramatic failure of the regime was its reluctance to industrialize. One theory of why Paraguay failed to industrialize can be traced to the power-bonds of rewards. Through Stroessner’s patronage system, loyal Military officers and Colorado Party officials received large land grants. These same officials were the main beneficiaries of Itaipú related capital. Therefore, the elites invested in their own land holdings and expanded their crop production. As a result of this land-capital connection, the regime failed to invest in industries that could take advantage of the new energy created by Itaipú. Another theory as to why Paraguay failed to make meaningful changes to their economic institutions is because the Stroessner regime feared losing power. More specifically, the regime resisted new technologies and economic advancement because they feared those changes would cause turbulence, weaken their hold on power, and lead to their replacement. Ultimately, the regime’s fear of being replaced perpetuated “inefficient government policies and institutions, at the cost to society as a whole.”

Paraguay's fiscal policy was another reason the country failed to create sustainable growth. Although the fixed exchange rate in the 1960’s helped stabilize the

economy, by the 1970’s the pegged currency became so overvalued it led to a sharp rise in cheap imports.\textsuperscript{106} These imports then out-competed Paraguay's domestic industry. Ultimately, these economic failures prevented the establishment of sustainable economic growth. In spite of Paraguay's institutional economic backwardness, the Itaipú dam construction project enabled Paraguay to mask these faults and boast a claim to be the fastest growing economy in Latin America.\textsuperscript{107}

The economic boom came to an abrupt end in the early 1980s.\textsuperscript{108} In the final year of Itaipú construction, 1981, Paraguay’s GDP growth rate fell from 11% to 8.7%. This was a noticeable drop, however after the work stopped in 1982, Paraguay's GDP growth reached -1.0%.\textsuperscript{109} In addition to the loss of thousands of jobs, the situation was made worse since Paraguay did not diversify its economy during the boom years. For this reason Paraguay remained overly dependent on agriculture. This dependence left Paraguay extremely vulnerable to the forces of world recession and Mother Nature. For example, during the early 1980’s the world recession caused “soybean prices to decrease 2.6% in 1981 and 5.4% in 1982. Additionally, cotton prices decreased 11.4%}

\textsuperscript{106} United States Library of Congress http://countrystudies.us/paraguay/41.htm


\textsuperscript{108} The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson ; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209

\textsuperscript{109} The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson ; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209
in 1981 and 16.7% in 1982.” Flooding in 1982 and 1983 dealt an additional blow to Paraguay’s agricultural production. The economic boom-bust also had a profound effect on Paraguay’s population as an estimated 60% of Paraguayans were working outside of the country in the early 1980s. In 1984 the economy bottomed out as a result of improving world commodity prices. During this post-bust stage, agriculture still accounted for 48% of the nation's employment, 23% of GDP, and 98% of export earnings. The Stroessner regime was unable to solve Paraguay’s economic problems. Even abandoning the fixed exchange rate could not prevent the flight of capital to the undervalued Argentinean market.

110 The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209

111 The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209


During the boom era, political instability started to grow as corruption, new wealth, and positioning for power started to take its toll. As a result, the Colorado Party started to divide. The formal division occurred in 1984 when the Traditionalist and Militant factions emerged. At the center of the divide was the issue of Stroessner and ultimately who would take power once the aging dictator was gone. The Traditionalists had their roots in the pre-Stroessner era and tended to be large landholders who drew their wealth from agriculture. They were growing tired of Stroessner and did not agree with the positioning of his son to succeed him. In contrast, the Militants largely...
consisted of the new bourgeoisie that came into the party at the time of the Itaipú project. As a way to show their party loyalty, the Militants were adamantly pro-Stroessner. Lastly, a small third faction called the Ethicals soon emerged. This group was dissatisfied with the corruption displayed by the two major factions and called for liberalizing the political process. The Ethicals were firmly anti-Stroessner.\textsuperscript{114}

Starting in 1984, a four year period of violence ensued. The Ethicals were crushed and the Militants replaced the Traditionalists as the majority power within the party. Finally, in 1988, with the support of the Militants, Stroessner was elected for the 8th time with 90\% of the vote.\textsuperscript{115} With the rise of the Militants, the bond between the Colorado Party and the Military was threatened. Since the Military and the Traditional faction of the Colorado Party had ties that pre-dated Stroessner, they did not agree with the way the Militants placed their loyalty to Stroessner above the Party. Additionally, the Military was deeply offended when Stroessner’s son, who they viewed as incompetent, was quickly promoted to an Air Force Colonel by the Militants. The Military-Colorado base was further destabilized when the Militants started training and

\textsuperscript{114} The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209

\textsuperscript{115} The Overthrow of the Stroessner Regime: Re-Establishing the Status Quo, Andrew Nickson; Bulletin of Latin American Research, Vol. 8, No. 2. (1989), pp. 185-209
arming their own paramilitary units. This was a direct threat to the Military’s monopoly of force.\textsuperscript{116}

In addition to the internal factors, international pressure added to the regime’s instability. The United States policy towards Paraguay had started to shift in the 1970’s and in 1985 President Reagan labeled Stroessner a “dictator”.\textsuperscript{117} At the same time Paraguay was becoming a major transit point for cocaine and marijuana.\textsuperscript{118} Consequently, during the second half of the 1980s, US support dried up with the ‘War on Drugs.’ Another international blow to the regime was Pope John Paul II’s visit to Paraguay in 1988. During the Pope’s visit, a televised ceremony with Stroessner showed the Pope “somber and, by subtle gestures, indicated disapproval whenever Stroessner attempted to glorify the human rights record and democratic credentials of his government.”\textsuperscript{119} These international pressures helped strengthen the fledgling church and civil societal movement against the regime.

With Stroessner’s health failing, the stage was finally set for the political aftershock caused by the Itaipú economic explosion. Thus, on February 2, 1989, after

\textsuperscript{116} Illiberal democracy is a country that lies between dictatorship and consolidated democracy. Fareed Zakaria, “The Rise of Illiberal Democracy” Foreign affairs, November/December 1997 [23]

\textsuperscript{117} The Economist Intelligence Unit, Country Profile 2007, Paraguay

\textsuperscript{118} Samuel Huntington, The Third Wave, pp. 109-163. Reverse Wave is the theory of a return to authoritarianism after a forward wave towards liberalization.

\textsuperscript{119} Encyclopædia Britannica. 2007. Encyclopædia Britannica Online. 13 Aug. 2007
35 years in power, Stroessner was replaced by a military coup. Prior to the coup Paraguay had a few elements that made it a candidate to transition to a democracy. First, it was a sovereign state with a largely homogeneous population. It also did not have to overcome a regime-induced ideology. Additionally, besides the hydroelectric potential, Paraguay did not have the natural resource curse since it lacked oil reserves or large mineral deposits. In spite of these positive elements, Stroessner was not replaced by a group of reformers as part of the ‘third wave of democratization.’

There are several reasons why Paraguay failed to transition to a successful democracy. First, Paraguay had a weak political society since it had always been ruled by a series of strongmen. This strongmen culture was at the root of Stroessner’s replacement since the coup was motivated by the elites within the Military-Colorado base to preserve their power. For example, the coup was led by General Rodriguez with the support of the Military and the Traditionalist faction of the Colorado Party. When Rodriguez addressed the public shortly after the coup he mentioned democracy and liberties, nevertheless, “much more revealing was the fact that he prefaced these noble objectives by two others; that the rebels had acted in defense of the dignity of the

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armed forces and for the full and total unification of the Colorado Party.”

This declaration provided insight to the motivation for the regime change and foreshadowed the future political transformation. There was extreme inequality between the strong oligarchy and the huge rural population. Thirdly, the rule of law was very weak since the constitution was meaningless and the dictator controlled policy. Fourthly, although the state apparatus was strong, it was extremely corrupt and inefficient. Lastly, economic society was weak since it was dependent on agriculture and had institutionalized smuggling. Therefore, the transition process was a quasi-transformation that created a government somewhere between a semi-authoritarian regime and an illiberal democracy.

A few months after the coup Rodriguez easily won the presidential election and his government differed little from Stroessner’s regime. It took another three years until a new constitution was created and a more democratic government to be established. Although the Colorado Party remained firmly in control, the new government slowly moved towards liberalization and a multi-party system. In 1994, civil society started to show signs of life with the first ever peasant march and its first

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122 Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America; A Report Prepared by the Federal Research Division, United States Library of Congress under an Interagency Agreement with the Director of Central Intelligence Crime and Narcotics Center, (July 2003)
general strike since 1958. This liberalization led to a “reverse wave” in the form of a coup attempt by General Oviedo in 1996.

Following this failed coup, Paraguay witnessed more political conflicts including the rise of Oviedo himself. The situation came to a crisis in 1999 after the assassination of Vice President Luis María when demonstrators filled the streets protesting against Oviedo, who they accused of being responsible for the assassination. After a couple of days of demonstrations, the protesters were fired on, “killing several.” Although the president resigned and Oviedo left the country, things did not improve. Economic recession lead to more demonstrations and another presidential resignation. Then, in 2003, the Colorado Party candidate Nicanor Duarte Frutos came to power declaring to “tackle corruption, and improve the country's finances.”


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During the Stroessner period, crime in the TBA consisted mostly of alcohol beverages, cigarettes and electronic goods. After Stroessner was replaced crime in the TBA exploded. This trade grew to “include stolen vehicles, armaments, as well as drug-trafficking and associated money-laundering.”\(^{127}\) In response to this epidemic, in 1996, the three nations of the TBA established a multi-national Tri-border command. The goal of this command was to control the flow of commerce and people in the region.\(^{128}\)

Around this time there was growing concern of terrorist connections between the TBA and the Middle East. The TBA is home to approximately 25,000 people of Syrian, Lebanese, and Palestinian descent.\(^{129}\) These people arrived to the Southern Cone of South America in three waves. The first wave occurred sometime after 1860 and was due to the deteriorating economic state in the Ottoman Empire as well as the demand for manual labor in South America.\(^{130}\) The second wave occurred after World War I and the breakup of the Ottoman Empire, and the third wave occurred after World War II


and the Arab-Israeli War of 1948. These immigrants developed a close society with their own schools and clubs. Against this backdrop, a bomb destroyed Israel’s embassy in Buenos Aires on 17 March 1992 and another one blew through the Jewish Community Center (AMIA) in Buenos Aires on 18 July 1994. The people behind these bombings have not been brought to trial and the suspects have included the Iranian Government, the Argentinean Government and Hezbollah. The TBA has frequently been mentioned as a possible staging ground for these attacks.

In 2002, in response to the crime in the TBA, the United States joined Argentina, Brazil and Paraguay in the Tri-border command. This new group became known as the 3+1 Group on Tri-Border Area Security, or simply the 3+1 Group. The 3+1 Group, however, did little to slow down the flow of traffic into the area. For example, in 2004, each day, 30,000 people were crossing the Friendship Bridge between Brazil and Paraguay. Next, in 2006, the Brazilian government established the South American

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133 United States Central Intelligence Agency FactBook 2007 (Downloaded February, 2008)

134 18, March 2008 Clarin (Argentine Newspaper)
Intelligence Center in the Brazilian city of Foz do Iguacu. This center is staffed by officers from Argentina, Brazil and Paraguay.¹³⁵

Before the literature explaining the causes of crime in the TBA is discussed, it is important to further address the debate on terrorist activity in the TBA. In the aftermath of the September 11, 2001 attacks there was a frenzy of publications debating the terrorist connections between the TBA and the Middle East. On one side of this debate are the governments of Brazil and Argentina, who deny any connection between extremist fundraising and the TBA.¹³⁶ On the other side of the debate is the U.S. Government and its firm belief that the TBA is a source for terrorist funding. For example, the U.S. State Department claims that people from Ciudad del Este provide logistical support to Hizballah.¹³⁷ The U.S. Treasury Assistant Secretary for Terrorist Financing Patrick O’Brien stated that millions of dollars have been raised and moved

¹³⁵ The RAND Corporation, “Film Piracy, Organized Crime, and Terrorism” 2009


through the TBA. Additionally, the U.S. Department of Treasury claimed Hatim Ahmad Barakat of Ciudad del Este, traveled to Chile in 2004 in order to collect funds for Hizballah. Continuing this argument is the CIA Factbook which states that fundraisers for extremist organizations raise money from the cocaine trade and launder the proceeds in Paraguay. Israel supports the U.S.’s view. For example, in 2008, Israel's Minister of Internal Security visited Argentina and said that Hezbollah is still active in the TBA and Argentina. A 2009 report by the RAND Corporation supports this view as well. In this report RAND states;


139 The forth reason was derived from: “Fourth, and perhaps most important, Hezbollah and other Middle East militant and terrorist organizations have established a global presence. The last factor is likely to increase in importance as the international pressure and denial of sanctuaries in traditional host countries forces organizations like al-Qaeda to look for alternative bases of operations.”; The RAND Corporation, “Beyond al-Qaeda. Part 2. The outer rings of the terrorist universe” (2006)

140 Production is the action of creating what is to be sold. This action can produce something called a crop, good, product or merchandise. To simplify the discussion this thesis will use the term ‘product’ to represent all of these possibilities. The product can be legal or illegal in nature and can be harvested, manufactured or refined. The production phase can also include the recruitment of people. Shipping is the transport of the product or person by sea, land, or air by any means. Shipping can be legal or illegal. Generation is the exchange of the product for currency (money), other products and sometimes services. Placement occurs after the collection of the ‘dirty money’ and involves the introduction of the money into a physical part of the legal financial system such as a bank, money-wiring office or retail store. Layering is the stage where money is moved through financial institutions to hide the origins of the money. In the integration stage the money appears to be legitimate and thus can be used as if it were legal. At this point, criminals can purchase real estate, luxury assets, make financial investments, or reinvest into the activity that generated the original ‘dirty’ money.

141 This definition was reached at the conclusion of this thesis research. Additionally, this thesis recognizes the possibility that cultures have different ‘starting points.’ Therefore, considering what was there ‘before’ the start of a culture, such as native populations and endowments, are also important when considering culture.
“The tri-border area of Brazil, Argentina, and Paraguay has emerged as the most important financing center for Islamic terrorism outside the Middle East, channeling $20 million annually to Hezbollah. At least one transfer of $3.5 million was donated by known DVD pirate Assad Ahmad Barakat, who received a thank-you note from the Hezbollah leader. Barakat was labeled a “specially designated global terrorist” by the U.S. government in 2004.”

In the middle of the debate is Paraguay. First, Paraguay appears to support the U.S.’s stance. For example, in 2008 the Paraguayan Ambassador to the U.S. expressed Paraguay’s “solidarity with the United States of America in the fight against terrorism and related crimes.” The reality, however, is that Paraguay is not committed to tackling this problem. This is evident in that fact that Paraguay does not have a counter-terrorism law or a law criminalizing terrorist fundraising.

The previous paragraphs have shown that the TBA has had a long history of illicit commerce. To better understand this history, the following as a review of the literature that discusses the variables that have been driving this development. The majority of the literature explaining the causes of this phenomenon focuses on local

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142 All Culture definitions taken from the University of Minnesota Center For Advanced Research On Language Acquisition; accessed April 11, 2009. http://www.carla.umn.edu/culture/definitions.html

143 Acemoglu, Johnson, Robinson, “Institutions as the Fundamental Cause of Long-Run Growth”, (2004)


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factors. For example, when explaining the perpetuation of crime in the area, a 2003 report by the US Library of Congress the US Government cites;

“endemic corruption within the police, criminal justice systems, and governments of the TBA countries; poor pay; inadequate training, equipment, funding, law enforcement techniques, and penal codes; poor organization; human rights abuses; weak anti money-laundering laws and enforcement thereof; and secrecy provisions of banking laws.”145

This local explanation was reiterated in 2008 by the US State Department when they said, “weak controls in the financial sector, open borders, and minimal enforcement activity for financial crimes allow money launderers and terrorist financiers to take advantage of Paraguay’s financial system.”146 Expanding this argument is a 2006 report by the RAND Corporation. In this report they go outside the local explanation to include some global forces. Specifically, RAND gives four reasons why terrorist organizations are specifically involved in the TBA (which are very similar to the theories presented by this thesis on money laundering). The first reason is geography, specifically, the concentration of people of Syrian, Lebanese, and Palestinian descent in one area with a continuing connection to the Middle East. Furthermore, RAND describes the strategic location of the TBA with its’ proximity to


two major regional economies as well as access to transportation and communication infrastructure. The second reason terrorist organizations are in the TBA is because of the prior existence of a criminal infrastructure. The third factor is “Paraguay’s weak political institutions and investigative and law enforcement capabilities, as well as pervasive official corruption, have created the conditions for the unchecked growth of terrorist and criminal networks.” The fourth reason is due to the fact that as these organizations have been pushing their presence across the globe, the TBA has become more attractive compared to other areas that have been increasing their enforcement capabilities. This explanation comes closest to addressing the entire phenomenon, however it only address terrorism and does not include the wider issue of smuggling or money laundering.

In sum, the current debate related to the phenomenon of the TBA is extremely fragmented. This section described this fragmentation by discussing the conventional view of smuggling, money laundering, and TBA specific literature. Each separate part

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147 These endowments were population density of native populations and the presence of mineral wealth. Specifically, when the colonialists arrived, they were able to enslave the highly concentrated native populations to extract the nearby gold and silver. From this initial population-endowment relationship, institutions developed that would perpetuated the inequality. Their theory gains traction once comparisons are make between North and South America. Specifically, the original North American settlers arrived a few years after their South American counterparts and they sought to duplicate the ‘success’ of the South American colonialists by extracting mineral wealth. However, the lack of minerals the dispersed nature of the native populations did not enable the North American colonialists to mimic the South American colonialists. Thus the colonialists spread out and engaged in agriculture. Consequently, the institutions that developed in the north were strikingly different compared to the south.
of this debate provides important insight into the phenomenon of the TBA, however the literature still lacks one unifying model and theory. The error in this deficit is that any subsequent policy based on this scholarship will also be fragmented and/or narrow to adequately address the entire phenomenon.

