



MONEY LAUNDERING: AN ECONOMIC CRIME AND ITS IMPACT

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Capital as such is not evil; it is its wrong use that is evil. Capital in some form or other will always be needed

Mahatma Gandhi

Abstract

Money laundering constitutes a serious threat to national economies and respective governments. The infiltration and sometimes saturation of dirty money into legitimate financial sectors and nations accounts can threaten economic and political stability. Economic crimes have a devastating effect on a national economy since potential victims of such crimes are far more numerous than those in other forms of crime. Economic crimes also have the potential of adversely affecting people who do not prima-facie, seem to be the victims of the crime. This paper provides a brief overview of the concept of money laundering and its impact.

Keywords: *Money Laundering, Global Economy, Economic Crime, Terrorism, Hawala*

Introduction

Money laundering has been affecting the global economy for many years. Money laundering happens in almost every country in the world, and a single scheme typically involves transferring money through several countries in order to obscure its origins. Money laundering encompasses illegal activities that are used to make illegally-acquired funds appear legal and legitimate. Illegal sources of money and financial assets are often disguised and concealed using a smoke screen of deceptive practices. The most common types of criminals who need to launder money are drug traffickers, embezzlers, corrupt politicians, public officials, mobsters, terrorists and con artists. Drug traffickers are in serious need of good laundering systems because they deal almost exclusively in cash, which causes all sorts of logistics problems. Criminal activities such as terrorism, illegal arms sales, financial crimes, smuggling, or illicit drug trafficking generate huge sums of money and criminal organizations need to find a way to use these funds without awakening suspicions about their illicit origin.

The typical drivers for money laundering are similar across the globe. However, there are regional variations in terms of what primarily drives money laundering. For example, corruption is one of the primary drivers for money laundering in developing nations due to higher levels of corruption overall.

The literal meaning of ‘Laundering’ is ‘Washing’; and “Money Laundering” can, therefore be termed as washing of the money which is tainted or earned from illegal activities and subsequently mixing up with legitimate funds in such a way that the original source is concealed and it appears to be money earned from a legitimate source. Money laundering is a process where the proceeds of crime are transformed into apparently legitimate money or other assets. It is the processing of criminal proceeds to disguise its illegal origin. In simple words, it can be defined as the act of making money that comes from one source to look like it comes from another source. Interpol's definition of Money laundering is: "any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources". The act of money laundering is done with the intention to conceal money or other assets from the State so as to prevent its loss through taxation, judgement enforcement or blatant confiscation. The criminals herein try to disguise the origin of money obtained through illegal activities to look like it was obtained from legal sources because otherwise they will not be able to use it as it would connect them to the criminal activity and the law enforcement officials would seize it.

The UN defines it as “Money laundering is a process which disguises illegal profits without compromising the criminals who wish to benefit from the proceeds. It is a dynamic three stage process that requires: first, moving the funds from direct association with the crime; second disguising the trail to foil pursuit; and third, making the money available to the criminal once again with the occupational and geographic origins hidden from view”.

In the Indian context, Section 3 of the Prevention of Money Laundering Act, 2002 defines offences of money laundering as under: “whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering

The annual global turnover of laundered money in India is estimated to be around 500 million Dollar and the major share is generated by the illicit trade in narcotics. Huge sums generated by illegal drug trafficking forms the lion share of money laundered in India on account of the fact that India is a major illegal drug-transit country. Transportation

and distribution of drugs to affluent European and North American markets using the Border States as transit point facilitate black money generation, which is not only an economic phenomenon; but having political, social and historical dimensions too. The unholy nexus between politicians and bureaucrats on the one hand and the business men on the other, fuels black economy in India. The main source of black money is the illicit drug trade which has spawned large money laundering networks as a drain on the nation's economy.

India's pre-eminent place in Swiss Bank Accounts

According to the Swiss Bank Report 2011-12, the Nations who topped the deposits held in banks in the territory of Switzerland are as under:

Total Amount Held (Billion Dollar)

Country	Amount (Billion Dollar)
India	1,456
Russia	470
U.K.	390
Ukraine	100
China	96

Source- Swiss Bank Report 2011-12

Obviously, India with 1,456 billion or 1.46 trillion US Dollar has more money in Swiss Banks than the rest of the world put together. Simply put, these deposits are doubtless of questionable origin, which should continue to remain outside the domain of public knowledge and reach. So far as monies originating from India are concerned, it is clear that the Income-tax on the same has not been paid in our country, and such monies remain deposited in Swiss Banks, and will remain in Swiss Banks in a clandestine way. One of the significant facts is that U.S.A. does not figure at all in the Swiss Bank accounts.

