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Money Laundering: Concept, Significance and its Impact

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Abstract:

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. An attempt has been made in this article to explain the Concept, Significance and its impact.

*“Capital as such is not evil,
it is its wrong use that is Evil,
Capital in some form or other will always be needed”*

- Mohandas K.

Gandhi

Introduction:

If conducts a survey asking what is Money Laundering? The general guesses from most people would be that it must be something related to drying, washing or may be dry cleaning of the currency notes. To some extent correct but layman don't know much of this world's third largest industry. As per IMF reports the turnover of this industry could be somewhere around \$1.5 trillion.

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. But in simple terms it is the conversion of black money into white money. This takes one back to cleaning the huge piles of cash. If done successfully, it allows the criminals to maintain control over their proceeds and ultimately to provide a legitimate cover for their source of income. Money laundering plays a fundamental role in facilitating the ambitions of the drug trafficker, the terrorist, the organized criminal, the insider dealer, the tax evader as well as the many others who need to avoid the kind of attention from the authorities that sudden wealth brings from illegal activities. These criminal enterprises seek to obtain money and power through criminal conduct and then attempt to infiltrate the legitimate society, thereby

distorting the terms of the compact. They generate millions upon millions of dollars for the members of the enterprise and allow their associates to live lavish lifestyles that have been forged from the misery and despair that their criminal activity produces.

A. Concept of Money Laundering

“Money laundering is called what it is because that perfectly described what takes place-illegal of dirty, money is put through a cycle of transactions or washed, so that it comes out the other end as legal, or clean money. In other words, the source of illegally obtained funds is obscured through a succession of transfers and deals in order that those same funds can eventually be made to appear as legitimate income.”

- **Robinson**

Money Laundering as an expression is one of fairly recent origin. Money laundering is a sophisticated crime not to be taken very seriously at the first glance by anyone in the society. As compared to street crimes, it is a modern crime. At times people also refer to it as a victimless crime but the reality is that it is not a crime against a particular individual, but it is a crime against nations, economies government, rule of law and world at large. Money laundering has become a world wide menace.

The goal of a large number of criminal acts is to generate profit for the individual or group that carries out the act and then hide either the source or the destination of money. 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.

Some of the crimes like-illegal arms sales, smuggling, corruption, drug trafficking and the activities of organized crime including tax evasion generate huge sums. Insider trading, bribery and computer fraud schemes also produce large profits and create the incentive to legitimize the ill-gotten gains through money laundering.

When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention. Otherwise, they can't use the money because it would connect them to the criminal activity, and law enforcement officials would seize it.

If done successfully, it allows the criminals to maintain control over their proceeds and ultimately to provide a legitimate cover for their source of income. Where criminals are allowed to use the proceeds of crime, the ability to launder such proceeds makes crime more attractive.

B. Significance of Money Laundering

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 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.

C. Impact of money laundering on the economy of the country

*“The Fish sees the bait, not the hook;
A person sees the gain, not the danger”.*

- A Chinese Proverb.

The Money laundering has negative effects on economic development. 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. For example, tax evasion results in loss of government revenue, thus affecting the potential of the government to spend on development schemes thereby affecting a large section of the population who could have benefited from such government expenditure.

A company fraud not only results in cheating of the people who have invested in that company but may also adversely affect investors' confidence and eventually the growth of the economy.

The negative economic effects of money laundering on economic development are difficult to quantify, yet it is clear that such activity damages the financial-sector institutions that are critical to economic growth, reduces productivity in the economy's real sector by diverting resources and encouraging crime and corruption, which slow economic growth, and can distort the economy's external sector international trade and capital flows to the detriment of long-term economic development.

Developing countries' strategies to establish offshore financial centre (hereinafter OFCS) as vehicles for economic development are also impaired by significant money laundering activity through OFC channels. The negative effects of money laundering activities may be on financial sector, real sector of formal agents such as state, financial institutions and banking sector.

The Financial Sector

Financial sector may get negative effects of money laundering especially financial institutions including banking and non –banking financial institutions (NBFIs), and equity markets- may directly or indirectly be affected. Basically, these institutions facilitate concentration of capital resources from domestic savings and funds from abroad. These institutions provide impetus to furtherance of investment prospects by providing conducive environment and efficient allocation of these resources to investment projects which contributes substantially to long run economic growth.

Money Laundering impairs the sustainability and development of financial institutions in two ways:

- 1.** Firstly the financial institutions are weakened directly through money laundering as there seems to be a correlation between money laundering and fraudulent activities undertaken by employees of the institutions. Similarly, with the increase in money laundering activities, major parts of financial institutions of a state are vulnerable to crime by criminal elements. This strengthens the criminals and other parallel system of money laundering channels. This may lead to the eviction of less equipped competitors & giving rise to monopoly.
- 2.** Customer trust is fundamental to the growth of sound financial institutions, and the perceived risk to the growth of sound financial institutions, and the perceived risk to depositors and investors from institutional fraud and corruption is an obstacle to such trust.