1b. Thesis’s Argument: Illicit Economic Cycle Model and Theory of Forces

This thesis argues that there needs to be a re-conceptualization of the problem of the TBA based on a holistic approach. Specifically, this thesis has two proposals. First, the traditionally separate concepts of smuggling and money laundering should be merged to create one unified model describing the stages of a continuous illicit system. Thus, this thesis proposes a model that contains the stages of production, shipping, generation, placement, layering and integration. This model demonstrates how the TBA’s illicit economy functions and sustains itself. These stages have already been thoroughly discussed in the previous section and will be further developed in the case study of the TBA in the next section; therefore, I will now focus on developing the thesis’s theory of forces.

The second proposal is that the currently fragmented theories explaining the forces behind the TBA, smuggling and money laundering should be combined and deepened. As stated in the introduction, my argument is that illicit commerce is driven by; history, culture, geography, flawed institutions, corruption, imbalanced trade policies as well as the criminals’ desire to use their proceeds and the consumers’ demand for illicit products. As the world became more globalized, economic crime in the TBA became further entrenched by technological advances in shipping and telecommunications, the globalization of the financial system, political trends towards integration and the spread of offshore havens. Most of these variables were introduced above, however the following section further develops these variables.

This thesis defines culture as the accumulation over time of customs, arts, social institutions, events and achievements. Culture is also influenced by forces such as the environment (ex. weather, resources) and geography (ex. location, population density). In other words, culture is the sum of a people’s (nation’s, or social groups) history.\textsuperscript{149} To understand the current culture of the Triple Border Area (or any other nation, people

\textsuperscript{149} Metz, S, “Rethinking Insurgency”, (June, 2007)
or other social group), it is critical to understand the historical forces behind culture.

Other authors have also defined culture. Below are a few examples:

“Culture is defined as the shared patterns of behaviors and interactions, cognitive constructs, and affective understanding that are learned through a process of socialization. These shared patterns identify the members of a culture group while also distinguishing those of another group.” University of Minnesota Center For Advanced Research On Language Acquisition


"A culture is a configuration of learned behaviors and results of behavior whose component elements are shared and transmitted by the members of a particular society" (p. 32). Linton, R. (1945)." The Cultural Background of Personality. New York.

"Culture...consists in those patterns relative to behavior and the products of human action which may be inherited, that is, passed on from generation to generation independently of the biological genes" (p. 8).” Parson, T. (1949). Essays in Sociological Theory. Glencoe, IL.

"Culture has been defined in a number of ways, but most simply, as the learned and shared behavior of a community of interacting human beings" (p. 169). Useem, J., & Useem, R. (1963). Human Organizations, 22(3).

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Next, culture has a direct impact on institutions. This thesis defines ‘institutions’ as governmental and economic organizations, systems or structures that set the rules, facilitates and enforces behavior. Specific examples of institutions can include the form of government (ex. democratic), specific governmental agencies (ex. judiciary) economic systems (ex. capitalism), or private firms (ex. banks). The American Heritage Dictionary of the English Language defines institutions as an established organization or foundation, especially one dedicated to education, public service, or culture. The Merriam-Webster Dictionary defines institutions as a significant practice, relationship, or organization in a society or culture; an established organization or corporation (as a bank or university) especially of a public character. According to Acemoglu, Johnson, and Robinson, (2004); “Economic institutions determine the incentives and the constraints on economic actors, and shape economic outcomes.”

In sum, history gives birth to culture, culture gives birth to institutions, and institutions shape events and culture (present and future). Although, this thesis recognizes that this is a simplified description (and there are also cases that do not

152 This thesis will focus on the second example when discussing the TBA, however both are present.
follow this linear process), this thesis believes this generalization has enough supporting evidence and moreover, is a good starting point for developing the framework for further discussion.

In recognition of the importance of history, culture, geography and institutions, many academic disciplines have discussed these forces within their work. For example, political science, economics, and geography have all tackled these ideas. As a result of this multi-pronged approach, a murky picture quickly develops with overlapping, interwoven, and conflicting theories. In an effort to clarify this picture, the following is a brief description of some of the relevant ideas.

In Putnam’s 1993 study on democracy in Italy, he concluded that “social context and history profoundly condition the effectiveness of institutions.” Similarly, in a study of inequality in Latin America by the World Bank (2004), the authors researched the relationship between the colonial past of Latin America and today’s institutions and found that inequality was ultimately caused by the ‘factor endowments’ that greeted the Europeans and consequently molded future institutions. Another example is provided by Malmberg and Maskell’s (1997) study on regional specialization and industry. According to these authors, “regions which


155 Ship Scheduling and Network Design for Cargo Routing in Liner Shipping. Richa Agarwal, Ozlem Ergun School of Industrial and Systems Engineering, Georgia Institute of Technology, Atlanta, GA USA.
enjoy effective government, and economic growth, in the 1990s have a legacy of civic engagement that can be traced back to the early Middle Ages.”¹⁵⁶ Metz (2007) argues the cause of organized crime is due to “ineffective governance, systemic weakness and pathology, and a culture or tradition of clandestine activity.”¹⁵⁷ Ultimately, a wide variety of disciplines have drawn the conclusion that the process of history, culture and geography are essential to understanding the process of institutionalization.

There is also something to be said about history and culture’s influence on establishing economic activities in specific geographical locations. There are two main ways to look at this. First, migrating people can bring with them a specific economic activity or quickly assume a specific economic activity that their kin have already established. Examples include Arab traders in Argentina,¹⁵⁸ Chinese immigrants working in supermarkets in Buenos Aires or Armenian immigrants working in the shoe business in Brazil.¹⁵⁹ Secondly, an economic activity can be established in a specific area (for whatever reason) then become embedded over time as an associated


¹⁵⁷ Ship Scheduling and Network Design for Cargo Routing in Liner Shipping Richa Agarwal, Ozlem Ergun School of Industrial and Systems Engineering, Georgia Institute of Technology, Atlanta, GA USA.

¹⁵⁸ For example, HSBC (Hong kong and Shanghai Banking Corporation) Holdings was established in 1990. In 1992 BankAmerica merged with Security Pacific to create the second largest bank in the U.S. Next, in 1998 NationsBank acquired BankAmerica and became Bank of America. Citigroup was created in 1998 Citigroup from the merger of Citicorp and Travelers Group, Inc.

¹⁵⁹ The Economist ‘International Banking: Thinking Big’, (May 18th 2006)
infrastructure of support develops around it. In other words, an industry originally might have had specific reasons for starting in an area (for example proximity to natural resources such as coal or iron); but it is the accumulation of associated business, workers and infrastructure that helps keep the industry in that area. Examples of this include the automotive industry in Detroit and the computer industry in Silicon Valley.\(^{160}\)

Economic geography is one academic discipline that attempts to explain these arguments. Encyclopedia Britannica defines economic geography as the study of the “the distribution of various productive activities—with subdivisions into, for example, the geography of agriculture, industrial geography, and the geography of services—and patterns of trade such as transport geography.”\(^{161}\) The roots of this study can be traced back to conventional trade economics based on Adam Smith’s Wealth of Nations (1776) and David Ricardo’s (1817) theories on endowments, comparative advantage and specialization. One of the first attempts to focus on distance within the relationship of economic activity and location was Thünen’s (1826) theory of agricultural location related to a market in an isolated state. At the base of his theory was the relationship

\(^{160}\) The Economist ‘International Banking: Thinking Big’, (May 18th 2006)

\(^{161}\) Citibank alone processes $1 trillion in financial transactions each business day, maintains a local presence in 100+ countries and supports 100+ currencies. (January, 2008) [http://www.citibank.com/uae/gcib/gts.htm](http://www.citibank.com/uae/gcib/gts.htm)
between production location (land/crops), transportation costs to the market and market value. This was later followed by Alfred Weber’s (1909) theory of industrial location. Weber sought to optimize costs based on the relationship between transportation, production location (factory), labor, market location and sources of raw materials. Weber was followed by the central-place theories of Christaller (1933) and Lösch (1940) which described the relationship between the location of settlements and a central market. Although this review is not designed to be all inclusive, it is designed to give a broad overview and to show that distance and transportation costs were a recurrent theme over the past two centuries.

The discussion between economic activity and location entered a new phase on the eve of the age of globalization. The following is a brief overview of the major forces of globalization that are important to economic geography; political integration, technological advancements and financial convergence. Although trends towards globalization are centuries old, the roots of globalization can be found during the World War II era. During the Bretton Woods conference of 1944 the International Bank for Reconstruction and Development (World Bank), the General Agreement on Tariffs and Trade (GATT), and the International Monetary Fund (IMF), were created to promote international economic stability, integration and political peace. During the Cold War there were also policies to integrate the economies of South America with
the creation of the Latin American Free Trade Association (1960), Andean Community (1969), and the Latin American Integration Association (1980). Although these economic institutions would evolve throughout the Cold War, it was not until the fall of communism that the world economy started to resemble true globalization. For example, the Common Market of the South (Mercosur, 1991), North American Free Trade Agreement (NAFTA, 1994), and the World Trade Organization (WTO, 1995) have installed liberal trade policies that advocate the reduction of tariffs and customs duties; and sought to open access to markets such as banking, commodities and transportation.

While the policies between governments removed legal barriers and set the stage for global integration, the simultaneous emergence of the ‘Logistical Revolution’ in shipping and telecommunications has made these political agreements physically possible. Although the first cargo container was used in 1956, by the early 1980s it still only accounted for around 20% of all general cargo shipments. Since the end of the Cold War, however, the global shipping industry has been revolutionized by the use of standardized cargo containers and the super ships that carry them. Since containers

162 Western Union website (January, 2008) http://corporate.westernunion.com/history.html
163 Paul Krugman is an Op-Ed columnist for the The New York Times and is a professor of Economics and International Affairs at Princeton University.
are built to universally accepted dimensions; ships, shipping and docking equipment have also been standardized. The result has been the automation of loading and unloading cargo. For example, as soon as a cargo ship enters port, the cargo containers are automatically whisked away by enormous cranes. The containers are then placed on trucks, trains, or other ships until they reach their final destination. The containerization and computerization of this process has increased efficiency, reduced shipping costs, and reduced human involvement. By 2001, cargo containers accounted for 60% of all general cargo shipments. Today, there are 200 million containers traded annually\textsuperscript{164} and container shipping continues to expand with a growth rate of 8-10% per year.\textsuperscript{165}

At the same time, the advancements in telecommunication have helped spur the convergence of the global economic community. For example, since the early 1990’s, the liberalization of international banking has accelerated and the global trend towards bank mergers and acquisitions has created a series of private “megabanks.”\textsuperscript{166} This is evident in the United States where the ten largest private banks control 49% of the


\textsuperscript{165} Martin, Sunley, “Paul Krugman’s Geographical Economics and Its Implications for Regional Development”, Economic Geography, Vol 72 1992, 259-292

\textsuperscript{166} The idea of ‘locking in’ an economic activity comes from; Martin, Sunley, “Paul Krugman’s Geographical Economics and Its Implications for Regional Development”, Economic Geography, Vol 72 1992, 259-292
country's banking assets, an increase of 20% over that last decade.\textsuperscript{167} Also, in Japan, three large banks have recently acquired 11 smaller banks and in central Europe, foreigners have purchase “80% of the top local banks since the fall of communism.”\textsuperscript{168} Spurred by personal computers and the internet, these international “megabanks” now have the ability to process daily capital transactions worth trillions of dollars.\textsuperscript{169} In addition to traditional banking, there also has been a proliferation in wire transfer agencies. For example, in 2006, Western Union had over 100,000 worldwide locations and “handled 147 million consumer-to-consumer money transfers and 249 million consumer-to-business transactions.”\textsuperscript{170}

As a result of these globalization forces some authors have argued that distance is no longer as important as it once was for determining the location of economic activity. For example, the Pulitzer Prize winning author, Thomas L. Friedman, describes a converging world economy by the leveling of barriers and increasing competition

\begin{itemize}
\item \textsuperscript{167} Malmberg, Anders, Maskell, Peter, “Towards an explanation of regional specialization and industry agglomeration” European Planning Studies, 09654313, Feb97, Vol. 5, Issue 1
\item \textsuperscript{168} “To communicate tacit knowledge normally requires a high degree of mutual trust and understanding, which in turn is related not only to language but also to shared values and culture.”; Towards an explanation of regional specialization and industry agglomeration. By: Malmberg, Anders, Maskell, Peter, European Planning Studies, 09654313, Feb97, Vol. 5, Issue 1
\item \textsuperscript{169} “Organised Crime, Trafficking, Drugs: Selected papers presented at the annual Conference of the European Society of Criminal Criminolog, Helsinki, 2003”; “Criminal Networks and Trust, On the importance of Expectations of Loyal behavior in Criminal Relations”, Klaus von Lampe and Per Ole Johansen, Freie Universität Berlin, Germany, and University of Oslo, Norway
\item \textsuperscript{170} “Snowball effect” taken from; Fujita and Thisse, “Economics of Agglomeration” Journal of the Japanese and International Economies (1996)
\end{itemize}
between emerging markets and industrial countries. A few of his main “flatteners” include the spread of personal computers, software, internet and outsourcing.\textsuperscript{171} Other authors, however, still argue that distance, or rather proximity, still matters when determining why certain economic activities gather in a small number of locations. To illustrate the contemporary ideas behind this argument, the following will concentrate on the theories of agglomeration economics and the work of Paul Krugman.\textsuperscript{172}

Agglomeration economics studies the relationship within a system of customers, suppliers, competitors and institutions that are located near each other in one geographic area. One of the pillars of this area is the Marshallian externalities that described the forces that pull economic activity toward a specific center. These forces include (1) mass-production (the so-called internal economies which are similar to the scale economies), (2) the formation of a highly specialized labor force based on the accumulation of human capital and face-to-face communications. (3) the availability of specialized input services and (4) the existence of modern infrastructures.\textsuperscript{173}

\textsuperscript{171} Towards an explanation of regional specialization and industry agglomeration. By: Malmberg, Anders, Maskell, Peter, European Planning Studies, 09654313, Feb97, Vol. 5, Issue 1

\textsuperscript{172} More than 200,000 people who work for the state depend on the ruling party for their jobs. From the BBC “Final rally for Paraguay hopefuls”; Paraguay has a population of approximately 6 million people, 40\% of which live as rural farmers. From the Economist Intelligence Unit, Country Profile 2007, Paraguay

Similarly, Krugman’s work has recently advanced the study of the role of geography in determining economic activity location. Krugman argues that “in order to understand trade we need to understand the process of regional development within nations.” A few of his main arguments are that decisions on specialization of trade are made on returns based on economies of scale rather than endowments and comparative advantage; specialization ‘to some extent’ is dependent on history; and with imperfect competition a government can create trade policies that stimulate specialization.

Using economic geography as a base we can explain why the TBA has become a center of gravity for illicit commerce. First, throughout the TBA’s turbulent history the area has accumulated a specialized labor force, human capital, specialized services and infrastructure for an illicit economy. Specifically, once illicit activity was established in the TBA more than 400 years ago, the activity got ‘locked in’ over time. During this time, the actors involved in this activity were faced with a dangerous and uncertain environment. Consequently, it is likely developed and shared knowledge in order to survive, adapt and grow. In the absence of law, to facilitate this collaboration, the

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actors would have developed their own routines, customs and personal relationships. Malmberg and Maskell (1997), describe this time dependent process in the legal sector;

“... To communicate tacit knowledge will normally require a high degree of mutual trust and understanding, which in turn is related not only to language but also to shared values and culture. Such trustful relations are, however, not just something that comes into existence once a firm is located in proximity with others. Trust has to be built, and this takes time. Time compression diseconomies' is thus the second important factor hindering competitors ready imitation of established successful behaviour. A firm can't just plug into the information channels of a particular local business system. Some knowledge can't simply be bought. On the contrary, knowledge is often exchanged directly without the use of money, in a very old fashioned, pre-capitalistic way: by barter. You simply need to produce knowledge in order to get knowledge.”

Concurrently, proximity (social and cultural closeness) is another element for developing customs, knowledge, personal relationships and trust. This proximity helps facilitate ‘face-to-face’ interaction and is critical to building trust and exchanging

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176 The BBC “Final rally for Paraguay hopefuls”, (2008); Paraguay has a population of approximately 6 million people, 40% of which live as rural farmers. From the Economist Intelligence Unit, Country Profile 2007, Paraguay
information of a sensitive nature.\textsuperscript{177} This trust is especially important once we consider the nature of economic activity because crime is known for high levels of personal trust.\textsuperscript{178}

Although the process of ‘locking’ crime into the TBA was a slow process at first, it likely reached a critical mass in the second half of the 20th century with the construction of modern infrastructure such as the Asuncion-Cuidad del Este highway, friendship bridge connecting Paraguay and Brazil, and the Itaipú dam. Additionally, the influx of workers related to these activities and their subsequent unemployment during the economic crisis of the early 1980s would have created a new pool of workers for the illicit economy. Once this point was reached, the stage was set for a snowball effect attracting more criminals, criminal activity and support services to the TBA.\textsuperscript{179}

\textsuperscript{177} Nickson, Andrew and Lambert, Petter, “State Reform and the ‘Privatized State’ in Paraguay”, Published online in Wiley InterScience, \url{www.interscience.wiley.com} Public Admin. Dev. 22, 163–174 (2002)


Besides Paraguay’s history of having weak state institutions, associated endemic levels of corruption and low levels of resources; one of the driving forces of crime in the TBA is its national economic policy. “In this extremely open economy, corruption assumes a myriad of forms. Trade-related contraband activities, however, stand out as the most pervasive form of corruption. From its origins during the Stroessner period in alcohol beverages, cigarettes and electronic goods, this trade diversified in the 1990s to include stolen vehicles, armaments, as well as drug-trafficking and associated money-laundering.”; Nickson, Andrew and Lambert, Petter, “State Reform and the ‘Privatized State’ in Paraguay”, Published online in Wiley InterScience, \url{www.interscience.wiley.com} Public Admin. Dev. 22, 163–174 (2002)

\textsuperscript{178} The Economist Intelligence Unit, 2007 Brazil Commerce report

Supporting evidence is found in the formal economy where “theory predicts and empirical evidence supports the notion that entrepreneurs in a given business sector will concentrate in areas where the sector is already strongly represented.”

