

Money Laundering as a Form of Illicit Profit-Making

Прање новца као облик незаконитог стварања профита

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Сажетак: Прање новца обухвата делатности усмерене на прикривање имовинске користи остварене криминалним делом, те укључивањем, депоновањем и друго располагање тим предметима уз стварање привидне легалности. Према томе прање новца је свака техника усмерена на претварање непоштено и незаконито стеченог прихода тако да се чини као поштена и законита зарада. Прање новца, као и остале незаконите активности, условљавају регресивну дистрибуцију дохотка и стварање велике потрошачке моћи појединаца у условима опште рецесије. Велика средства која се зарађују прањем новца утичу на пораст потражње за луксузним производима, повећање цена некретнина и неких потрошних добара, а све напред наведено између осталог поспешује и инфлацију. Сваки случај прања новца може да се докаже, али да би се доказало потребан је озбиљан рад и ефикасан процес откривања и санкционисања. Да би се новац „опрао“ он мора да уђе у легалне токове, а кад је у легалним токовима свако мора да докаже и порекло тог новца.

Кључне речи: прање новца, трансакције, улагање, прикривање, интеграција.

Abstract: Laundering money includes activities directed toward the concealing the source of benefit obtained by illicit means, as well as placing, depositing and other availability of these means with creating the illusory legality. Therefore, money laundering is any technique oriented to the transfer of dishonest and illicit obtained income making the act as being honest and legal profit. Money laundering, as well as other illicit activities, causes regressive income distribution and creating big consumer power of an individual in the conditions of the general recession. Large resources obtained by money laundering influence the increase of luxurious goods demand, price increase of real estates and some consumer goods, and all the above cited increases inflation. Any case of money laundering can be proved, but it needs a serious work and efficient process of revealing and sanctioning. To launder money, it must enter the legal flows. Once being in legal flows, the origin of this money must be proved.

Key words: money laundering, transactions, investment, concealing money, integration.

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Introduction

Concealing money represents the inclusion of money obtained by illicit transaction or in transactions of the grey economy in the normal financial and economic flows, giving legality to illegally obtained sources, which by depositing funds in an account transfer becomes cash. It includes falsifying financial documents and manipulations in the system of banking transactions. At the same time, money laundering also includes the money originated from criminal activities (drug trade, corruption) to make revealing the origin of this money impossible (Boskovic, 2001, p. 567). The problem of money laundering is very complex, from appropriate regulations to the end application of the law in practice in different countries and legal systems. Money laundering is a process to cover up the tracks of the real source of illegally acquired money where the financial, and more frequently, the non-financial sector are used. The main functions and authorities of the Office for Money Laundering Prevention are the data from taxpayers, analysis, keeping data safe and data distribution, and taking legal measures and actions to prevent money laundering. The process of money laundering understands the placement, i.e. the change of forms of these resources or placement outside the reach of the law, dividing into layers and integration. Making layers of this money is the process of dividing incomes from criminal activities with different complex financial transactions and credit, credit letters, investment or insurance in order to hide tracks of money, its criminal and geographical origin to evade investigation. Integration covers up illegal incomes by using legal transactions and placing it at these criminals' disposal.

1. The Stages of Money Laundering

The desire to acquire profit is the fundamental motive for the majority of criminal deeds. In order to use regularly the so-called 'hot money' acquired in this way, individuals or criminal groups conceal its origin. Therefore, to make this money 'clean', it needs money 'laundering'. Any method of money laundering to use, the process is normally done in three stages including numerous transactions by money 'launderers', trying to conceal the process of investigation. Although this process of money laundering looks very complicated, it usually includes three stages:

- Investment stage,
- Layering stage,
- Integration stage (Serbian Government, 2008, p. 1-2)

In the investment stage, illicit profits are introduced into the financial system. On the pretext of some regular activities, cash obtained by criminal activities is deposited in the bank account. Money is mostly deposited for some legal business where payment is done in cash. In situations when the cash, acquired by the criminal way, is joined with the income from legal transaction, the possibility of revealing of the 'hot money' is decreasing. To deposit this money in the bank, different procedures are used and they are characteristic for the placement stage: depositing of the 'hot money' as being the regular business income, establishing shell companies, i.e. fake companies

that are established for no reason than to launder money, and depositing cash in bank accounts by breaking large amounts of money into smaller deposits, which are then deposited in many bank accounts. These sums are very small or even under the legal level; therefore, they are not suspicious to bankers and cannot be subject of special reporting and investigating. In this stage, some enterprises, being in serious financial problems, have been recently bought or taken over with a view to use their bank accounts for merging the money previously deposited in the bank accounts of different financial institutions.