It has been said that "the amount from India is about 13 times larger than the country's foreign debt. Once this huge black money comes back to India, the entire foreign debt can be repaid in 24 hours, even after paying the entire foreign debt; we will have surplus funds that are about 12 times larger than the foreign debt. If this surplus money is invested in earning interest, the entire amount of interest shall be more than the annual budget of the Central Government. Even if all the taxes were to be abolished, then also the Central Government will be able to maintain the country very comfortably. It is one of the largest loots witnessed by mankind in entire economic history of the world since 1947." Thus, India has more money in Swiss Banks than all the other countries put together.

In 2007, Indian authorities began investigating Hasan Ali Khan, an Indian businessman for suspicion of money laundering. He reportedly had a Swiss bank account with 8 billion dollar in deposits and has stashed away billions into Swiss bank account with the help of Kolkata based businessman, Kashinath Tapuria using hawala. In Decemember 2012, Finance Ministry told the standing committee on finance that recovery of Hasan Ali's tax arrears (of approximately Rs 91,000 Crore) is not possible. Enforcement Directorate shows that he had transactions of over, 112,000 Crore between years 2005 and 2006, and he is only one of the big tax offenders and this stash is only a part of the huge illicit outflow from India. This amount is enough to fund the national drinking water project in all the six lakh villages in India for the next 10 years.

By its very nature, money laundering occurs outside the normal range of economic statistics. Nevertheless, with other aspects of underground economic activities, rough estimates have been put forward to highlight the magnitude of the problem, International Monetary Fund (IMF) has estimated that funds worth a whopping US \$590 billion to \$1.5 trillion are laundered annually through the global economy which amounts to two to five per cent of the global GDP. India and Pakistan figure in a list of 77 countries which are of "primary concern" in terms of "major money laundering" activities. In 2000, the Central Vigilance Commission estimated black money to be around 40% of GDP which was Rs.70, 000-80,000 Crore, while the size of America's black economy was around 5% of GDP, about 500 billion US Dollar, almost double the size of India's black economy.

Money laundering is an issue that has gained increasing significance following the events of 9/11, attack on the twin towers in the U.S. Since then the world has focused its attention on the entire concept of money laundering and has recognized it as a source of the funding of terrorist activities. The globalization process and the communications revolution have made crime increasingly international in scope, and the financial aspects of crime have become more complex due to rapid advances in technology. The spread of international banks all over the world has facilitated the transmission and the disguising of the origin of funds. This may have devastating social consequences and poses a threat to the security of any country, large or small. It provides fuel for drug dealers, terrorists, illegal arms dealers, corrupt public officials and all types of criminals to operate and expand their criminal activities. Laundering enables criminal activity to continue.

Money Laundering - An Organized Crime

Money Laundering has a close nexus with organized crime. Money Launderers accumulate enormous profits through drug trafficking, international frauds, arms dealing etc. Cash transactions are predominantly used for Money Laundering as they facilitate the concealment of the true ownership and origin of money. It is well recognized that through the huge profits the criminals earn from drug trafficking and other illegal means, by way of money laundering could contaminate and corrupt the structure of the State at all levels, this definitely leads to corruption. Further, this adds to constant pursuit of profits and the expansion into new areas of criminal activity. Through money laundering, organized crime diversifies its sources of income and enlarges its sphere of action. The social danger of money laundering consists in the consolidation of the economic power of criminal organizations, enabling them to penetrate the legitimate economy. In advanced societies, crime is increasingly economic in character. Criminal associations now tend to be organized like business enterprises and to follow the same tendencies as legitimate firms; specialization, growth, expansion in international markets and linkage with other enterprises. The holders of capital of illegal origin are prepared to bear considerable cost in order to legalize its use.