The low risk of apprehension is another strong pulling force for illicit activities and is primarily due to Paraguay’s weak governmental institutions. One of the main causes of this institutional deficiency is the country’s lack of an independent, effective, and accountable bureaucracy. This problem has deep roots. As previously discussed, during the Stroessner regime Paraguay’s state institutions became bastions for patron-client relations for the regime’s elites. For example, as a cost cutting measure the Stroessner regime provided public servants with low wages and encouraged them to supplement their salary by corruption. Consequently, the public sector “became less concerned with service provision, and increasingly tied to political spoils, providing

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180 Giovanni Facchini, Marcelo Olarreaga, Peri Silva, Gerald Willmann; ‘Substitutability and Protectionism: Latin America’s trade policy and imports from China and India’; World Bank Policy Research Working Paper 4188, (April 2007); “Given the substantial degree of flexibility enjoyed by domestic policy makers in implementing trade policies within the WTO rules, we are interested in exploring whether the characterization of China and India as sources of “cheap” and “unfair” imports has led to increased protectionism on goods that are heavily imported from the two Asian economies. Our initial analysis indicates that this is indeed the case for Latin American imports from China.”


182 The Economist Intelligence Unit, 2007 Brazil Commerce report; “Most Brazilian tariffs and other trade barriers have fallen since the country began its trade liberalization in 1990. Import tariffs dropped sharply from an average of 32.2% in 1990 to 12.9% in 2001. Brazil has also scrapped most non-tariff barriers to imports.”
sinecures for activists of the Colorado Party.” In 2000, Paraguay attempted to pass a law to modernize its public service and establish a transparent system of selecting civil servants. Unfortunately, this law was not passed and Paraguay continues to have a patronage system with hiring practices based on “political favors and support of political parties.” As a result, with a population of approximately 6 million people, more than 200,000 people work for the state and depend on the ruling party for their jobs. Compounding this problem are meager salaries which lead to rent-seeking officials. Ultimately, due to the government’s history, lack of resources, and high levels of politicization, Paraguay’s institutions responsible for combating crime in the TBA have been plagued by low levels of efficiency and effectiveness and extreme corruption.

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184 Television sets made in the Brazilian Manaus Free-Trade Zone are now subject to a 21.5% tariff when entering Argentina. The Economist Intelligence Unit, Brazil Commerce (2007)

185 "Brazilian authorities have started imposing a variety of import-licensing rules and anti-dumping measures on imports” (EIU Commerce, 2007) as well as restrictions based on “environmental concerns (WTO faults Brazil for used tire ban By Bradley S. Klapper, Associated Press Writer | December 3, 2007)

The TBA is also geographically connected to the mass-production of marijuana and soybeans that are smuggled to Argentina and Brazil. This production does not appear to be a major force, however its presence depends the explanation of why the TBA is a major hub for illicit commerce. Another, and more important force behind illicit profit generation in the TBA is a high demand for illegal products. These products tend to fall into two main categories. The first category consists of inherently legal products that are smuggled illegally around trade barriers. Examples include toys, electronics and agricultural products. The second category, which will be discussed further in the next section, consists of inherently illegal products such as cocaine, pirated movies and arms.

Addressing inherently legal products, one of the main causes for the demand is the imbalance of trade policies between the countries of the TBA. Mercosur was created in 1991 and its goal was to establish common economic policies between its member states and to promote economic development. In 1994, in an effort to reach this goal, Mercosur eliminated import duties on 9,000 products that could be traded freely between each member state and established a common external tariff of 20% on these same 9,000 products if they originated from outside the common market.187

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187 O Shafey, V Cokkinides, T M Cavalcante, M Teixeira, C Vianna, M Thun, “Case studies in international tobacco surveillance: cigarette smuggling in Brazil” (2002), Downloaded from tobaccocontrol.bmj.com on 5 May 2008
Although, the Southern Common Market (Mercosur) has been a force for globalization, the reality is that this market has fallen short of attaining truly ‘free trade.’ For example, “full harmonization has eluded Mercosur: some internal goods were still subject to customs duties, and, though members agreed to apply a common tariff on imports from nonmembers, disparities on such duties continue to exist.”\(^{188}\)

One of the factors that has prevented Mercosur from achieving a harmonization has been the protectionist policies by individual governments fearful of intra-Mercosur competition and cheap imports from overseas.\(^{189}\) An example of this protectionist attitude can be found in Brazil.

Brazil has had a long history of protecting domestic industries such as cigarettes, alcohol, computers and tires.\(^{190}\) Although Brazil has recently moved in the direction of more liberal trade policies, this liberalization has only been partial.\(^{191}\) For example, after the financial crises at the turn of the century (1999-2002), “trade wars” arose between Brazil and Argentina.\(^{192}\) Conflict again occurred in 2004, when Argentina


\(^{190}\)Dutt, Pushan, “Does Protection Beget Corruption?” INSEAD Working Paper Series, (2005). The results show that activist trade and industrial/protectionist policies lead to an increase in corrupt activities on the part of the bureaucracy.


imposed barriers on Brazilian electronics and as a result Brazil has lost a “significant market share” to Chinese products in the Argentinean market.\textsuperscript{193} Besides losing out to Chinese competition in Argentina, Brazil has erected high tariffs against Chinese imports in order to protect specific domestic markets. For example, Brazil has a 37% tariff on toys and a 35% tariff on shoes “because the country fears an invasion of low-priced imports from countries such as China.”\textsuperscript{194} Consequently, Brazil has maintained significantly greater protectionist policies than its neighbor Paraguay.

As a result of this protectionist induced imbalance, smugglers have received a window of opportunity to meet illegally consumer demand. For example, toys,

\textsuperscript{193} “In Malaysia, the Ang Bin Hoey triad has engaged in turf battles to maintain control over lucrative piracy markets, battles that resulted in knife and spear fights; robberies of bystanders, including families at bus stops; and assassinations of rival gang leaders.” The RAND Corporation, “Film Piracy, Organized Crime, and Terrorism” 2009

The cause of Malaysia’s initial rise in production and distribution of pirated movies can be contributed to the “balloon effect” caused anti-piracy measures in China and Hong Kong.; Wang, Shujen and Zhu, Jonathan “Mapping Film Piracy in China.” Theory Culture Society (2003); 20; 97

“In 2006 13 pirate versions of Motion Picture Association member company titles distributed globally were forensically linked to illegal copies being made on camcorders in Malaysian cinemas.”; International Intellectual Property Alliance; 2007 Special 301 Report, Malaysia;  \url{http://www.iipa.com/index.html}

\textsuperscript{193} Wang, Shujen and Zhu, Jonathan “Mapping Film Piracy in China.” Theory Culture Society (2003); 20; 97

\textsuperscript{194} Freedom House, Country Report 2007, \url{http://www.freedomhouse.org/template.cfm?page=22&year=2007&country=7223}

\textsuperscript{194} “In 2006, Malaysia continued to take IPR enforcement actions, including: conducting raids against pirate optical disc production facilities; seizing pirate goods and machinery used to produce pirate materials; arresting IPR infringers; and revoking or declining to renew licenses for pirate optical disc facilities, resulting in the reported movement or closure of at least eleven optical plants in 2006.”; 2007 Special 301 Report; Office of the United States Trade Representative
electronic equipment, information technology, beverages, toys, watches, textiles, and cars are frequently smuggled through the TBA. Another example can be found in cigarettes. For example, in 1999, Brazil had a 70% tax on cigarettes while Paraguay’s taxes were 20%. Consequently, Brazilian smugglers would buy cigarettes in Paraguay and smuggle them back to Brazil to be sold tax-free and below market value.

There also appears to be a causal and mutually reinforcing relationship between protectionist policies and corruption. First, governmental corruption increases trade protection. Grossman and Helpman (1994) support this causal relationship with their “protection for sale” model. In this model, they conclude that domestic special interest groups make campaign contributions to selfish politicians in return for protectionist policies. Furthermore, Bandyopadhyay and Roy (2006) argue that when the government does not create the best trade solutions for the entire country, the cause is that corrupt governmental officials are enacting trade policies to meet the demands

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195 The Hong Kong Mafia is particularly active in large-scale trafficking of pirated products from mainland China to Ciudad del Este and maintains strong ties with Hizballah in the TBA.; Library of Congress (USA) Report; Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America, July 2003

196 For example, in 2006 Hong Kong was ranked 15th in Transparency International’s Corruption Perceptions Index.


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of domestic special interest groups.\textsuperscript{198} In sum, one of the motivating factors for approving protectionist policies is corruption by high level officials who have the power to influence policy.

On the other side of the corruption-protection nexus, once protectionist policies are in place, these policies leave governments more susceptible to corruption.\textsuperscript{199} In contrast to the high level corruption discussed above, this type of corruption mostly concerns civil service bureaucrats who are responsible for implementing the policy. This ‘lower level’ corruption can take many forms. In a study lead by Dutt (2002), they find that protectionist policies “lead to an increase in corrupt activities on the part of the bureaucracy.”\textsuperscript{200} For example, Dutt points out that tariffs promote smuggling and

\textsuperscript{198} “There are currently 90 optical disc production plants with 733 production lines in the Hong Kong Special Administrative Region (HKSAR) (with an annual production capacity of over 2.565 billion units).”; International Intellectual Property Alliance, 2007 Special 301 Report, Special Mention Hong Kong.

“Hong Kong has recently experienced an upsurge in the smuggling of illegally copied CD-ROMs from China.” Robert Davison, ‘GSS and action research in the Hong Kong police’, Department of Information Systems, City University of Hong Kong, Hong Kong, Information Technology & People, Volume: 14, Number: 1 Year: 2001

\textsuperscript{199} White House Office of National Drug Control Policy (ONDCP)\url{http://www.whitehousedrugpolicy.gov/international/colombia.html}

\textsuperscript{199} New Your Times, “Cocaine Trade Helps Rebels Reignite War in Peru” By Simon Remero: March 17, 2009

\textsuperscript{200} White House Office of National Drug Control Policy (ONDCP)\url{http://www.whitehousedrugpolicy.gov/international/bolivia.html}

consequently bribes paid to customs agents who have the ability to change shipping invoices.

An interesting relationship between the variables behind the TBA is that current crime in the TBA is strengthened by the prior variables of history, culture, geography and weak institutions; while weak institutions and a ‘backward’ economy are strengthened by the prior existence of crime. This cyclical relationship leads to the more problematic question of which came first; the crime or the culture and institutions? Unfortunately, this riddle may never be answered.

Regardless of which came first, as a consequence of this cyclical relationship over time, illicit economic activity became embedded. At the core of this activity were weak institutions that had been built over time by a culture that reinforced ‘backwardness.’ On top of this core was a network of customers, suppliers, traffickers and corrupt government officials that all used a vast infrastructure geared for criminal activity. This ‘human capital’ network had strong bonds and had an embedded knowledge of the industry that had developed over centuries. As the world became more globalized, economic crime became further entrenched by imbalanced trade policies, technological advances in shipping and telecommunications, the globalization of the financial system, political trends towards integration and the spread of offshore havens. Consequently, the TBA developed a regional, or competitive, advantage that
would have been difficult to duplicate in any another location. This is the essence of why the TBA became a major hub for illicit commerce.

1c. Case Study of Smuggling and Money Laundering Related to the TBA

This section consists of a case study of the TBA. To facilitate this case study the six stage Illicit Economic Cycle is used as a framework for analysis. Specifically, this case study will follow the flow of cocaine, pirated DVD movies and the dirty money they generate.

Production:

There is more than one-way to make a pirated DVD movie since the original pirated copy can originate from almost anywhere and can be mass produced at multiple locations. For example, the original copy can be created in New York, Hong Kong or Taiwan. The movie can be copied by a handheld camcorder, downloaded from the internet or burned from a legal copy. Once copied, mass production can occur in the same country where the original was copied or in a number of other countries (or regions) such as China, Malaysia or Ciudad del Este. Although this dynamic system of
production has a seemingly unlimited number of possibilities, this section will focus on one of the most probable paths; the U.S.-Asia path.

Since movies are traditionally first released in the United States weeks or even months before they are released in the rest of the world, a pirated movie frequently has its origin in the U.S. The majority of these early copies originates in New York City and are copied by using handheld video recorders. Once the master has been created it can then be quickly sent to Asia for mass production. Since the end of the 1990s, Malaysia has become a major center for pirated movies. Geography is one of the forces pulling production to Malaysia. Malaysia is centrally located in South East Asia, has a large coastline and has easy access to the Strait of Malacca, one of the busiest shipping lanes in the world. Once the original copy is in Malaysia it can then be


201 In 2007, Hong Kong logistics performance is ranked the eighth best in the world by the International Bank for Reconstruction and Development / World Bank’s Logistics Performance Index.

202 “While in transit, the container may be stationary for various periods of time as trucks are stopped on the roadside and or container-carrying trains are being assembled in freight yards. Once in port, the container is sent to a staging area before it is placed immediately next to the vessel at quay. Even within the port area, a container may be moved several times as required by the port operator and or customs.” Guy, Emmanuel, “Shipping line networks and the integration of South America trades” MARIT. POL. MGMT., JULY–SEPTEMBER 2003 VOL. 30, NO. 3, 231–242
massed produced and sent through neighboring Singapore for destinations in Asia, Latin America, Europe, New Zealand, Australia, South Africa and Canada.203

The importance of corruption during the production stage and throughout the entire Illicit Economic Cycle cannot be understated since it is the grease that moves this illegal machine. Corruption allows illicit production to take place and allows illicit commerce to pass from one stage to another, (such as between borders or shipping methods). Thus, corruption is one of the forces that pull illicit production to Malaysia. In 2006 Malaysia was ranked 44 out of 163 countries on Transparency International’s Corruption Perceptions Index. According to Freedom House, Malaysia experiences political corruption, graft in the police force as well as bribery and cronyism.204 Although Malaysia remains an ideal area for production, the Malaysian Government has recently been cracking down on intellectual property rights offenses.205 Therefore, another possible path the original pirated movie can take is through Hong Kong.206

203 Guy, Emmanuel, “Shipping line networks and the integration of South America trades” MARIT. POL. MGMT., JULY–SEPTEMBER 2003 VOL. 30, NO. 3, 231–242

204 Guy, Emmanuel, “Shipping line networks and the integration of South America trades” MARIT. POL. MGMT., JULY–SEPTEMBER 2003 VOL. 30, NO. 3, 231–242

205 New York Times; ‘Free Trade Zones Ease Passage of Counterfeit Drugs’; By WALT BOGDANICH, December 17, 2007

Geography is an important factor of why production occurs in Hong Kong. Hong Kong is located next to mainland China and is near Japan and South East Asia. Cultural proximity is another important force pulling production to Hong Kong. This city is densely populated overwhelmingly by ethnic Chinese. History is another variable for understanding production. British-controlled Hong Kong was established in the aftermath of the Opium War (1839-1842) and due to its natural deep sea port, quickly developed into a major trading city. Although Hong Kong has low levels of corruption compared to other countries, the city still struggles with corruption. It is difficult to find empirical evidence of corruption in Hong Kong, however there is a large amount of peripheral evidence that can be used to demonstrate the culture of corruption and what happens in the shadows. Corruption in Hong Kong takes many forms and ranges from domestic development projects to international commerce. Corruption also includes senior officials as well as lower level bureaucrats. For example, in 2009, the Independent Commission Against Corruption (ICAC), established in 1974, “arrested 20 people, including a former senior directorate government officer, for alleged corruption over the tendering and administration of

\[207\] The Asuncion-Ciudad del Este highway was build in the 1960s. Today it is the country’s major highway and is the primary link between to Brazil (via Ciudad del Este-the Friendship Bridge-Foz do Iguaçu, Brazil.
Another example occurred “in 1996 Hong Kong’s Independent Commission Against Corruption arrested an U.S. immigration agent who had dismantled an alien-smuggling operation. The U.S. agent had decided that these illicit profits were too tempting. He was caught conspiring with Honduran and Hong Kong officials to create for himself a similar smuggling operation.” This type of corruption, geography, and history are all likely forces pulling production and smuggling to Hong Kong.

Once in Hong Kong, the master copy of the movie can then be replicated onto recordable disks that were produced in Hong Kong or main land China. Next, the pirated movies can then be loaded into shipping containers, sealed and sent to Hong Kong harbor.

Turning to drugs, the Andean region of South America is one of the leading producers of illegal narcotics. For example, Colombia accounts for over “90 percent of

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208 24, June 2008 Clarin (Argentine Newspaper)
Black cocaine is cocaine that has been diluted with chemicals in order to avoid detection by customs officials, drug sniffing dogs and chemical tests.

According to the United States General Accounting Office, “the traffickers add charcoal and other chemicals to cocaine, which transforms it into a black substance that has no smell and does not react when subjected to the usual chemical tests.” United States General Accounting Office, June 1999 DRUG CONTROL Narcotics Threat From Colombia Continues to Grow


the cocaine entering the United States and a significant source of the heroin on American streets.”211 This trade has been ruled by drug cartels, paramilitary forces and guerrilla insurgents. Colombia is also a source of the cocaine that is sent south towards the TBA. Peru is the world’s second largest producer of cocaine212 and Bolivia is the world’s third largest, “primarily supplying Europe and other markets in South America.”213

Bolivia has been producing and consuming cocoa leaves for centuries to “numb fatigue, increase productivity, undertake rituals and tighten social bonds.”214 In the 1970s coca leaves started to be used for the production of cocaine. Contributing to this cocaine production today are Bolivia’s flawed governmental institutions. Its judicial branch is weak and its judges and administrative officials are underpaid and poorly trained. This weakness leaves the system “susceptible to financial and political


213 9 July 2008 La Nacion (Argentine Newspaper)

214 The money that is obtained from cocaine sales is then used by the Brazilians to “strengthen the groups’ control over the slums of Rio and Sao Paulo. From: United States Department of State Bureau for International Narcotics and Law Enforcement Affairs International Narcotics Control Strategy Report, Volume I Drug and Chemical Control March 2007
pressure.” Bolivia also has a cumbersome bureaucracy where private firms regularly have to bribe public officials. Freedom House cites a national survey that concluded that “13% of interactions between individuals and public institutions require bribes, with an estimated cost of $115 million in 2005; nearly half of Bolivian households reported making an illicit payment to state actors in 2005.” This corruption is government-wide and includes police, customs officials, or judicial officials. As a result of this culture, Bolivia is one of the most corrupt countries in South America; in 2007 Bolivia was ranked 105th out of the 168 countries on Transparency International’s Corruption Perceptions Index.