The Real Sector

Money laundering adversely affects economic growth through the real sector by diverting resources to less productive activities and by facilitating domestic *corruption* and *crime*.

*“The less expensive the money laundering input to crime is,
As a result of lax anti-money laundering policies,
The more productive (active) the criminal will be”.*

Money laundering carried out through the channels other than financial institutions includes more “sterile” investments such as real estate, art, antiques, jewelry and luxury automobiles, or investments of the type that gives lower marginal productivity in an economy. These sub optimal allocations of resource give lower level of economic growth which is a serious detriment to economic growth for developing countries. Criminals reinvest their proceeds in companies and real estate with the purpose to make further profits, legal or illegal. Most of these investments are in sectors that are familiar to the criminal, such as bar, restaurant, prostitution. The real estate sector is the largest and most vulnerable sector for money laundering. Real estate is important for money laundering, because it is a non-transparent market where the values of the objects are often difficult to estimate and where big value increases can happen and is an efficient method to place large amounts of money. The price increase in real estate is profitable and the annual profits on real business create a legal basis for income. The real estate has the following features, which make it attractive for criminal money:

- a safe investment
- the objective value is difficult to assess
- it allows to realize “white” returns.

The External Sector

Money laundering activities may impair any country’s economy through the trade and international capital flows. Excessive illicit capital flight from a state may be facilitated by either domestic financial institutions or by foreign financial institutions. That illicit capital flight drains scarce resources specially from developing economies; so by that way economic growth of respective economy is adversely affected⁵⁸. Money laundering negatively affects trust of local citizens in their own domestic financial institutions as well as trust of foreign investors and financial institutions in a state’s financial institution which ultimately contributes to economic growth. Money laundering channels may also be associated with distortions of a country’s imports and exports. As with the involvement of criminal elements on the import side they may use illicit proceeds to purchase imported luxury goods, either with laundered funds or as part of the process of laundering such funds.

Such imports do not generate domestic economic activity or employment, and in some cases can artificially depress domestic prices, thus reducing the profitability of domestic enterprises.

The integrity of the banking and financial services market place depends heavily on the perception that it functions within a framework of high legal, professional and ethical standards. A reputation for integrity is the one of the most valuable assets of a financial institution. Dangers for the reputation can occur when a country deliberately declares to want to attract ‘criminal money’.

If funds from criminal activity can be easily processed through a particular institution-either because its employees or directors have been bribed or because the institution turns a blind eye to the *criminal nature* of such funds-the institution could be drawn into active complicity with *criminals* and become part of the *criminal network* itself. Evidence of such complicity will have a damaging effect on the attitudes of other financial intermediaries and of regulatory authorities as well as ordinary customers. Money laundering not only threatens the financial system of a country by taking away command of the economic policy from the government, but also deteriorates the moral and social standing of the society by exposing it to activities such as drug trafficking, smuggling, corruption and other criminal activities.

The Global Sector

Money Laundering has become a global problem. Criminals target foreign jurisdiction with liberal bank secrecy laws and weak anti-money laundering regulatory regimes as they transfer illicit funds through domestic and international financial institutions often with the speed and ease of faceless internet transactions. This easy and vast infiltration of Criminal proceeds into world market can be stabilize them and can have a corrupting effect on those who work within the market system. The penetration of criminals into the legitimate markets can also shift the balance of economic power from responsible and responsive entities to rogue agents who have no political or social accountability. In short, when criminal enterprises are able to enjoy the fruits of the criminal ventures, the world market can be destabilized, leaving some countries vulnerable to persuasion and interference by corrupt organization.

CONCLUSION

Thus one can safely conclude that Money Laundering is global problem and must attract global concerns. Without international cooperation money laundering cannot be controlled. The criminals outsmart the enforcing agencies and deploy a team of experts like chartered accountants, attorneys, bankers mafia, to disguise their illicit money and masquerade it as legitimate income. These experts charge fee between 10 to 15% of the sum involved. The nexus between white-collared criminals, politicians, enforcing agencies and mafias cannot be rules out. Bankers play the most prominent role and without their connivance the operation cannot be carried out. Development of new high-tech coupled with wire transfer of funds has further aggravated the difficulties to detect the movement of slush funds. The international nature of money laundering requires international law enforcement cooperation to successfully investigate and prosecute those that instigate these complex criminal schemes. Money laundering must be combated mainly by penal means and within the frameworks of international cooperation among judicial and law enforcement authorities. Last but not the least it is vitally important to keep in mind that simple enactment of Anti-Money Laundering Laws are not enough, the Law enforcement Community must keep pace with the ever changing dynamics of money Launderers who constantly evolves innovative methods which helps them to stay beyond the reach of law.

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