The Process of Money Laundering (PLI)

Money laundering is a process which involves cleansing of “dirty” money earned through criminal/illegal activities to disguise their illegal origin. When criminal activity generates substantial profits, the individual or the group involved tries to disguise the sources of ill-gotten funds or change the form of such funds, or move the funds to a place where they are less likely to attract attention. Consequently, the links between the politicians and businessmen, money laundering of foreign accounts and insider-trading remain a mystery to the public. There are three distinct steps involved in the process of money laundering:

Placement

Placement refers to the physical disposal of bulk cash proceeds derived from illegal activity. This is the first step of the money-laundering process and the ultimate aim of this phase is to remove the cash from the location of acquisition so as to avoid detection from the authorities. This is achieved by investing criminal money into the legal financial system by opening up a bank account in the name of unknown individuals or organizations and depositing the money in that account.

Layering

Layering refers to the separation of illicit proceeds from their source by creating complex layers of financial transactions. Layering conceals the audit trail and provides anonymity. This is achieved by moving money to offshore bank accounts in the name of shell companies, purchasing high value commodities like diamonds and transferring the same to different jurisdictions. Now, Electronic Funds Transfer (EFT) has become boon for such layering exercise. Different techniques like correspondent banking, loan at low or no interest rates, money exchange offices, back-to-back loans, fictitious sales and purchases, trust offices, and recently the Special Purpose Vehicles (SVPs) are utilized for the purpose of laundering the money.

Integration

Integration refers to the reinjection of the laundered proceeds back into the economy in such a way that they re-enter the financial system as normal business funds. The launderers normally accomplish this by setting up unknown institutions in nations where secrecy is guaranteed. New forms of business give a platform for integration exercise. Now a person can start a business with just a webpage and convert his illegal money to legal by showing profits from the webpage. There are other ways like capital market investments, real estate acquisition, the catering industry, the gold market, and the diamond market. Money laundering, at its simplest, is the act of making money that comes from Source A look like it comes from Source B.

Some Techniques of Money Laundering

At each of the three stages of money laundering various techniques can be utilized. It is really not possible to enlist all the techniques of Money Laundering exercise; however, some techniques are illustrated for the sake of understanding:

Hawala

Hawala is an alternative or parallel remittance system. It exists and operates outside of, or parallel to 'traditional' banking or financial channels. It was developed in India, before the introduction of western banking practices, and is currently a major remittance system used around the world. In Hawala networks the money is not moved physically. A typical Hawala transaction would be like a resident in USA of Indian origin doing some business wants to send some money to his relatives in India. The person has option either to send the money through formal channel of banking system or through the Hawala system. The commission in Hawala is less than the bank charges and is without any complications for

opening account or visit the bank, etc. The money reaches in to the doorstep of the person's relative and the process is speedier and cheaper.

Structuring Deposits

Also known as smurfing, this method entails breaking up large amounts of money into smaller, less-suspicious amounts. In the United States, this smaller amount has to be below \$10,000, the dollar amount at which U.S. banks have to report the transaction to the government. The money is then deposited into one or more bank accounts either by multiple people (smurfs) or by a single person over an extended period of time.

Third-Party Cheques

Utilizing counter cheques or banker's drafts drawn on different institutions and clearing them via various third-party accounts Third party cheques and traveller's cheques are often purchased using proceeds of crime. Since these are negotiable in many countries, the nexus with the source money is difficult to establish.

Credit Cards

Clearing credit and charge card balances at the counters of different banks. Such cards have a number of uses and can be used across international borders. For example, to purchase assets, for payment of services or goods received or in a global network of cash-dispensing machines.

Peso Broker

A drug trafficker turns over dirty U.S. dollars to a peso broker in Colombia. The peso broker then uses those drug dollars to purchase goods in the United States for Colombian importers. When the importers receive those goods (below government radar) and sell them for pesos in Colombia, they pay back the peso broker from the proceeds. The peso broker then gives the drug trafficker the equivalent in pesos (minus a commission) of the original, dirty U.S. dollars that began the process.

Causes of Increase in Money Laundering and Inability to Control

There are various causes for increase in Money Laundering and the few of them can be enlisted as follows which is popularly known as 'Features of an Ideal Financial Haven':

- No deals for sharing tax information with other countries
- Availability of instant corporations
- Corporate Secrecy Laws – as the corporate law of certain countries enables launderers to hide behind shell companies.