In sum, history, culture, geography, flawed institutions, and corruption play an important role in determining where production occurs. These variables pull a specialized labor force, human capital, specialized services and infrastructure into a specific area and ultimately create a ‘safe haven’ for criminals to produce their products with limited risk.

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215 H.Richard Friman and Peter Andreas, “The Illicit Global Economy and State” Introduction: International Relations and the illicit Global Economy


Shipping:

The shipment of drugs and pirated movies follow a complex logistical system. Hong Kong's free-trade policy and strategic location has made it one of Asia’s key commercial hubs. Servicing this trade is the container port of Hong Kong, which is one of the world's largest and is famous for its logistical efficiency.\(^{218}\) Although Hong Kong’s capacity to quickly handle large numbers of containers with little human involvement is essential to its economy, this capacity also makes the smuggling of the pirated movies harder to detect. For example, since containers are often held in large staging areas at the port, smugglers can break into a previously sealed container, load the movies and reseal the container themselves.\(^{219}\) Regardless of how the pirated movies find their way into a container, when the pirated movies are finally sealed into the container they are ready to be shipped globally.

\(^{218}\) “The United Nations says the increase in the use of cocaine paste, or paco, in Argentina has risen by 200% in the past couple of years. Other agencies put the figure as high as 500%. BBC News, Aug 2007 [http://news.bbc.co.uk/2/hi/americas/6896056.stm](http://news.bbc.co.uk/2/hi/americas/6896056.stm)


However, since the paste has not been traditionally exported from traditional cocaine producing areas, the recent explosion of paco/crack use in the southern cone might indicate new cocaine production facilities located in more southern parts of South America. 'Paco' Under Scrutiny, The cocaine base paste market in the Southern “Cone Drugs & Conflict Debate” Papers Nr. 14 October 2006

\(^{219}\) “Some debt-strapped developing nations have become dependent on the illicit global economy.” H.Richard Friman and Peter Andreas “The Illicit Global Economy and State” Introduction: International Relations and the illicit Global Economy
Container shipping service routes were first established between the developed economies of the northern hemisphere and were structured on east-west trade routes between Europe, North America and Asia. Today, although this east-west service still dominates global shipping, liberal trade policies and cheaper shipping costs have led major shipping companies to extend their services in South America. In general, carriers have established ‘circuits’ between North America and South America. Therefore, once the South American products reach a North American port they then can then join the east-west routes and thus find markets in Europe and Asia. Conversely, South Americans can also easily receive products that originate on the east-west axis. As a result of these routes, previously secluded or under utilized emerging markets have been further exposed to the global economy.

Throughout this journey the pirated movies will take advantage of several logistical hubs like Singapore, Dubai or New York. These free trade zones/ports are especially problematic for smuggling since tariffs are often waived and there is

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220 Beyond al-Qaeda. Part 2. The outer rings of the terrorist universe, 2006 RAND Corporation


221 US Embassy [http://paraguay.usembassy.gov/volume_1.html](http://paraguay.usembassy.gov/volume_1.html); Colorado Party had been the ruling party since 1954. Although it recently lost the presidential elections, the party is still a major force.

“minimal regulatory oversight.”\textsuperscript{222} Lastly, since only “one to five percent of imported sea cargo containers are inspected”\textsuperscript{223}, it is likely the container carrying the pirated movies will remain sealed until it arrives to South America.

The pirated movies can enter Mercosur at several different ports; Santos and Paranagua ports in Brazil, Iquique port in Chile, and Montevideo port in Uruguay are all major destinations for in-bound container ships. Since, the TBA has no seaport, the pirated movies must first pass through one of these coastal ports. If the shipper is in a rush and willing to spend more money, the container can be sent from any one of these coastal ports overland to the TBA and Ciudad del Este. If the shipper is more concerned about saving money or is not worried about time the cheapest route to the TBA starts at the port of Buenos Aires. Once in Buenos Aires, the container will be transferred to a feeder ship capable of making the nine day journey up the Paraná River, to the Paraguay River, and to Paraguay. There are five terminals in Paraguay that shippers can select to receive their containers. Two of these are public and three are


\textsuperscript{222} United States Department of State Bureau for International Narcotics and Law Enforcement Affairs International Narcotics Control Strategy Report, Volume I Drug and Chemical Control March (2007)

\textsuperscript{223} United States Department of State Bureau for International Narcotics and Law Enforcement Affairs International Narcotics Control Strategy Report, Volume I Drug and Chemical Control March 2007
private. Having the ability to select from different ports aids smugglers since they can take advantage of widespread corruption and personal relationships in order to ensure the passage of their containers. Consequently, once the feeder ship docks in Asuncion, the container is quickly transferred by crane to an awaiting truck that then sets off on its five hour journey to Ciudad del Este.224

The smuggling of cocaine is more complex than the smuggling of inherently legal products like toys, clothes or compact discs. First, the small weight to high value ratio of cocaine allows the smugglers to take advantage of a wider range of shipping methods such as small planes, speed boats and people. These shipping methods have allowed cocaine smugglers to break free from traditional transportation infrastructure. Additionally, the inherently illegal nature of cocaine has driven the traffickers to find more clandestine and fluid methods to avoid detection and interception by governmental authorities. Consequently, the southbound South American cocaine trade does not only follow a traditional shipping path, it also follows its own complex path that passes through several countries.

One of these paths originates in Bolivia and transverses overland to Argentina. For example, in July of 2008, a 29 year old woman and a 64 year old man were arrested in Salta, a city in northwestern Argentina that borders Bolivia, with 8 kilos of

black cocaine hidden under their clothes.\textsuperscript{225} Another path starts in Colombia. The US State Department reported that there are “significant quantities of cocaine” that originate from Colombia and follows routes through Bolivia, Brazil, Argentina, Chile, and Paraguay.\textsuperscript{226} The cocaine is destined for the growing South American domestic market, however, it is also re-exported by cargo ships to Europe, Africa and the Middle East.\textsuperscript{227} One specific path Colombian cocaine takes runs through Venezuela. According to the Washington Post, between 2003 and 2006, cocaine smuggling in Venezuela increased “threefold” to [220 tons of cocaine -- a third of what Colombia produces...most of it is bound for the United States and burgeoning markets in Spain.

\textsuperscript{225} Library of Congress (USA) Report; “Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America”, (July 2003)

“Sociologist and immigration historians have long noted that as migrants move to new countries, criminal organizations from their homelands often follow. New immigrant communities, often ethnically isolated from the surrounding society and wary of state institutions in their new country, offer markets and bases of operations for ethnic crime groups.” H.Richard Friman and Peter Andreas “The Illicit Global Economy and State” Introduction: International Relations and the illicit Global Economy

\textsuperscript{226} 20, June 2008 Clarin Based on a study by La Camara Industrial de La Indumentaria (The Chamber of Industrial Clothing) 500 billones dollars counterfit products in the world annualy. 8.000 millones?

\textsuperscript{227} Library of Congress (USA) Report; Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America, July 2003
Britain and Italy.

Another path involves high quality cocaine and it follows Brazil’s eastern coast. This path involves the transfer of cocaine by the use of coastal boats or small airplanes in order to reach Brazil’s seaports. Once the cocaine reaches the ports, it is then hidden in cargo containers that are bound to join the east-west shipping routes and international markets.

An additional route for cocaine is through the TBA. Cocaine can enter the TBA by land or small plane via Paraguay’s desolate northern border with Bolivia. The cocaine that transfers through the TBA can be re-exported for Argentina or Brazil via land, river boats or small planes. For example, a 2003 Library of Congress report states that the Brazilian Government discovered approximately 100 secret “airstrips in Paraguay adjacent to the border that are used for contraband and other smuggling to Argentina and Brazil.” Similarly, in 2006, Argentine authorities discovered 12 clandestine airstrips used for smuggling drugs from Bolivia and Paraguay. According

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228 This is based on a personal visit to the Cuidad del Este in December 2007. Furthermore, “The nonbank financial sector (particularly exchange houses) is used to move illegal proceeds both from within and outside of Paraguay into the U.S. banking system.”; US State Money Laundering, 2008

The RAND report cites Argentine officials who “point to evidence of terrorist financial activity in the form of thousands of U.S. dollars stamped by Lebanese currency dealers from Lebanese currency exchange banks, tens of thousands of counterfeit dollars, and receipts from wire transfers made between the tri-border area and the Middle East.” The RAND Corporation, “Beyond al-Qaeda. Part 2. The outer rings of the terrorist universe” (2006)

to the BBC, these authorities claim that the planes that used these airstrips were each capable of “carrying up to 500kg (1,100lbs) of illegal drugs.”\textsuperscript{230} The cocaine that is smuggled through the TBA into Argentina and Brazil can also be re-exported to Europe, Africa or the Middle East. For example, in July 2008, a smuggling ring run by Colombians was discovered using prostitutes as drug mules which were flown from Buenos Aires to Spain.\textsuperscript{231} In addition to shipping cocaine, the TBA is also a major producer of marijuana and exports large quantities to Brazil and Argentina.\textsuperscript{232} Besides drugs, the TBA is also a transit point for the precursor chemicals required to produce cocaine. Since the traditional cocaine producing countries lack the required chemicals, they import them through the TBA from the chemical industries based in Argentina and Brazil.

In sum, the shipment of drugs through South America and the TBA flow along a complex logistical system that is frequently being changed by the smugglers to avoid

\textsuperscript{230} Although the last part of placement typically involves moving the money abroad, “money laundering does not require international transactions since there are many instances of purely domestic laundering.” Levi and Reuter, “Money Laundering”, The University of Chicago; (2006) Not TBA specific.


\textsuperscript{232} “The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. The FATF is therefore a 'policy-making body' created in 1989 that works to generate the necessary political will to bring about legislative and regulatory reforms in these areas.” http://www.fatf-gafi.org accessed 17 Oct, 2008
authorities. The variables of history, geography, flawed institutions, corruption, trade policies and shipping technology help pull products from production areas and push them towards areas for generation.

Generation:

It is estimated that globally, illegal drugs generate around $500 billion dollars annually.\textsuperscript{233} The TBA is a major generation hub for this trade. The TBA’s drug trade is largely run by Brazilian criminal gangs based in Sao Paulo and Rio de Janeiro.\textsuperscript{234} These gangs control the trafficking of cocaine, cocaine precursor chemicals, and marijuana.\textsuperscript{235} In general, these gangs are motivated by the desire to meet the demand in Brazil and Argentina and increase their power domestically. An example of Brazil’s and Argentina’s demand for drugs can be found in their slums. For example, the

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\item One can think of OFCs as a close cousin to the TBA. They both are ‘hubs’ where commerce is collected, stored, processed, and redistributed until it reaches its final destination. The TBA, however, reflects the connection of the physical world to the virtual world, while OFCs represent a predominately virtual hub. My Thesis section on smuggling will introduce free trade zones (or free ports) as hubs connecting the integration phase with the production phase; as well as serving as major hubs during the shipping phase.
\end{enumerate}
\end{footnotesize}
cocaine based drug “paco” in Argentina, which is called “crack” in Brazil, has been growing in popularity among poorer populations because of its intense high, addictive qualities, and since it is sold for “pennies.” According to a 2007 BBC report, the United Nations says the use of paco has increased by “200% in the past couple of years”, however the BBC also states that “other agencies put the figure as high as 500%.”

Another, more controversial, aspect of demand involves Paraguay desire to retain its illicit economy. Paraguay is a poor undeveloped country and an argument can be made that Paraguay welcomes the illicit economy because it is a source of revenue and jobs. The money from this economy finds its way to underpaid border agents, politicians and citizens. Thus, to help facilitate the TBA’s drug trade, international traffickers often receive help from corrupt Paraguayan military officers and

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politicians.\textsuperscript{239} Although the U.S. State Department has said there is no official link between the Paraguayan Government and the distribution of illegal drugs, the institutionalization of smuggling and corruption is still evident in Paraguay. For example, in 2003 the “law enforcement minister, the commandant of the national police, and the head of customs were all forced to resign following revelations about a smuggling and corruption scandal.”\textsuperscript{240} Additionally, in 2006 charges of connections to drug traffickers were brought against a deputy from the ruling Colorado political

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\textsuperscript{239} For example, one of the first examples of these havens in the Americas can be found in the time of seafaring buccaneers and smugglers during the ‘Age of Sail.’ Age of Sail is defined as the period between the age of exploration in the 1400s until the advent of steam ships in the 1800s. This age covers the colonization period of both North and South America, the “‘golden age’ of piracy” in the Americas (mid 1600s-early 1700s), as well as the smuggling of teas, alcohol, tobacco, coffee and slaves. Examples of these centers include Tortuga Island (off present day Haiti) and Port Royal, Jamaica. Sullivan, “The Devil’s Brethren: the Evolution of Pirate Counter Culture in the Caribbean”; Teaching Anthropology: Sacc Notes Vol. 8, No.2 Spring 2002

Towards the end of the “Age of Sail” the concept of offshore financial centers entered a new phase with the advent of the practice of ‘flags of convenience.’ Specifically, flags of convenience occurs when shipping companies register their merchant ships under a foreign flag, like Panama or Liberia, in order to take advantage of fewer regulations such as ship inspections, maintenance standards and taxes. This practice first started in the late 1800s when wealthy ship owners from the US and other European countries sought to avoid their own governments policies and taxes. Next, this practice was expanded by ‘rum runners’ during the United States’ prohibition on alcohol (1920-33) and was later utilized after World War Two by foreign oil tankers. Prem Sikka (2003) The Role of Offshore Financial Centres in Globalization Accounting Forum 27 (4) , 365–399

The island of Bermuda offers an excellent example of the connection between the history of smuggling with current practices of off shore financial services. During the American Civil War the island was used by blockade runners to Southern US ports; and later used by ‘rum runners’ during the Prohibition period (1919–33). Since then, the island has grown into an international finance center.

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As a result of this trafficker-institutional nexus it is estimated that ten metric tons of cocaine is transferred through the TBA annually. This trade generates a large amount of wealth in a very poor country. Depending on how high corruption goes and how widespread corruption is, it is possible that there is a strong incentive for an institutional commitment to maintain the criminal economy.

Besides Brazilian criminal groups there is evidence that the Revolutionary Armed Forces of Colombia (FARC) also has a “fundraising presence” in the region. For example, some of the cocaine that the Brazilians transfer through Paraguay is

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243 Delaware is an interesting example of an OFC within the United States. From the Encyclopedia Britannica; [Dating from its liberal incorporation law (1899), the state has become home to thousands of American and foreign corporations and more than three-fifths of the companies listed on the New York Stock Exchange are incorporated in Delaware. The law does not require Delaware corporations to maintain more than a token presence in the state.] Delaware. Encyclopædia Britannica. 2008. Encyclopædia Britannica Online. 25 May 2008 http://0-www.search.eb.com.library.lausys.georgetown.edu/eb/article-260226

From Fortune Money Group; [Financial firms began earnestly banking on Delaware in 1981, when the Financial Center Development Act was enacted. The act liberalized laws that governed banks operating there. Today, Delaware houses six of the ten banks with the highest volume of credit card lending]. Fortune/Money Group http://www.timeinc.net/fortune/services/sections/fortune/region/2002_12delaware.html

bought from the FARC in exchange for money or weapons.²⁴⁴ The drug/arms supply line that runs through the TBA also provides arms for Brazilian organizations. For example, in 2006, the U.S. Drug Enforcement Administration (DEA) seized 588 firearms in eastern Paraguay and the U.S. State Department believes the firearms were intended for the Primero Comando de Capital (PCC) criminal organization in Brazil.²⁴⁵ Although the distribution and sale of cocaine and arms largely takes place in the shadows of the TBA, other illegal products are easily sold in the light of day. An example of this is the pirated movie trade.

There is no shortage of places to sell pirated movies in Cuidad del Este. The several square-block area at the foot of the Friendship Bridge is a crazed bazaar with small merchants crammed into every available space. Although obtaining the exact numbers of merchants is next to impossible, one estimate puts the number at “5,370 registered stores and about 7,000 street vendors.”²⁴⁶ Determining who these vendors are is equally difficult, however, it is possible they are from Argentina, Brazil, Paraguay, Chile, China, Colombia, Ghana, Libya, Italy, Ivory Coast, Japan, Korea,


²⁴⁶ Based on a class with Professor Chernick
Lebanon, Nigeria, Russia, and Taiwan. These individual venders are likely connected to criminal groups from Hong Kong, Korea, Libya, Taiwan or Lebanon.²⁴⁷

Regardless of who the venders are, there appears to be two types of transactions. First, these products can be sold ‘in-mass’ and re-exported to meet high demand at destinations within Paraguay, Brazil or Argentina. For example, in Argentina there are several open-air markets where counterfeit products are openly sold. The counterfeited products that are sold at these markets include CDs, DVDs and high-end fashion clothes. Through these markets, 6 out of 10 Argentineans buy counterfeit products.²⁴⁸ Although 82% of the consumers can easily identify these products as counterfeit, they still buy the product because they are considerably cheaper than the original. Another example of demand can be found in Brazil where, according a 2003 US Library of Congress report, [more than half of the business software and music CD market is pirated.]²⁴⁹

Besides these ‘wholesale’ type transactions, there is also a large market for individual buyers in the TBA. The individual buyers come mostly from Brazil and to a lesser extent from Argentina and Paraguay. Since tourism is a major industry in the

²⁴⁷ The FARC and Colombian drug production is discussed further during the case study on Colombia.

²⁴⁸ Economist Intelligence Unit; Colombia Country Report 2007

region with the nearby Iguazu Falls, it is common for day-trippers to spend a few hours winding their way through the maze of shops picking up the latest movies from the United States, electronics and clothes. These shoppers then easily return with these illegal purchases to Brazil via the friendship bridge without any major concern of border interference.

In sum, during the generation phase, ‘dirty’ money can be produced by a wide range of activities involving several actors. Regardless of how the products are sold, the fact is they generate a large amount of ‘dirty’ cash that needs to be ‘cleaned.’

Placement:

Placement is the start of the traditional money laundering cycle and occurs after the collection of the ‘dirty’ money. This stage is driven by the criminals desire to introduce, or hide, the money into the legal system. Luckily for these criminals this remote area of South America is directly connected to the world’s financial economy due to the globalization of the financial sector and advancements in telecommunication technology. For example the TBA is filled with countless international banks, money wiring offices, casinos and retail stores. Thus the TBA attracts money laundering because the area has a well established financial infrastructure to help process and

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ultimately protect the criminal’s illicit proceeds. Another force behind placement in the TBA is the fact that there is an extremely low risk of apprehension for this activity. For example, although Paraguay has a law that requires people physically transporting more than $10,000 USD to register with customs, this law is rarely enforced and thus large sums of money flows through Paraguay’s porous borders unchecked.\(^{251}\) Since criminals are at their most vulnerable to detection during this stage funds can be smuggled into another country and given to a bank or store there to make placement less risky.\(^{252}\) For example, according to a 2003 Library of Congress report there is a nightly convoy of armored trucks ferrying money from Ciudad del Este to Foz do Iguaçu (Brazil). Furthermore, according to a 2007 report by the US State Department, “large sums of dollars generated from normal commercial activity and suspected illicit commercial activity are transported physically from Paraguay through Uruguay to banking centers in the United States.”\(^{253}\) Ultimately, due to an advanced infrastructure and weak controls money can freely flow in and out the TBA.

Besides analyzing the low risk of apprehension in Paraguay as an isolated case, criminals are particularly drawn to Cuidad del Este because Paraguayan controls are

\(^{251}\) Economic Resources and Internal Armed Conflicts: Lessons from the Colombian Case; Marc Chernick  

\(^{252}\) Economist Intelligence Unit; Colombia Country Report 2007

inadequate compared to Argentina and Brazil. A way to visualize this is to imagine two areas of high pressure next to an area of low pressure. The criminals are simply following the path of least resistance and flow towards the area of low pressure (Paraguay and the TBA). This imbalance is reflected in the fact that both Argentina and Brazil are full Financial Action Task Force Members\textsuperscript{254} while Paraguay is only an associate member as part of the regional South America Financial Action Task Force Against Money Laundering (GAFISUD). One of the likely reasons Paraguay has not become a full FATF member is because it has not met the criteria. Specifically, Paraguay’s penal code is not yet up to standard. Paraguay only recently passed an enhanced anti-money laundering bill. Furthermore, Paraguay does not have anti-terrorist finance legislation.\textsuperscript{255} Lastly, even with the hope of an improving penal code, the reality of enforcing these laws will fall well short of any written legislation. This inadequacy, according to the United States Department of State, is due to limited resources and training, but moreover, due to the fact that the selection of judges, prosecutors and public defenders is largely based on politics, nepotism and influence.

\textsuperscript{254} “Colombia.” Encyclopædia Britannica. 2007. Encyclopædia Britannica Online: Other sources include Soviet Union and Colombia’s Communist Party (Chernick FARC-EP)

\textsuperscript{255} Economic Resources and Internal Armed Conflicts: Lessons from the Colombian Case; Marc Chernick
peddling, affording the ruling party an opportunity to manipulate the judicial system to its advantage.]256

In sum, placement occurs in the TBA because of low risk due to inadequate legislation and enforcement, geographical proximity to generation, and the existence of a financial infrastructure that serves as a portal to the global financial system. This system enables a producer on one side of the globe to easily receive profits generated on the other. Ultimately, thanks to the combination of these local and global forces the money generated in the TBA is ready join the world’s economy.

Layering

The goal of the layering stage is to move the criminal’s money around the world to several different institutions in order to make it difficult for authorities to trace


256 Chernick Rethinking the peace process in Colombia; Chapter 5 Illegal commodity export booms, development and armed conflict

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its origins. Essentially, the criminals are putting layers between the source of the money and themselves. For example, the money can be sent from a bank in the TBA via wire transfer to an offshore bank. Next, the money can be wired again to a loan company and then to another international bank. All of these transactions can occur at traditional financial centers such as New York, Tokyo or London.257

Another important location for layering has been offshore financial centers (OFCs).258 OFCs are centers that are known for attracting a high level of non-resident economic activity by collecting low or zero taxes and providing no or low regulation; as well as specialized services, infrastructure, secrecy and anonymity.259 This definition is not universal due to the dynamic nature of the global economy as well as the complexity traditional financial centers. For example, the IMF cites overlap in services and function between some OFCs with traditional financial centers such as London, Hong Kong and Singapore.260 Further complicating the definition of OFCs is

257 Shortly after the terrorist attacks the U.S./World labeled most political insurgencies as terrorist organizations.


259 Economist Intelligence Unit, Colombia Country Profile 2008


260 Economist Intelligence Unit, Colombia Country Profile 2008
the fact that some sources draw a distinction between offshore financial centers and tax havens while others consider them as one.\textsuperscript{261} Since the definition of OFCs is not universal, the agreed geographical location of the specific OFCs can vary. There does appear, however, to be an agreement that the majority of OFCs are commonly located in former British colonies (or dependencies) and other small countries/areas that want to attract capital from non-residents.\textsuperscript{262} Regardless of the obvious difficulties with reaching a universal definition, OFCs play a critical role in layering.

OFCs have a long history. Early examples of these ‘havens’ can be traced back centuries to pirates seeking to store and use their booty; as well as to smugglers circumventing regulation, taxation or prohibitions.\textsuperscript{263} Besides a long history of shipping related activities, the type of economic activity most commonly associated with OFCs today is banking related. An early example of this can be traced to the 1920s when Americans and Europeans set up banking accounts in the Bahamas to

\textsuperscript{261} Freedom House, Colombia Country Report 2007, accessed 5 April, 2009 \url{http://www.freedomhouse.org/template.cfm?page=22&year=2007&country=7156}

\textsuperscript{261} Foreign Assistance and USAID Operations FY 2008


\textsuperscript{263} Garry Leech, The New Face of Plan Colombia: An Alliance for Progress for the 21st Century?, February 23, 2009 \url{http://www.colombiajournal.org/colombia305.htm}

\textsuperscript{263} European Union, “Colombia: The peace laboratory – a marriage of rural development and peace” \url{http://ec.europa.eu/world/peace/geographical_themes/colombia/peace_laboratory/index_en.htm}
protect their wealth from taxes. Another example includes the Swiss Banking Law of 1934 which protected a clients’ information and encouraged companies to base their operations in Switzerland although most of their operations occurred outside of the country. Ultimately, these factors helped establish Switzerland as one of the world's most important financial centers. Switzerland’s success helped spur many imitators

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264 Chernick Rethinking the peace process in Colombia, Chapter 5, Illegal commodity export booms, development and armed conflict.

265 The balloon effect can also be applied to the drug cartels. The most notorious example was Pablo Escobar’s Medellin Cartel. During Pablo Escobar’s rise, he amassed a fortune, was involved in the local community, and even became politically active. However, his highly antagonistic behavior, attracted pressure from both the U.S. and Colombian governments. Ultimately, Pablo Escobar was attacked and killed in 1993. After the fall of the Medellin cartel the U.S. and Colombian governments continued to squeeze the drug trade. However, the cartels were not destroyed, they simply changed form to attract less pressure. For example, after the Medellin cartel was dismantled, the Cali cartel popped up to take its place. This new cartel marked the transition to less antagonistic, more horizontal, and “compartmentalized” structures.

Despite this shift, governmental pressure continued and the Cali cartel was broken up. This lead to the prominence of the Norte del Valle cartel. However, the recent capture of Diego Montoya, the head of the Norte del Valle cartel, could mark the final phase of the shift towards flatter and more ambiguous organizations with decentralized resources and decision making authority.

Fight Brews in Colombia Drug World washingpost.com/The Associated Press; By Toby Muse, September 15, 2007

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and the number of OFCs has doubled since the 1980s to reach more than 60 separate centers.\textsuperscript{266} Examples of current OFCs include the Bahamas, Montevideo (Uruguay) and Delaware (USA).\textsuperscript{267} Besides banking accounts, the type of banking activity has also recently diversified. For example, the financial secrecy and generous tax laws in OFCs has attracted several hedge fund managers, insurance companies and tax planners.\textsuperscript{268} Ultimately, the same conditions that attract legal businesses also attracts illicit economic activity such as tax evasion and money-laundering. Thus, the “dirty” money can piggy-back on the world’s global economy and move from one financial institution to another. Finally, once the money has been “spun” around this stage, it is ready to be integrated into the legal economy.

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\item \textsuperscript{266}The ‘southern cone’ is the southern part of South America that includes Paraguay, Chile, Argentina, Uruguay, and southern Brazil.
\item \textsuperscript{267}‘Paco' Under Scrutiny, The cocaine base paste market in the Southern Cone Drugs & Conflict Debate Papers Nr. 14 October 2006
\item Peru offers more recent evidence of a shift in production. Evidence suggests that coco and cocaine production has increased in the past few years. This as aided the reinsurance of the Shining Path rebels. Fueled by Coca, New York Times, “Peru’s Rebel War Reignites” March 17, 2009 \url{http://www.nytimes.com/2009/03/18/world/americas/18peru.html?pagewanted=1& r=1&hp}
\item \textsuperscript{267} National Drug Intelligence Center, National Drug Threat Assessment 2007, October 2006 \url{http://www.usdoj.gov/ndic/pubs21/21137/cocaine.htm}
\item \textsuperscript{267} National Drug Intelligence Center, National Drug Threat Assessment 2007, October 2006 \url{http://www.usdoj.gov/ndic/pubs21/21137/cocaine.htm}
\item \textsuperscript{267} Washington Post, “Clinton: U.S. Drug Policies Failed, Fueled Mexico's Drug War” By Mary Beth Sheridan, Thursday, March 26, 2009; A01
\end{enumerate}
\end{footnotesize}
Integration:

Once the funds have been sufficiently disguised, the money enters the integration stage. During this stage, the money appears to be legitimate and thus can be used by the criminals as if it were legal. At this point, the criminals can purchase real estate, luxury assets, make financial investments, or reinvest into the activity that generated the original ‘dirty’ money; thus they can use the proceeds to start the cycle again. Since the ‘dirty’ money is essentially indistinguishable from clean money this phase is arguably the simplest and consequently has a limited amount of supporting evidence.

In sum, the TBA is part of a continuous global cycle of criminal commerce and illicit money flows. This cycle involves production, shipping, generation, placement, layering and integration. Driving this cycle are history, culture, geography, flawed institutions, corruption, imbalanced trade policies, the criminals desire to use their proceeds, consumers desire for illicit products, technological advances in shipping and telecommunications, the globalization of the financial system, political trends towards integration and the spread of offshore havens.

The goal of this first chapter was to clearly demonstrate the phenomenon of the TBA and present the first part of my argument; that the TBA needs to be re-conceptualized. To do this, this chapter first reviewed the fragmented debate
concerning smuggling, money laundering and the TBA. The next section proposed the Illicit Economic Cycle model as well as my theory of forces. To reinforce this argument I then gave an in-depth case study of the TBA using Illicit Economic Cycle. Now that the complete realities of the system and variables have been presented, the next chapter will review a similar case study.

Chapter II. Similar Case Study: Colombia

To better understand the TBA and the U.S.’s policy, it is useful to look at a similar case study. Colombia offers a great example of the U.S.’s involvement in South America where illicit commerce is a major concern. Over the past few decades Colombian drug cartels and the Fuerzas Armadas Revolucionarias de Colombia (FARC) have been at the center of this trade. This case study focuses on the cocaine trade and the FARC.

The FARC is a Colombian leftist guerrilla group that has been involved in an armed conflict against the government of Colombia since the 1960’s. In spite of the
difficulty determining how lucrative or important the drug trade is for the FARC,\(^\text{269}\) it is clear that they participate in the globalized Illicit Economic Cycle and the variables described above have helped the FARC procure resources, maintain military strength, and prolong their decades old conflict. The strength of the FARC and their control over the cocaine trade has recently been in flux, however in 2007 it had an estimated strength of 15,000\(^\text{270}\) troops and had control over vast stretches of land. The FARC are primarily motivated by their grievances over land, rural development, and political

\[\text{269} \text{ Senator Feinstein’s web-site, in 2000 stated one percent was inspected while a 2004 Boston Globe article stated it was six percent.} \]


Senator Feinstein, Calls for More Inspectors, Detection Technology at U.S. SeaportsFebruary 16, 2000, [http://feinstein.senate.gov/releases00/seaport_security.html](http://feinstein.senate.gov/releases00/seaport_security.html)

\[\text{269} \text{ H.R. 1 Implementing the 9/11 Commission Act of 2007,} \]

reforms\textsuperscript{271}, however one of the reasons that the FARC are still involved in armed conflict today is that they have been able to use the drug trade to maintain military strength.\textsuperscript{272}

Although the FARC are in their fourth decade of armed conflict, they live in a diverse country with many economic, social, and political advantages. Geographically, Colombia has a land-mass roughly twice the size of Spain. It shares borders with Venezuela, Brazil, Peru, Ecuador, and Panama and has seaports on the Pacific Ocean and the Caribbean Sea. Politically, Colombia has a long history of democratic government and a population of approximately 45 million people. Economically, Colombia participates in the global economy and has strengths in agricultural, industry, and services. In 2006, Colombia had a GDP of $136 billion U.S dollars and a growth

\textsuperscript{271} US Constitution Article 1, Section 7: All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills; Article 1, Section 8, Clause 12: To raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years.

As a result of this constitutional relationship the US State Department describes six ways the executive branch can make foreign policy: (1) responses to foreign events, (2) proposals for legislation, (3) negotiation of international agreements, (4) policy statements, (5) policy implementation and (6) independent action. Additionally, the State Department describes six ways the legislative branch can make foreign policy: (1) resolutions and policy statements, (2) legislative directives, (3) legislative pressure, (4) legislative restrictions/funding denials, (5) informal advice and (6) Congressional oversight. Richard F. Grimmett, ‘Foreign Policy Roles of the President and Congress’, (1999). (Accessed 21 January, 2008) \url{http://fpc.state.gov/6172.htm}

\textsuperscript{271} US Constitution Article 1, Section 7

\textsuperscript{272} US Constitution Article 2, Section 2, Clause 1
rate of 6.8%. In spite of these positive indicators, Colombia is still struggling to overcome a long history of civil and political violence. The following is a brief review of this history.

In 1819, after nine years of fighting, Colombia gained its independence and became part of Gran Colombia. Gran Colombia included the modern nations of Colombia, Panama, Venezuela, and Ecuador. Due to regional differences and the death of its founder Simon Bolivar, Gran Colombia dissolved in 1830. Following a brief period of economic success, Colombia was plunged into a civil war that lasted from 1840 to 1903. This period is notable because it saw the rise of the two political parties that would grow to dominate Colombian politics; the Liberal and Conservative parties. The Liberal Party was supported by the coffee plantation owners, preferred a liberal market economy, and supported federal government. The Conservative Party favored a slow changing economy and a strong centralized government. Although these two parties were at odds throughout the civil war, violence reach a pinnacle during the War of a Thousand Days (1899-1903). The result of this intense conflict cost an estimated 60,000-130,000 lives and helped lead to the loss of Panama in 1903. After the end

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273 US Constitution Article 2, Section 2, Clause 2: He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur.

of the civil war, Colombia enjoyed a period of growth and stability fueled by the expanding commodities market. Since Colombia’s economy was overly dependent on commodity exports like coffee and fruit it was extremely vulnerable to the global forces. Thus, during the great depression of the 1930’s, Colombia was plunged into economic, civil, and political instability. Due to the growing instability and simmering tension between the Liberal and Conservative parties, the country soon experienced another violent conflict.275

La Violencia (1946-64) was a politically motivated conflict between the Liberal-backed guerrillas and the Conservative-controlled state and paramilitary forces. Similar to the War of a Thousand Days, the issue of government control was a principle source of conflict. Although the war had political roots, the control of coffee was an additional source of conflict and provided resources for both the Liberal combatants and the Conservative troops.276 Finally, after 18 years of fighting and the loss of an estimated 300,000 lives277, the two sides agreed to peace and a power sharing government called


276 Merriam-Webster’s Dictionary defines Agenda as: “1. a list or outline of things to be considered or done (agendas of faculty meetings) 2 : an underlying often ideological plan or program (a political agenda)”; Furthermore, although this thesis recognizes the multiple possible agendas such as private (examples: press, think tanks, academics) and public (governmental) and the import influence between the two; this thesis will focus on the ‘official’ agenda of the government. In other words, the list of problems discussed by governmental actors.

the National Front. The National Front government alternated the presidency between the Liberal and Conservative parties and split representation throughout the rest of the government. Although this agreement brought an end to La Violencia, it essentially locked out anyone who was not part of the established system. Thus, the National Front sowed the seeds for the next phase of violence and the rise of the FARC.²⁷⁸

In 1964 Colombia entered a new period of low intensity conflict. This conflict was between the National Front-controlled state and groups that were left out of the power sharing government. Some of the rejected groups became insurgent guerrilla groups and one of these guerrilla groups became known as the FARC. The FARC was established in 1964 by the Colombian Communist Party and the majority of its resources were from local rural communities. Although the early years of the FARC coincided with the development of Colombia’s drug trade, the FARC did not use drugs as a means of support. Furthermore, even with international assistance from sympathizers like Cuba²⁷⁹, the FARC’s supplies were limited and the insurgency remained a small and peasant based force.²⁸⁰


Colombia’s illegal drug industry started slowly in the 1970s with the exportation of marijuana. Soon after, the boom of cocaine in the United States during the 1980s transformed the small Colombian drug operations into powerful international drug cartels with complex supply lines. In the early years of the cocaine trade the Colombian drug cartels imported coca leaves from the Andean region of Peru and Bolivia. The Colombians would then process the leaves and produce cocaine for export.