- Excellent Electronic Communication
- Tight Bank Secrecy Laws
- A Government that is Relatively Invulnerable to Outside Pressures
- A high degree of Economic Dependence on the Financial Services Sector
- A Geographical Location that Facilitates Business Travel to and from rich neighbors.
- Increase in sophistication and employment of professional people for doing the task

Harmful Effects of Money Laundering

Money Laundering threatens national governments and international relations between them through corruption of officials and legal systems. It undermines free enterprise and threatens financial stability by crowding out the private sector, because legitimate businesses cannot compete with the lower prices for goods and services that businesses using laundered funds can offer. There are few specific challenges which are posed by Money-laundering activities throughout the world.

Terrorism

Terrorism is an evil which affects each and everybody. Now and then we can find terrorist attacks being made by terrorists. These attacks definitely cannot be done without the help of money. Money Laundering serves as an important mode of terrorism financing. Terrorists have shown adaptability and opportunism in meeting their funding requirements. Terrorist organizations raise funds from legitimate sources, including the abuse of charitable entities or legitimate businesses or self financing by the terrorists themselves. Terrorists also derive funding from a variety of criminal activities ranging in scale and sophistication from low-level crime to organised fraud or narcotics smuggling, or from state sponsors and activities in failed states and other safe havens. Terrorists use a wide variety of methods to move money within and between organisations, including the financial sector, the physical movement of cash by couriers, and the movement of goods through the trade system. Charities and alternative remittance systems have also been used to disguise terrorist movement of funds.

Threat to Banking System

Across the world, banks have become a major target of Money Laundering operations and financial crime because they provide a variety of services and instruments that can be used to conceal the source of money. With their polished, articulate and disarming behaviour, Money Launderers attempt to make bankers lower their guard so as to achieve

their objective. Though norms for record keeping, reporting, account opening and transaction monitoring are being introduced by central banks across the globe for checking the incidence of Money Laundering and the employees of banks are also being trained to recognise suspicious transactions, the dilemma of the banker in the context of Money Laundering is to sift the transactions representing legitimate business and banking activity from the irregular suspicious transactions. Launderers generally use this channel in two stages to disguise the origin of the funds first, when they place their ill gotten money into financial system to legitimize the funds and introduce these funds in the financial system and second, once these funds have entered the banking system, through a series of transactions, they distance the funds from illegal source. The banks and financial institutions through whom the 'dirty money' is laundered become unwitting victims of this crime.

Threat to Economic and Political Stability

The infiltration and sometimes saturation of dirty money into legitimate financial sectors and national accounts can threaten economic and political stability. An International Monetary Fund (IMF) working paper concludes that money laundering impacts financial behaviour and macro-economic performance in a variety of ways including policy mistakes due to measurement errors in national account statistics; volatility in exchange and interest rates due to unanticipated cross border transfer of funds; the threat of monetary instability due to unsound asset structures; effects on tax collection and public expenditure allocation due to misreporting of income and many more such ways.

Efforts to Combat Money Laundering

The serious threat posed by money laundering to the financial systems and the sovereignty was being progressively realized by various countries of the world. As a consequence of this realization, the international community took the following initiatives to curb the menace of money laundering:-

1. The 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention of 1988) provided a comprehensive legal definition of "money laundering". This definition formed the basis of subsequent legislation on money laundering of various countries.
2. The Basle Statement of Principles enunciated in 1989 outlined basic policies and procedures that banks should follow in order to assist the law enforcement agencies in tackling the problem of money laundering.

3. The Financial Action Task Force (FATF) on Money Laundering which was established at G-7 summit held in Paris in 1989 to address the global problem of money laundering made forty recommendations which provide the foundation for comprehensive legislation to combat the problem of money laundering. In short, the recommendations urged all countries to adopt practical measures to apply the United Nations Convention signed in Vienna in December 1988 so that new legislation in bank secrecy could be drafted in harmony with those recommendations.
4. Political Declaration and Global Programme of Action adopted by UN General Assembly inter alia called upon the member States to develop a mechanism to prevent financial institutions from being used for laundering of drug related money and enactment of legislation to prevent such laundering.
5. The United Nations in its Special Session on 'Countering World Drug Problem Together' which was concluded on 10th June 1998 stressed the need to deal firmly with money laundering.
6. The Global Programme against Money Laundering (GPML), 2000 is the key instrument of the United Nations Office on Drugs and Crime in this task. Through GPML, the United Nations helps member States to introduce legislation against money laundering and to develop and maintain the mechanisms that combat this crime. The programme encourages anti-money laundering policy development; monitors and analyses the problems and responses; raises public awareness about money laundering and co-ordinates joint anti-money laundering initiatives of the United Nations with other international organizations.