During the rise of the drug trade, Colombian domestic violence escalated. One of the main sources of conflict was over the control of land. Estates were bought by drug cartels for investments and some land was used for cocaine production. To protect their investments the cartels created paramilitary groups. Since the FARC had a presence in some of the same areas as the drug cartels, conflict ensued and the FARC soon controlled areas of the cocaine industry. Consequently, just as the Cold War was ending and their international support started to dissolve, the FARC stumbled upon a new resource that would change the nature of their decades old insurgency. Ultimately, the convergence between the drug industry, political insurgencies, and organized crime laid the foundation for the next phase of Colombia’s conflict and the development of a globalized drug network.
During the 1990s, the Logistical Revolution quietly converged with the drug trade. The result of this convergence made the act of smuggling easier to conduct and harder to detect. For example, once the FARC sell their drugs to criminal organizations they are able to launder their money locally at money exchange houses, or casas de cambio, within Colombia. This process starts when the FARC introduce foreign currency to a local exchange house. Next, the foreign currency is exported from Colombia and the FARC receive Colombian pesos that they can use locally.\(^{281}\) After the FARC sell their cocaine it is often bound for the East Coast of the United States through the Caribbean. This cocaine is smuggled using advanced speedboats, cargo ships and small aircraft; and passes though the Bahamas, Puerto Rico, the Dominican Republic, Haiti, and Jamaica. Once the cocaine arrives to one of these Caribbean destinations it is then smuggled “to the Florida coast using speedboats, pleasure craft, and fishing vessels.”\(^{282}\) From Florida, the cocaine is then shipped to destinations along the east coast and throughout the United States. Once sold, according to a PBS report, authorities believe proceeds are “laundered through 


\(^{282}\) A general explanation of this agenda is available to the public and can be found in sources such as the 2008 Congressional Budget Justification for Foreign Assistance and a 2003 report prepared by Library of Congress; 1. Congressional Budget Justification, Foreign Assistance and USAID Operations FY 2008 Budget Request Congressional Budget Justification; 2. Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America: A Report Prepared by the Federal Research Division, United States Library of Congress under an Interagency Agreement with the Director of Central Intelligence Crime and Narcotics Center, July 2003.
Another possible scenario involves the FARC, a Colombian cartel, a paramilitary group, and Hezbollah. In 2008, after a two-year investigation by American and Colombian authorities, at least 36 suspects were arrested including Lebanese Chekry Harb. According to the Los Angeles Times, authorities said Harb;

“acted as the hub of an unusual and alarming alliance between South American cocaine traffickers and Middle Eastern militants. Authorities accuse Harb of being a "world-class money launderer" whose ring washed hundreds of millions of dollars a year, from Panama to Hong Kong, while paying a percentage to Hezbollah, which is designated as a terrorist group by the United States and Israel. The suspects allegedly worked with a Colombian cartel and a paramilitary group to smuggle cocaine to the United States, Europe and the Middle East. Harb traveled extensively to Lebanon, Syria and Egypt and was in phone contact with Hezbollah figures. The profits from the sales of drugs went to finance Hezbollah.”

The U.S. started to address this drug trade in the 1980s due to the rise of cocaine use and the popularity of crack cocaine. These efforts became known as the “War on Drugs.” Marc Chernick describes this anti-drug strategy in four phases. Strategy number one (1986-1989) was to “repress peasant farmers and coca fields.” Strategy number two (1989-1995) was the bottleneck or “kingpin” strategy and its goal was to

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attack the cartels that transferred drugs. Strategy number three (1994-2000) was called “the air bridge denial strategy” and its aim was to shoot down airplanes flying from the coca fields in Bolivia and Peru to the processing plants in Colombia. Consequent to this strategy, the Colombians were forced to grow coca leaves domestically. This led to strategy number four, Plan Colombia (2000-2008). Plan Colombia is a multi-year plan that focuses on military aid as well as economic and political assistance. At the start of this strategy the U.S. Government continued to see the drug trade as one separate issue, however, this view would soon change. After the terrorist attacks of September 11, 2001 the U.S. began to see the war on drugs as one military front in a new global war against interconnecting networks of drug trafficking, smuggling, money laundering, and terrorist organizations. Thus, Plan Colombia became part of the wider war on terror. In addition to the four strategies, the U.S. Government has recently applied pressure to the southern flow of drugs. For example, the U.S. Government launched “Operation New Dawn” to interrupt the supply lines of Bolivian drug traffickers along Argentina’s northern border. Furthermore, the U.S. started “Operation

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285 This is based on interviews and a review of budgets and governmental documents.
Alliance” with Brazilian and Paraguayan counter-drug interdiction forces to combat the drug trade in the Triple Border Area.286

This brief overview of Colombia demonstrates how the FARC participate in the globalized Illicit Economic Cycle. The FARC produce large amounts of cocaine, sell it to smugglers who then ship it to market. Once there, the cocaine is sold and the proceeds are laundered. The FARC receive the proceeds from this transition and are able to reinvest in cocaine production and support their decades long conflict.

Similar to the TBA, there are multiple variables that are responsible for driving Colombia's cocaine cycle. Colombia has had a long history of conflict and instability that has weakened the government. As a result, in 2008 the Economist Intelligence Unite described Colombia as a “flawed” democracy.287 In this weakened state corruption has thrived. According to Freedom House, “corruption affects virtually all aspects of public life” and was ranked 59 out of 169 in Transparency International’s 2006 Corruption Perceptions Index.288 Evidence of this corruption surfaced in 2006 when the Colombian military recovered a [computer belonging to paramilitary leader

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287 This is evident when he referenced the U.S. as a “shinning city on the hill” that serves as an example for the world.

“Jorge 40” that revealed a web of financial connections with politicians, as well as records of murder and money laundering.]289 The proximity of Colombia to the demand of the U.S. drug market has made it an ideal location for producing drugs. At the same time, Colombia’s access to sea ports enabled the drug trade to piggyback on an advanced transportation infrastructure. Closing the loop was the globalization of the financial system allowing the FARC and drug cartels to receive their profits.

Studying Colombia is advantageous because it can offer lessons learned that can be used towards the TBA. Although current evidence is difficult to access, it appears Plan Colombia has had recent success. After a decades-long conflict, Colombia is in transition from an almost failed state to a state with an improving democracy, economy and significantly lower levels of violence. For example, since 2006, the Economist Intelligence Unit (EIU) has stated that Colombia’s democracy has been improving and is “near the highest in the region.”290 The EIU cites Colombian President Uribe’s focus on security and democracy as a “likely” force behind this positive trend. The EIU also


“Mr. Bush was the reluctant internationalist, the man who allowed that “we've got to do a lot of work in Africa to promote democracy and trade” and then insisted that America should keeps its troops out of Africa and Haiti, or anyplace else where the mission sniffed of “nation-building.”
states that there has been a 40 percent decrease in murders between 2002 and 2007 as well as an 87 percent decrease in kidnappings during the same time. This improvement could not have been made without the help of Plan Colombia.

There are several lessons learned from this success. The first lesson is that to noticeably improve a complex problem such as Colombia, the U.S. has to fully commit itself. Over the past decade the U.S. has contributed more than 7 billion dollars. This significant amount makes Colombia the 4th largest recipient of U.S. aid in the world.

Another lesson learned is how to disrupt production areas. First, attacking the shipping lanes did reduce production in Peru and Bolivia; however production simply moved to Colombia. Therefore a new approach was developed to attack the production areas themselves. During the initial years of Plan Colombia the vast majority of U.S. aid was for the Colombian military and aerial fumigations were employed. This strategy had limited results and was causing environmental and health problems. In the past few years, however the amount of aid for development programs has increased.


292 Walter Lafeber, “The Bush Doctrine”

Garry Leech from Colombia Journal demonstrates this duel pronged approach in his report on the remote village of La Cooperativa in the La Macarena region of eastern Colombia. In 2006 this small bustling town was a FARC stronghold and was fueled by the cultivation of coca leaves. For years the area had been bombarded by U.S. backed aerial fumigations, however, this did not diminish production. Around this time there was a policy shift away from fumigations towards increasing the State’s presence to provide security and services. In 2007, the Colombian army moved into La Cooperativa and took control. Once the area was secured, the Colombian government put resources into social and economic development. For example, the local school received computers and a generator to run the satellite that provides an internet connection. New farming equipment was also brought in to cultivate cacao, the ingredient used to make chocolate. The town’s population has fallen since it was under the FARC’s control, however, coca production was all but wiped out.294


294 New York Times, ‘Bush Plans to Raise Foreign Aid and Tie It to Reforms’; By Elisabeth Bumiller (March 15, 2002); Another useful article, New York Times, ‘Turmoil in Africa Alters Focus of Bush’s 5-Nation Tour’, By Sheryl Gay Stolberg (February 15, 2008), shows 6 years on policy continuity; “We’ve seen that conditions on the other side of the world can have a direct impact on our own security,” Mr. Bush said”
The transition from cocoa production to cacao production in La Cooperativa has been difficult. First, the farmers received loans from the government to implement the transition in crops however they have not received a subsidy to help survive the few years it requires for their new crops to reach maturity. This has made residents to long for the days of FARC control and they fear they will never make the same amount of money they did with cocoa.

This example of La Cooperativa effort has a few important lessons. First, a government presence that provides security and services can disrupt production. The areas controlled by the FARC lack governmental involvement. In this void, the FARC and the cocaine industry provides jobs and order to society. To have a meaningful impact in these areas, the government must insert itself and proved these basic services. Second, development, and specifically transitioning from illegal to legal production is a slow process that requires resources. If the farmers at La Cooperativa had received a modest subsidy to help them live before their first legitimate harvest, they would be more stable and less likely to support the FARC. Lastly, the government needs to think long term. They need to secure a market and sufficient market value for the cacao so that the farmers can regain the quality of life they once enjoyed while producing coca. An example of how to do this can be found in the European Union’s (EU) peace laboratories. The EU’s peace laboratories were set up in Colombia in 2002
with an 8 year budget of € 42.2 million (approximately 55.5 $USD) and have sought to provide some basic services where the state has been absent. The EU has constructed schools and invested in alternative agriculture such as palm oil and cacao. The EU has also opened their markets to these products.\(^\text{295}\) It is difficult to evaluate the long term success of these laboratories, however the World Bank cites meaningful progress in social and economic development.\(^\text{296}\)

Another lesson learned from Plan Colombia is that the U.S. has allotted substantial resources to disrupt the shipment of cocaine. The U.S. Navy and Coast Guard commonly patrol off Colombia’s Caribbean and Pacific coasts looking for smuggling vessels. For example, on a 2008-2009 deployment the USS Samuel B. Roberts “made five separate drug busts, capturing more than 7.9 metric tons of cocaine, with a street value of approximately $557 million.”\(^\text{297}\) In 1999, on the eve of Plan Colombia, the United States signed a ten year lease to use the Manta air base in Ecuador. Since then the U.S. has spent $71 million to renovate airport and contributes


\(^\text{295}\) International Herald Tribune, “ U.S. Senate panel accuses Bush of Iraq exaggerations”, Friday, June 6, 2008


\(^\text{297}\) NSS 2002
$6.5 million to the local economy. The flights out of this base focus on surveillance and drug interdiction that helped seize $1.1 billion worth of drugs in 2007.

In spite of the apparent success from Plan Colombia there have been some failures that we can learn from. First, Plan Colombia did not decrease the production

298 Specifically, Central and South America, the Caribbean (except U.S. commonwealths, territories, and possessions), Cuba and the Bahamas, and their territorial waters; as well as for the force protection of U.S. military resources at these locations. SOUTHCOM is also responsible for ensuring the defense of the Panama Canal and canal area. [http://www.southcom.mil/AppsSC/pages/about.php](http://www.southcom.mil/AppsSC/pages/about.php)

298 Although most of these fall outside of the Military’s area of responsibility, the CS 18 does address Medical Readiness Training Exercise (MEDRETE)

“This year (2007), the U.S. will conduct 65 MEDRETEs in 15 countries throughout Central and South America and the Caribbean, at an estimated cost of nearly $3 million. Last year, these figures were similar, as the U.S. spent nearly $3 million and conducted 70 exercises in 18 separate countries. Combined, the MEDRETEs will provide medical care to more than 200,000 individuals – in many cases the only professional medical care they will receive.” MEDRETEs provide medical aid, foster international relations. Jan 26 2007 [http://www.southcom.mil/AppsSC/news.php?storyId=84](http://www.southcom.mil/AppsSC/news.php?storyId=84) accessed 19 Nov, 2008.

299 This thesis makes this division with caution since some of the ‘traditional’ aid is also based on conditions. Additionally, this aid should not to be confused with US backed IMF/World Band assistance that often comes with separate conditions. Furthermore, similar to the overlap of problems, there is also an overlap between these two implementation areas. Regardless, there is sufficient evidence of a division and it enables an analysis.
or the “overall flow of narcotics into the U.S.” What did happen is commonly referred to as the ‘balloon effect.’ To visualize this effect, image holding a small balloon in your hand. If you were to gradually squeeze the balloon, the air inside would move to areas of lesser pressure. In the end, there is an equal amount of air, but it is just in a different place. The most obvious application of the balloon effect has to do with coca production. For example, as a result of the air bridge strategy, coca production in Peru and Bolivia declined; however, production consequently grew in Colombia. It appears that the balloon effect concerning cocaine might have occurred again and sifted production to another location. Evidence of this shift can be seen in the increased use of cocaine paste called paco/crack in the southern cone of South...

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Another example: “The Ministry of Industry and Commerce’s Specialized Technical Unit (UTE), working in close coordination with the Attorney General’s Trademarks and Intellectual Property Unit, has effectively opened a number of significant investigations against groups involved in piracy.”; United States Department of State Bureau for International Narcotics and Law Enforcement Affairs International Narcotics Control Strategy Report, Volume II, Money Laundering and Financial Crimes March 2007

Another Example: “The U.S. Government is funding a training project through which U.S. Department of Justice and U.S. Department of Homeland Security officials will train prosecutors, police, and customs officials from the Tri-Border Region to combat intellectual property crime.”; 2007 SPECIAL 301 REPORT, The “Special 301” Report is an annual review of the global state of intellectual property rights (IPR) protection and enforcement, conducted by the Office of the United States Trade Representative pursuant to Special 301 provisions of the Trade Act of 1974.

301 Overview of the Congressional Budget Justification, Foreign Assistance and USAID Operations, FY 2008
The paste is the substance left over from cocaine production and it is laden with chemicals. Since the paste has not historically been exported from traditional cocaine producing areas, the recent explosion of paco/crack use in the southern cone might indicate new cocaine production facilities located in more southerly parts of South America. Another indication of the shift in production is that in spite of record levels of eradication and seizures, the overall flow of drugs in the U.S. has remained steady. Besides a shift in production, the last few years has seen a shift in shipping routes. The level of estimated traffic through the Caribbean has declined while the “smuggling via the U.S.-Mexico border, particularly in South Texas, remains very high.” This shift has sparked a surge in drug trafficking and violence within Mexico and along the U.S. border.

The cause for this shift in production and shipping, and consequent steady supply of drugs that reach generation areas, is the failure of U.S. policy to address the problem

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302 There are currently 17 indicators used for eligibility.


304 NSS, “The form that freedom and democracy take in any land will reflect the history, culture, and habits unique to its people.”

305 Overview of the Congressional Budget Justification, Foreign Assistance and USAID Operations FY 2008 Budget Request
systematically. The U.S. led policy has shown progress in reducing violence and disrupting production areas within Colombia and has achieved impressive gains in intercepting shipments, however, several variables have remained largely un-addressed. Secretary of State Hillary Clinton recently acknowledged this failure and stated that the U.S.’s “insatiable demand for illegal drugs fuels the drug trade.”

Addressing how the U.S. should solve domestic demand is beyond the scope of this thesis, however any future debate must resolve this variable before any sustainable solution is achieved.

Another lesson learned is the need to control the shipping infrastructure that drug smugglers use. This includes both the inherently legal shipping paths on-board traditional shipping vehicles as well as the underground shipping paths that flow outside the legal system. A General Accounting Office 2000 report “noted that at the seven busiest ports of entry along the Southwest Border, 14 percent to 47 percent of commercial vehicles underwent a detailed inspection for narcotics”; and only 1 to 6 percent of all cargo entering the United States is inspected. The U.S. government has

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306 Millennium Challenge Corporation (MCC) Threshold Quarterly Report, Paraguay, November 2007


recognized this and in 2007 it passed an act requiring 100 percent inspection of all passenger aircraft cargo by 2010 and maritime cargo entering the United States by 2012. The goal of this policy has yet to be met.

Additionally, the U.S. policy should take a muti-national approach. The U.S. policy currently does this, however, recent political conflicts with countries such as Bolivia, Venezuela and Ecuador have prevented the U.S. from implementing a truly regional strategy. Until this is resolved, the criminal activity will simply be pushed (and pulled) into these areas. For example, in 2007, Peru experienced a 4 percent increase in coca cultivation and its “estimated cocaine production rose to a 10-year high of about 290 tons, second only to that of Colombia.”

In sum, Colombian cocaine and the FARC participate in a globalized Illicit Economic Cycle of production, shipping, generation, placement, layering and integration. The forces driving this cycle have been the variables of history, culture, geography, flawed institutions, corruption, supply and demand, technological advances


310 Coronelismo, rule of the Colonel, started in the times of colonization in Brazil and gained dominance during the first Republic (1889-1930) of Brazil. These Colonels comprised the local agrarian oligarchy and were part of a parton-client system between the national administration, state governors local Colonels. The Colonels were land owners and controlled their local population. Their leadership style was authoritarian.
in shipping and telecommunications, and offshore havens. A recent commitment by the U.S. and Colombian governments has addressed this cycle and forces with modest success, however, the overall goal of diminishing the drug trade has not been met. To reach this goal, the U.S. must lead an effort to apply adequate pressure to all parts of this cycle and forces, or else the drug trade will simply ‘pop up’ someplace else and the flow of drugs will continue. Based on these lessons, this thesis will now describe and analyze the U.S.’s TBA policy.

Chapter III. Summary and Analysis of U.S. TBA Policy

As previously described, the United States Government has had a long history of involvement in the TBA. This involvement started slowly over a hundred years ago and became more profound during World War Two and the Cold War. The U.S.’s TBA policy today is rooted in the Bush Doctrine. The Bush Doctrine is a term used to describe President George W. Bush’s foreign policy principles created in the aftermath of the September 11, 2001 (9-11) attacks. Although there is no single document that encompasses the Bush Doctrine, its foundation is the 2002 National Security Strategy (NSS). The three key principles of the NSS are the proactive use of the military, diplomacy and development. These principles guide the U.S.’s TBA policy. In spite of
this aggressive policy, crime in the TBA still persists. The goal of this chapter is to
determine why this policy has failed. To reach this goal this chapter summarizes U.S.
policy development, analyzes the U.S.’s TBA policy and offers predictions for the
future.

United States policy is a complex process. It involves a large group of actors
and changes under different economic/geo-political situations. For this reason, a wide
variety of theories have attempted to explain U.S. policy. In general, these theories tend
to focus on domestic policy and the initial stages of policy development. Furthermore,
these theories discuss the roles of actors both inside and outside the government; and
identify the sequence of events and/or elements required for policy development. As a
result, a murky picture quickly develops. To clarify this picture and establish a base to
better understand the U.S.’s current policy in the TBA, the following is a review of
four policy theories/explanations; Constitutional View, the Garbage Can, Public Policy

At the core of the United States Government’s foreign policy is the U.S.
Constitution which separates foreign policy powers between the executive (President)
and legislative (Congress) branches. Although the powers are divided, they are not
exactly balanced since the President is the clear leader of US foreign policy. For
example, while the Congress has important budgetary and oversight powers; the president is the Commander in Chief of the armed forces, has the power to make treaties, and “serves as the official spokespersons for American foreign policy.” Although this explanation of foreign policy is an excellent description of the executive and legislative roles, it does not capture the full reality of the policy process. For example, the role of the actors involved is not always clear since there are multiple ways the executive and legislative branch can initiate or form foreign policy. Furthermore, there is considerable overlap between these two bodies and their influence/dominance has fluctuated throughout history. Additionally, this view does not describe the role of specific actors within these branches such as federal bureaucracies, actors/groups outside the constitutional executive-legislative structure such as the

311 “The Economist Intelligence Unit expects the global financial crisis to have a strong negative impact on Brazil’s economic activity in the first half of the outlook period. We now expect real GDP to contract by 1.5% in 2009, before it recovers modestly to 2.7% in 2010. The 3.9% average annual growth projected for 2011-13 is significantly weaker than the 4.5% average of 2004-08.” [http://www.economist.com/countries/brazil/profile.cfm?folder=Profile-Economic%20Data]

The Economist Intelligence Unit, Argentina Country Profile 2003


“Argentina, for example, has put new licensing requirements on auto parts, textiles, televisions, toys, shoes and leather goods that create a new layer of bureaucracy for overseas exporters.”

313 World Health Organization, “Addressing the global economic crisis while fighting inequalities”, Copenhagen, Oslo, 2 April 2009

“Evidence from previous crises suggests that alcohol and drug use, as well as mental illness, could increase.” [http://www.euro.who.int/mediacentre/PR/2009/20090402_1]
judiciary, the press, the public, special interest groups or foreign governments. Ultimately, the constitutional view is a good first step to understanding U.S. foreign policy, however a more in-depth explanation is required.

The Garbage Can model addresses a decision making process in a complex organization. In general, the theoretical base of this model uses a non-linear way of describing decision making. An example of the ‘linear’ process starts with a specific problem. Then, there are decision (policy) alternatives that are generated to address the problem. Next, the consequences of the potential decisions (policies) are evaluated. Ultimately, a finally decision (policy) is selected. Thus, contrary to a linear model, the Garbage Can model separates the elements of the decision process into four independent ‘streams.’ These streams are problems, solutions, choice opportunities, and participants.

In this model, problems are similar to problems in linear policy models. Problems are mostly independent and can be generated from inside or outside the organization and all require attention. For example, problems could be corruption, money laundering or drug trafficking. Next, solutions in this model are strikingly different from a linear model since solutions are generated independent of the problems. In other words, solutions are looking for a problem and not problems looking to be solved. For example, a military arms company develops a way to destroy
intercontinental ballistic missiles (ICBMs) launched towards the US, although no threat exists. Consequently, in order to sell their product, the company seeks to convince members of Congress that a ‘rogue’ state has the ability and intent to attack the US. Next, choice opportunities are when decisions are made by actors because they feel required to make a decision regardless of the need to solve a genuine problem. For example, a new manager is working in a well running department, however, to get noticed the manager must make a ‘decision’. Therefore, the manager decides to replace a well functioning program with a new program to show he/she is an agent of positive ‘change’. Lastly, participants ‘come and go’ and can change the decision process. Furthermore, a participant might ‘carry around’ a set of problems or solutions to which they are partial. For example, a manager might like to make decisions based on committee and consensus. Moreover, the new manager can change the structure of a decision making process and consequently potential outcomes.

Diagram 5: Garbage Can Model
Lastly, this model is described as a ‘garbage can’ because each stream is independent from each other and they are not time dependent. For example, organizations produce ‘solutions’ which are thrown away due to a lack of problems. Later, appropriate problems may develop and thus solutions maybe retrieved from the ‘garbage’. Ultimately, this model address that reality that in organizations (such as bureaucracies) the decision making process is not always linear and not always motivated by the need to solve pressing problems.

The Constitutional View and the Garbage Can Model give particular attention to the actors involved, the process and the elements required for developing policy. Unfortunately, they do not address how to administer, or implement the policy. Furthermore, they do not discuss how to evaluate the intended outcomes such as the policy’s products, results or impacts. Consequently, there seems to be a division between the ‘development’ of policy and the ‘administration’ of policy. Although this thesis recognizes the inherent differences between these two ideas, this thesis argues that ultimately they should be considered together as one ‘whole’ in order to have an effective and continuous problem solving process.

The Public Policy Cycle is a good framework when considering the entire policy process. The Public Policy Cycle model has five basic stages; problem definition

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(agenda setting), policy formation, decision making (policy adoption), implementation and policy evaluation.

Diagram # 6: Public Policy Cycle

This thesis proposes another way to visualize the first three stages of this process.
Although the policy cycle is continuous, it generally starts with identifying the problem and setting the agenda. Thus, there is a pre-stage where an unlimited number of problems already exists and requires governmental intervention. The goal of the pre-stage is to understand the problem, or ‘raw material’, without looking through a biased lens. Although any reporting by a public or private entity is subject to its own inherent bias, it is important to look at many sources in order to obtain the closest picture of the ‘true’ problem.

Next is Agenda Setting (Problem Definition). This stage addresses the selection of a specific problem out of all possible problems. This selected problem will
ultimately be put on the government’s agenda. Once on the agenda, the problem will be considered for possible action or become part of an ideological plan or program. In a perfect scenario, the problems placed on the agenda would be identical to the raw problems. Since the officials creating the agenda are often driven by their own ideological agenda or by the institutional realities of combating those problems, nevertheless, the problems placed on the agenda may not represent all of the raw problems. In other words, some problems will be left off the agenda. Furthermore, since there is human interpretation, there is also likelihood that the definition of these problems will not reflect the 100% reality of the raw problem. This is arguably the most important stage of the entire policy cycle because it will determine the subsequent policy stages. Moreover, if an existing problem is left off the agenda, governmental action is unlikely.

Next is the Policy Formation stage where a policy, or plan, is developed with the goal of solving a problem from the agenda. In other words, it is the process of deciding in advance what to accomplish and how to accomplish it. Specifically, there is a strategic approach and the policy’s mission and goals are established. Next, the policy narrows to specific objectives, benchmarks, and tactical elements can also be proposed. For example, the policy can give details on schedules, budgets, controls and methods for measuring success. Also, policy starts to transition from strategic to
tactical planning. It is important to note that the emphasis is on effective policies that are also cost effective. Furthermore, multiple policies can be formulated that address the same problem. Next, the Policy Adoption Stage (Decision Making) is where a specific policy is selected from a group of possible choices and formally adopted by the government.

Once the policy has been chosen it is then implemented. During this stage there is further planning at the agency level on how to implement the policy such as the creation of a budget and the distribution of tasks. At this point, it is important to take into consideration the structure/elements of the bureaucracy that are in charge of implementing the policy. For example, the recruitment of personal, management of resources and the structure of planning are directly connected to the outcomes of the policy. Policy evaluation is where the products, results and impacts are analyzed for efficiency and effectiveness. In other words, the policy process is evaluated to see if the original policy’s mission, goals and objectives are being met. Lastly, after the policy has been evaluated the implementation can be refined to better meet the goals of the policy or the policy cycle can start over again.

This five stage cycle is not without controversy since some critics believe this model is too generic and simplified to describe a complex and dynamic process. Furthermore, some believe this model is ‘unrealistic’ since the stages often overlap and
that the reality of the public policy process has too many factors. For example, some authors have identified up to eighteen stages and sub-stages of the policy cycle.

     Kingdon’s Policy Stream Approach is based on three individual streams; Problem Stream, Policy Stream, and Political Stream; and a window of opportunity. The problem stream, similar to the problems found in Garbage Can model and the Public Policy Cycle, is based on real world problems and past governmental actions. The policy stream is where a policy (or plan) is developed with the goal of solving a problem. This is also similar to the policy formation stage of the Public Policy Cycle and the solutions stream of the Garbage Can model. Lastly, multiple policies can be formulated by different sources, such as think tanks, that address the same problem. The Political Stream is composed of politicians influenced by elections and leadership contests. In this stream the U.S. President has the leading role regarding foreign policy. This leading role is granted in the U.S. Constitution and has evolved over time. For example, according to Robert F. Durant and Paul F. Diehl, Congressional “members historically deferred to presidential prerogatives amidst a general feeling during the Cold War that disagreement could threaten national security or even be treasonous.” The President also has enormous power over federal agencies and can even bypass them during the policy development process. For example, President Ronald Reagan's Star Wars speech changed the foreign agenda without consulting the Secretaries of
State or Defense. Kingdon proposes that a policy reform happens when a “window of opportunity” joins these three streams. Essentially, policy is not initiated until a “window” forces action. The flaw in this model is that it is “decidedly non-incremental in nature” and does not take account for the prolonged process of policy development.

Diagram #8: Kingdon’s Policy Stream Approach (original diagram based on Kingdon’s Approach)

The Constitutional View, the Garbage Can, Public Policy Cycle and Kingdon’s Policy Stream Approach provide important insight into different ways policy is developed, implemented and evaluated. Each of these models also shed important light on the U.S’s TBA policy. The following analysis will use these models, however Kingdon’s Policy Stream Approach is used as the main framework because of its description of outside forces and window of opportunity.
The Problem Stream can be traced back throughout the TBA’s history. From colonial times, to independence, to dictatorships, and globalization; this thesis has shown the importance of history and the problems that currently plague the TBA. To summarize, the most recent problems prior to the 9-11 attacks were governmental corruption, drug trafficking, arms trafficking, counterfeit products trafficking, money laundering, document forgery, trafficking in persons, intellectual property rights
violations, and terrorist fundraising. There were problems outside the TBA that also contributed to the problem stream. For example, the 1990s embassy bombings in Kenya and Tanzania, the 1993 World Trade Center attack, the attack on Israeli institutions in Argentina and the 2000 bombing of the USS Cole were all part of a long series of problems leading up to the TBA policy and the larger Bush Doctrine.

In the political stream, although the President (and lesser extent Congress) dominates the setting of the U.S.’s foreign agenda, there are additional minor actors involved. For example, “interest groups, the media, and public opinion are significantly less involved in the agenda setting and alternative specification phases of the agenda process.” One of the reasons these actors play a diminished role is because the redistribution of wealth is less for them in foreign policy compared to domestic policy. There are, however, two notable exceptions related to the TBA; U.S.-based multinationals and foreign governments. U.S. based multinationals appear to have a considerable amount of influence when determining the U.S.’s agenda in the TBA. For example, the entertainment and computer industry lose hundreds of millions of dollars annually in the TBA due to piracy. At the same time, intellectual property rights is one of, if not the highest, priority of U.S. counter-crime efforts. Consequently, it can be inferred that these companies have pressured the U.S. government to help combat their losses. Since Paraguay is one of the poorest countries in South America, it is in
Paraguay’s interest to lobby the U.S. for economic aid. One of the ways to ensure this aid is to show how the TBA (and thus Paraguay) fit into the U.S.’s global priorities. For example, Paraguay has tried to demonstrate that it is a willing partner in the U.S.’s global war on terror.

In the policy stream there is little evidence of different TBA policies prior to the 9-11 terrorist attacks. This deficiency is likely due to the fact that the TBA was not high on the U.S.’s agenda. Therefore, this thesis looks at the broader U.S. policy stream prior to 9-11. This stream tends to be divided into two general camps. The first camp calls for a more proactive approach towards foreign policy and security, while the other camp argues for a cautious and withdrawn approach. Other parts of this debate included democratic peace theory which promotes spreading of democracy by arguing that democracies do not go to war against each other; and American exceptionalism, which is the belief that the United States is a superior country and serves as a model for the rest of the world. Over the past few decades this debate was played out on the international stage from one U.S. administration to the other.

The Reagan Doctrine called for a proactive policy of engaging the “Evil Empire” of the Soviet Union and communist insurgencies across the globe. The result of this doctrine led the U.S. to become covertly involved in ‘proxy wars’ in Afghanistan, Nicaragua and El Salvador. Reagan also believed in the spread of
democracy and American superiority. The international context started to change under President George H. Bush who saw the fall the Soviet Union. At this time, another policy option was introduced by Colin Powell when he was chairman of the Joint Chiefs of Staff. The Powell Doctrine is a series of questions prior to committing US forces to war and questions on how to wage that war. In short, the doctrine calls for “clear objectives and the use of overwhelming force to achieve them.” President Bush followed this doctrine when he led the U.S. into the first Gulf War (1990-1992). During this war Bush also followed multilateralism by building a multi-nation coalition. The election of President Clinton marked a shift in U.S. foreign policy. Clinton inherited a world where the U.S. was the only superpower and the large scale threats of a Soviet type army were greatly reduced. In this environment Clinton followed a doctrine of smaller scale engagement based largely on humanitarian and regional stability concerns. When George W. Bush was running for election in 2000, he appeared even more reluctant to get involved overseas. During the campaign he said the U.S. should not get involved in ‘nation building’ and in a debate with Al Gore, Bush said:

"I'm not so sure the role of the United States is to go around the world and say, 'This is the way it's got to be,' "... "I just don't think it's the role of the United States to walk into a country, say, 'We do it this way; so should you.' "

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On the eve of 9-11 there were several different ideas on U.S. foreign policy. Some called for U.S. leading the world and becoming involved internationally. Others advocated a more limited role and a focus on domestic issues. After 9-11, President Bush would pull from a few of these ideas and ignore others.

Joining the problem, political, and policy streams was the ‘Window of Opportunity’ created by the attacks on 9-11 and the environment of fear during their aftermath. There is no definitive timeframe for this window, however during this time the conditions enabled the adoption and implementation of the Bush Doctrine. Since foreign policy is led by an individual President, the formulated policy can easily take on the traits of that President’s ideas and beliefs. This is interesting because the President’s reluctance to get involved internationally before 9-11 was quickly replaced by a proactive policy based preemption, military primacy, the spread of democracy and unilateralism. There are several sources of this new policy. The first source is from the policy stream described above. For example, according to Walter Lafeber, this unilateralism was based on Bush’s belief in American exceptionalism. Another source of this new policy direction was from Bush’s closest advisors; Vice President Dick Cheney and Defense Secretary Donald Rumsfeld. The Cheney Doctrine, or One Percent Doctrine, states that “threats with even a 1% likelihood must be treated as certainties.” This hyper-action contributed to the U.S.’s willingness to use its military
even with limited evidence of a threat. Michael E. O'Hanlon describes the Rumsfeld Doctrine;

Nation-building and peacekeeping are out. Possible pre-emptive attacks against Syria, Iran and North Korea are in. Long-term hegemonic competition with China is likely. Future warfare will be characterized more by space, missile, naval and air power operations than by the ground armies of old...[Sources] also suggest that the doctrine of overwhelming force espoused by Colin Powell, secretary of state, will soon be replaced by a new Rumsfeld doctrine emphasising high technology, special operations units and sheer brainpower to defeat future foes.

President Bush displayed these policy beliefs during the development of the Bush Doctrine. The Bush Doctrine is based on President Bush’s 2002 (and 2006 revision) National Security Strategy (NSS). This policy lays out nine “essential tasks”;

1. Champion Aspirations for Human Dignity
2. Strengthen Alliances to Defeat Global Terrorism and Work to Prevent Attacks Against Us and Our Friends
3. Work with Others to Defuse Regional Conflicts
4. Prevent Our Enemies from Threatening Us, Our Allies, and Our Friends with Weapons of Mass Destruction
5. Ignite a New Era of Global Economic Growth through Free Markets and Free Trade
6. Expand the Circle of Development by Opening Societies and Building the Infrastructure of Democracy

7. Develop Agendas for Cooperative Action with the Other Main Centers of Global Power

8. Transform America’s National Security Institutions to Meet the Challenges and Opportunities of the 21st Century

9. Engage the Opportunities and Confront the Challenges of Globalization

The NSS highlights the importance of regional coordination and pledges to support partners’ military, law enforcement, political, and financial tools. The backbone of this international coordination is integrated intelligence. Moving away from traditional security themes, the NSS discusses the importance of using international development as a tool to promote U.S. national security by addressing “underlying conditions that spawn terrorism.” Specifically, the NSS proposes the promotion of economic growth, labor, health, education, and agriculture development. The U.S.’s involvement in international development and assistance is not new, however, the NSS did make a departure from previous development by tying assistance to specific reforms and “measurable results to ensure that development assistance is actually making a difference in the lives of the world’s poor.” One result of this new
way of thinking was the creation of the Millennium Challenge Account. The roots of Millennium Challenge Account can be traced back to March, 2002 speech by President Bush when he called for “a new compact for global development, defined by new accountability for both rich and poor nations alike. Greater contributions from developed nations must be linked to greater responsibility from developing nations.”

Although this development policy might not seem directly related to U.S. security, President Bush has frequently linked U.S. foreign aid to the ‘eradication’ of terrorism. The US Patriot Act is another example of the Bush Doctrine. This act was signed into law on October 2001 and gave the U.S. government sweeping powers in surveillance, anti-money-laundering, border security and terrorism investigation.