Prevention of Money Laundering Act, 2002

The Prevention of Money Laundering Act, 2002 (PMLA) was enacted with effect from July 1, 2005. The PMLA forms the core of the legal framework to combat money laundering and terrorist financing in India. The PMLA and Prevention of Money-laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005 (PMLA Rules) impose obligation on banking companies, financial institution and intermediary to verify the identity of investors & maintain records of transactions with each investor. Rule 3 of PMLA Rules inter-alia requires maintains of records relating to following transactions:

- All cash transactions of the value of more than Rs.10 lakh or its equivalent in foreign currency.
- All series of cash transactions integrally connected to each other which have been valued below Rs.10 lakh or its equivalent in foreign currency where such series of transactions take place within one calendar month.
- All transactions involving receipts by non-profit organisations of value more than Rs.10 lakh, or its equivalent in foreign currency.
- All suspicious transactions whether or not made in cash and including, inter-alia, credits or debits into from any non monetary account such as demat account, security account maintained by the registered intermediary.
- All cash transactions were forged or counterfeit currency notes or bank notes have been used as genuine or where any forgery of a valuable security or a document has taken place facilitating the transactions

Anti-Money laundering law is necessary because money laundering tends to corrupt even the most professional players in the market. Now a money-launderer can be a white collar businessman doing the business legitimately. However, when lured by low interest rate loans (given from proceeds of crime), he would be tempted to launder the black money for that purpose. This illegal business in the long run contaminates the legal business and profession, for example, money laundering needs lawyers and the lure of money can transform the noble professionals to criminals (which they do not perceive they are doing). Money laundering promotes corruption and bribery in every sector, specifically the banking sector. Bribe is just like human blood to the tongue of a wild cat, which once gets the taste of it, cannot resist killing humans. Thus money laundering is an activity which is capable of corrupting a chain of financial institution. This provides a sufficient rationale for having an anti-money laundering law which acts like a slow poison, though to some it may seem as power vitamin.

India is labeled "vulnerable to money laundering activities" since it is a growing regional financial center. "Some common sources of illegal proceeds in India are narcotics trafficking, trade in illegal gems (particularly diamonds), smuggling, trafficking in persons, corruption, and income tax evasion. India should pursue its efforts to join the Financial Action Task Force. It also needs to quickly finalize the implementing regulations to the anti-money laundering law and bring the new Financial Intelligence Unit (FIU) up to speed in order to enhance information sharing with its counterparts around the world." The

International Narcotics Control Strategy Report of 2003 issued by US State Department's Bureau for International Narcotics and Law Enforcement Affairs does, however, note that India's historically strict foreign-exchange laws, transaction reporting requirements, and banking industry's know-your-customer policy make it difficult for criminals to use banks or other financial institutions to launder money. But there is still a challenge to counter the parallel system.

Conclusion

Money laundering causes a diversion of resources to less productive areas of the economy which in turn depresses economic growth. The possible social and political costs of money laundering, if left unchecked or dealt with ineffectively, are serious. The economic and political influence of criminal organizations can weaken the social fabric, collective ethical standards, and ultimately the democratic institutions of society. Money Laundering cause significant damage to the general economy of the country, affecting the growth and development of the nation. Where there is high incidence level of economic crime, the government and bureaucracy are also viewed as being corrupt and weak. Some of the major impacts on the national economy that may be caused by the economic crimes are increase in inflationary pressure, uneven distribution of resources and creation of elitism. marginalisation of tax base, generation of abundant black money, creation of parallel economy, undermining of developmental works, becomes a breeding ground for corruption, illicit businesses thrive affecting licit business, resources of financial and commercial institutions are diverted and distorted, weakens morale and commitment of citizens, poor/weakest continue to be at risk, countries' economic equilibrium with at stake.

Money laundering is the process by which large amount of illegally obtained money, from drug trafficking, terrorist activity or other serious crimes, is given the appearance of having originated from the legitimate source. Money laundering has an adverse impact on economy and political stability of country and hence such an activity must be curbed with an iron hand. Therefore, nations of the world must join hands and adopt measures to dismantle syndicates engaged in money laundering by resorting to aggressive enforcement of law. Hence, Money Laundering is economic crime which evokes serious concern and impact on the nation's security and governance.

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