President Bush relied on this doctrine during the build up to the Iraq War. For example, President Bush described the pending conflict as an issue of American security and the need to spread freedom and democracy in the Middle East. It is even argued that he believed in this end so much that he and his aides “built the public case for war against Iraq by exaggerating available intelligence and by ignoring disagreements among spy agencies about Iraq's weapons programs and Saddam Hussein's links to Al Qaeda.” During this time there is little evidence of alternative policies being proposed. One alternative view, however, came from Secretary of State Colin Powell. In the months leading up to the Iraq war, Secretary Powell served as
Bush’s pitchman leading the debate for invading Iraq. Privately, however, Powell offered an alternative to war. In a 2007 article by The Sunday Times, it is reported that “[the former American secretary of state Colin Powell spent 2½ hours vainly trying to persuade President George W Bush not to invade Iraq and believed conflict could not be resolved by US forces.]” Ultimately, Powell’s proposal failed to sway President Bush and Powell continued his public push towards implementing the Bush Doctrine in Iraq.

Ultimately, the terrorist attacks of 9-11 and the fear left in their aftermath gave President Bush and his close team of advisors the ability to enact the Bush Doctrine. Although this policy is sweeping and is aimed at the entire globe, there are some specific proposals that have a direct connection with the TBA. First and foremost, the NSS says the U.S. will engage terrorist cells in South America, although the NSS does not cite a specific country or location where they believe these cells are located. Second, the NSS addresses terrorist organizations ‘global reach’ and proclaims the US will attack these organizations material and financial support networks. Specifically;

The United States will continue to work with our allies to disrupt the financing of terrorism. We will identify and block the sources of funding for terrorism, freeze the assets of terrorists and those who support them, deny terrorists access to the international financial system, protect legitimate charities from being abused by terrorists, and prevent the movement of terrorists’ assets through alternative financial networks.
Turing to a regional focus, the United States Southern Command (USSOUTHCOM), is a unified Combatant Command in the Department of Defense that is responsible for providing contingency planning, operations, and security cooperation for Latin America. USSOUTHCOM’s ten year strategy, Command Strategy 2018 (CS 18), provides a strategy for Latin American and follows the national guidance set forth in the NSS, National Defense Strategy, and National Military Strategy. The goal of this strategy is to “build relationships and work cooperatively together in the context of both interagency and international activities to ensure security and enhance stability through a strong partnership for the Americas.”

The CS 18 demonstrates a clear understanding of the importance of the region and the challenges, goals, and objectives. Furthermore, the CS 18 outlines the resources and steps for completing this strategy. More importantly, the CS 18 describes and ‘holistic’ approach to the regions problems and the need for an interagency and international approach. Specifically, the CS 18 sees beyond traditional security elements and addresses poverty, health, inequality, corruption and the role of governments and democracy. Nevertheless, the CS 18 also shows the realities of a post 9-11 world. Frankly, to receive adequate funding and attention, the region must be framed within the global war on terror. Thus, the CS 18 gives considerable attention to drug trafficking, narco-terrorists, and terrorism.
Addressing the TBA, the U.S.’s involvement is mostly in the form of financial and advisory support. This financial support can be divided into two general areas. The first area describes the traditional type of assistance that is given by the U.S. government. In general, this aid is given by a wide range of agencies and is normally in the form of a grant, a loan and/or technical assistance. The second type of support comes from the Millennium Challenge Account which is relatively new and gives support based on prerequisites and evaluations.

Determining the exact amount of traditional U.S. support for the TBA is difficult since it includes three different recipient countries, multiple U.S. agencies and the potential for secretive funding/operations. To help simplify this complexity, the published support for Paraguay serves as a good proxy in determining U.S. support to the TBA. Fortunately, there is a wide range of budgets and reports of implementation by several U.S. agencies working in Paraguay. For example, there are budget and operational information by the Drug Enforcement Agency (DEA), State Department, Agency of International Development (USAID), and the Department of the Treasury. Unfortunately, having multiple agencies makes determining the exact type of support in Paraguay foggy since there might be overlap, re-wording or double statements between the different agencies. For this reason, the Overview of the Congressional Budget Justification, Foreign Assistance and USAID Operations (FY 2008), will be
used because it gives an excellent broad overview of U.S. support in Paraguay and sheds light on how the US implements its policy. Within this report there are four main objective areas: Peace & Security, Governing Justly & Democratically, Investing in People, and Economic Growth. The total amount of U.S. support for 2006 was 10.3 million dollars. Under the umbrella of these four objective areas, the U.S. government focuses on providing financial support, training, equipment and technical assistance to improve governance practices, fight against drug trafficking, property rights violations, human smuggling, money laundering and sponsor ‘projects to combat public corruption.’

For example, the U.S. Government set up special units to investigate trade. These Trade Transparency Units (TTUs) are comprised of US Governmental officials from the US Departments of State and Treasury that work with local governments to study trade related data for irregularities that could single corruption, document fraud, tax evasion, smuggling or money laundering. Furthermore, the US Government has provided “funding and logistical assistance for the creation of Paraguay’s first Intellectual Property Rights (IPR) manual, which provides standard guidance to prosecutors and judges who handle IPR infringement cases.” Another example of support is the US’s Department of Justice Resident Legal Advisor who was sent to help develop Paraguay’s legal infrastructure for prosecuting terrorist financing.
Besides this standard support, Paraguay is also part of the U.S.’s Millennium Challenge Account (MCA). This account was established in 2004 and is run by the Millennium Challenge Corporation (MCC) which is a United States Government corporation. The goal of this account is to promote ‘sustainable economic growth’ through incentive based aid. The criteria for eligibility is based on the categories of good governance, economic freedom and investments in people. In short, to receive assistance from the MCC a country must pass a threshold on independent policy indicators such as Civil Liberties (Freedom House), Trade Policy (Heritage Foundation) and Government Effectiveness (World Bank Institute).

Although Paraguay does not yet meet all of the requirements to receive a full MCA aid package, it has demonstrated enough progress that it recently signed a “$34.65 million Millennium Challenge Corporation Threshold program to initiate a multi-sectoral attack on corruption and create conditions conducive to economic growth and business development.” Through this program, Paraguay will receive assistance in ten specific areas including the strengthening of border and customs controls and the formalization of the registration of business in the TBA.
Conclusion:

At first glance the U.S.’s TBA policy appears to address a majority of the variables and the Illicit Economic Cycle. For example, this policy attempts to address weak institutions, corruption and the local criminal infrastructure. A closer look, however, shows several flaws. Drawing on the experience of Colombia, this thesis has several lessons learned and proposals to address these flaws.

The first major flaw is the lack of a coherent policy. The first part of a coherent policy is that the TBA’s Illicit Economic Cycle and associated variables need to be addressed systematically. There are two ways to approach this system for the TBA. The first approach is to apply sufficient pressure to each part of the Illicit Economic Cycle and variables. The NSS does a good job of viewing national security from this system-wide view by going beyond traditional security capacities to include the need for diplomacy, a stable economy and international integration. I am especially impressed with the considerable amount of attention the NSS gives to social and economic development. The NSS also admits that each individual problem requires a specific response, in other words, one size does not fit all. There are, however, some aspects of the NSS that are worrisome for the TBA. First, the NSS sees U.S. national security mostly through the prism of the ‘war on terror’ where the enemy is Islamic extremists. Little attention is paid to threats outside this view. For example, the NSS hardly
mentions criminal organizations that are non-ideological, political insurgencies or growing nationalism. Although the NSS does a good job of working toward a systematic approach, there is a disconnect between the relatively coherent global/regional approach and the TBA specific policy. To fix this, the U.S. needs to apply sufficient pressure to each part of the Illicit Economic Cycle and variables. In other words, surround the ‘balloon’ on all sides and apply equal pressure, slowing squeezing it until it pops. This approach is more likely to produce a sustainable solution, however it would require a serious financial commitment from the United States.

The second approach is to completely destroy one of the Illicit Economic Cycle’s stages and thus stop the cycle from perpetrating. For example, the generation capability of the TBA must be neutralized or the shipping capability in and out of the TBA must be cut off. This approach has one major advantage; this will allow governments to focus their resource on one area in hopes of stopping the entire system. One potential drawback to this approach is that it can cause a balloon effect, simply pushing the illicit activity into another area where the destroyed phase can be reproduced. Drawing on the lessons learned from Colombia, it is very difficult to completely destroy one part of this cycle. The U.S. did have limited success with its air-bridge strategy, however the balloon effect simply moved production to new areas. If the U.S. managed to destroy part of the cycle in the TBA, this balloon effect would
be less likely to occur because the TBA has several special variables that cannot easily be reproduced in another area.

The current U.S. approach to the system does not sufficiently follow either one of these policies. This may be due to the fact that the U.S. is unable or unwilling to make the financial commitment necessary to truly end crime in the TBA; and thus its efforts are simply tokens. Regardless of the reason, the U.S. floats in-between applying focused pressure and system-wide pressure.

Similarly, the second part of a coherent policy is having a unified policy. Simply put, the U.S.’s TBA policy is a hodgepodge of multiple policies from the global, regional and local levels written by several different governmental agencies. This fragmentation makes it extremely difficult to determine the level of commitment to the problem. Based on the Foreign Assistance and USAID Operations FY 2008 Budget and the Millennium Challenge Account funding the U.S. has recently committed around 50 million dollars to the TBA. Compare this figure to Afghanistan or Colombia and it is clear that the TBA is not a priority for the United States. SOUTHCOM’s CS 18 demonstrates a clear understanding of this reality. Since, the region is not a global priority of the U.S. Government and the U.S. Government is not likely to act unilaterally in the region, the CS 18 focuses on aspects that it can control such as improving regional integration and the reliance on intelligence.
The policy fragmentation also makes it difficult to have a reliable policy evaluation. United States foreign policy focuses on ‘traditional’ type of aid that are generally divided into four areas; *Peace & Security, Governing Justly & Democratically, Investing in People,* and *Economic Growth.* The reality is that these four areas are very complicated and dynamic and thus it can be difficult to analyze the ‘cause and effect’ of specific policies. More specifically, correlation does not equal causation since other non-policy/support variables might be causing a specific outcome. The Millennium Challenge Corporation (MCC) assistance is a little different and is targeted to areas that are measurable by independent sources. Although it is still difficult to determine a direct ‘cause and effect’, having 17 specific indicators of performance enables a better evaluation of the effects of policy. For example, one of the 17 indicators is ‘Business Start Up’ measured by the International Finance Corporation (IFC) which is a member of the World Bank Group. Since the MCC started to supply resources to Paraguay, “the number of days to start a business has been dramatically reduced through regulation, and the Government of Paraguay is now working to change the laws further to simplify some of the time-consuming local requirements.” Although the MCC does have ways to evaluate some policy programs, it does not directly address the TBA.
Since drugs in the TBA are a major concern for the U.S. government, one way to evaluate success is by the amount of narcotics confiscated by authorities. In 2006, Paraguayan authorities, with the support of the United States, seized 493 kg of cocaine, 58,671 kg of marijuana, 39 vehicles, three boats, one farm, and three planes. The authorities also destroyed 1,202 hectares of marijuana. Consequently, according to authorities, the total financial loss to narcotics traffickers was over $39 million.

Another example involves the Trade Transparency Unit’s (TTUs) efforts to combat smuggling by issuing “more than 128 arrest warrants and numerous search warrants were simultaneously served in 238 locations in Brazil.” Unfortunately, evaluating policy by this method is flawed since there is no exact way to determine the amount of drugs or contraband transferred through the TBA. For example, seizures could be increasing, however at the same time, the overall amount of illegal products transferred through the TBA could also be increasing. Consequently, the overall flow drugs/contraband can remain the same or even grow in the face of increased governmental seizures. Ultimately, it is difficult to evaluate the implementation’s impact on the policy’s mission, objectives and goals since seizures can reflect patterns of increased crime and not improved enforcement.

Moving beyond a coherent policy and looking at the specifics, the U.S.’s has not adequately addressed the production, generation and placement phases within the
TBA. The current limited aid focuses on addressing these concerns indirectly by improving local institutions through funding and technical assistance, however Colombia’s experience demonstrates that in order to have a noticeable effect in a geographical area, there needs to be an active state occupation providing security, services and economic alternatives. By most accounts an accountable state presence in the TBA is still very limited. For example, there has not been a push to create jobs in the legal sector so the illegal economy is still the only game in town. Luckily, The TBA is not plagued by violence and physical security is not a major problem, however security and border officials at all levels are involved in the illicit economy. This security issues overlaps with the failure to resolve the shipment, or smuggling, of goods in and out of the TBA. This is a difficult problem to resolve since the U.S. does not have jurisdiction in the TBA, however there needs to be more resources committed to customs training and technology; such as a container tracking systems, drug and weapons detection devices, and improved container seals. There also should be an investment in radar surveillance for smuggling aircraft and intercept capabilities. A State occupation of the TBA will also disrupt the ability of criminals to place their funds into the financial system to start the money laundering side of the Illicit Economic Cycle.
To combat layering there has to be transparency in the international financial system and offshore heaves. The recent financial crisis might provide the ‘window of opportunity’ to enact such transparency. A good recent example of this can be found in Switzerland. In February of 2009, the largest bank in Switzerland, UBS, “agreed to divulge the names of well-heeled Americans whom the authorities suspect of using offshore accounts at the bank to evade taxes.” This type of transparency is a positive step towards restricting criminals’ ability to move and hide their funds around the world.

Another flaw in U.S. policy is that the NSS demonstrates a clear misunderstanding of the importance and complexity of history. For example, the NSS states, “Regional conflicts are a bitter legacy from previous decades that continue to affect our national security interests today.” Addressing the history of conflicts in terms of “decades” shows a clear lack of understanding of the problems the U.S. faces or, at best, the fear to admit this complexity publicly. Similarly, the NSS is also highly ideological and takes the privilege to define the nature of man and society. For example, the NSS states, “democracy is the opposite of terrorist tyranny, which is why the terrorists denounce it and are willing to kill the innocent to stop it.” This statement fails to address other, more likely, root causes of terrorist activity. For example, the previous US actions in the region or globe. For example, ‘blowback’ created by US
actions during the Russian-Afghanistan War has been debated as a possible cause for the 9-11 attacks.

Similarly, the NSS also demonstrates a flawed view towards culture when it addresses the ‘nature’ of people and politics and the economic. Specifically; “the liberty to create and build or to buy, sell, and own property is fundamental to human nature and foundational to a free society. Economic freedom also reinforces political freedom.” Another example is when the NSS states that tyranny is not a fact of nature. Are these assumptions true or are there different cultures and values? Does China’s economic and political model void the NSS’s claim that people with more economic freedom will demand political freedom? Does Latin America’s long history of latifúndios, callidos and coronéis, void that the NSS’s argument of what is natural for a culture?

Answering these questions might be the most difficult and controversial of all the variables. Chapter one of this thesis demonstrated the complexity of history and culture by describing the different path Latin/South America has followed since European colonialization. To review, South American development started with a different set of endowments, geography, and demographics which led to the creation of different institutions and ultimately cultures. This culture has a strong patriarchal tradition based on clans and personal relationships. Thus, South America might have a
different ‘natural state’ than what is outlined in the NSS. From this history and culture corruption has flourished. Battling corruption has been one of the U.S.’s highest priorities, however simply addressing this end product will have limited success. To truly resolve corruption, there first must be a profound understanding of the region’s social and economic institutions; and a solution must be based on this knowledge.

Another issue the U.S. needs to address is the imbalanced trade policies of Argentina, Brazil and Paraguay. Free trade is a major goal of the U.S. and the NSS cites it as a tool for security. I agree with this assessment, yet the U.S. should do more to promote equal polices in the region. One way to achieve this is to promote the Mercosur and the WTO. Until this imbalance is solved, consumers will continue to demand inherently legal products that are sold illegally below the legal market value. Resolving the demand for inherently illicit products, like Colombian cocaine, is much more difficult. The CS 18 includes a sentence on the U.S.’s strong demand for illegal drugs. This one sentence only scratches the surface of a major driving force of crime in the region, however, it is a clear nod to the U.S.’s partner nations who frequently cite demand as the most important aspect of the war on drugs.

Regardless of which policy alternative the U.S. government follows, without a major commitment, the TBA is at risk of slipping into a failed-state area. This
prediction is based on the evidence presented throughout this thesis as well as the current political disinterest and deteriorating economic environment.

The current economic crisis is likely to make the situation in the TBA worse. Brazil’s economic growth has drastically slowed while Argentina is approaching a potential economic collapse similar to the one in 2002 where the country saw half of its population slip below the poverty line. The result of these forces has the potential of dragging Paraguay into a failed state status. In this lawless state, the TBA can destabilize the region and international criminals can reap uninterrupted profits. Furthermore, terrorist organizations will continue to have access to financing to prolong armed conflicts in other parts of the world. More concerning is the potential for the TBA to become a center for active terrorist activity. Currently, I feel that terrorist organizations do not conduct attacks from the TBA because that would draw attention to the area and disrupt a major source of income. If the region were to slip into total lawlessness, however, then they could carry out attacks without fear of retribution.

An alternative view is that the current global financial crisis will diminish the size of the illicit economy in the TBA. The economic crisis could cause a decrease in demand for the TBA’s products if consumers have less disposable income. This reduced demand could slow the amount of products passing through the TBA and
consequently reduce the amount of money generated in the area. I predict this reduction is unlikely because one of the TBA’s niche markets is its ability to undersell market prices. If people have less to send in the current crisis it creates the possibility of attracting even more consumers to smuggled and counterfeit products. The current economic crisis could also exaggerate the unbalanced trade policies of the region by inciting more protectionist policies. This could cause legal prices to rise, given smugglers more incentive to meet demand. This is a negative cyclical effect because if more products are sold on the black market it will leave governments with less revenue and thus fewer resources to control the TBA. Similarly, the demand of drugs may increase in bad times. If this occurs, then the TBA associated drug trade will likely experiences a boom. Therefore, an economic crisis could help crime in the TBA.

Despite the current state of the TBA and this forecast a significant investment into the TBA can have a impact towards improving the long-term stability of the region and minimizing potential threats to U.S. interests. I feel this investment is unlikely, however, since the TBA has been low on the U.S.’s agenda and since this area is a backwater of both Brazil and Argentina these countries have also paid it little attention. Consequently, crime in the TBA is likely to remain the same or deteriorate.
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