After transferring cash into the bank deposit, the next step in the process of money laundering is the layering stage, where money transfer is done by depositing these resources from one account to other bank accounts all over the world. It is done with the purpose of concealing the original source and destination of the beginning criminal capital. To hide the connection between this money and criminal activities, the basic task is to transfer the money from numerous transactions. Many transactions are done in this stage by which the money is transferred all over the world. Although most of these transactions are illogical, no business cover can be found. The essence is to conceal the trace of money flows, and to interfere with anybody trying to find out the origin of the money. In this stage, it is usual to buy insurance policies, giving loans, buying luxury goods, paintings, stocks or to use many other financial instruments.

The last stage in money laundering, where the money comes again into the legal economic flows, is investing in legal businesses appearing as the money originating from the legal activities. The most popular method of money integration acquired by criminal is purchasing real estates. The goal of this stage in money laundering is to transfer this money in legally admitted business. One of them is to invest bulk money to 'revive' enterprises being in troubles. These enterprises keep doing business using the money acquired by criminal as their own capital. The people who performed money laundering receive dividends and salaries as the legal form of income.

It often happens that these three stages cannot be differentiated. Some stages in money laundering can be the same or they can overlap. Which way individual stage will develop and which method will be used, it depends on available mechanisms for money laundering and requirements of the criminals who ordered this business. In any case, money laundering means numerous different techniques being usually complex, clever and secret. What they have in common is that the origin of money and the name of the money owner must be hidden. Based on it, the customer can keep control over the procedure and, if necessary, to realize its change.

Some vulnerable points are identified in the process of money laundering which the committers evade with difficulties and where their activities can be recognized, (a) money access in the financial system, (b) cross-border fund flows and (c) transfer within and outside the financial systems.

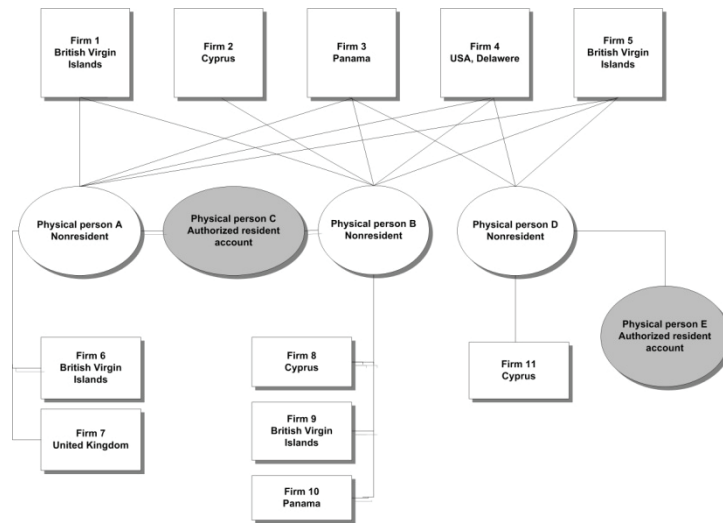
Although the majority of regulations on preventing money laundering are focused on the introduction/access stage, it is emphasized that banks and financial institutions, as providers of the wide range of services, are still vulnerable when used for money laundering in the integration stage. Credit prolongation and rapid fund transfer between accounts with different names and jurisdiction can be used as part of the

process of creating complex transactions. Banks and financial institutions included in the scheme of money laundering risk the legal accusation, loss of good trade reputation and the possible loss of operative license.

2. The Characteristics of Money Laundering

Today in the world, over 1,000 billion dollars are laundered each year, and only one percent of the 'dirty money' is caught. Therefore, it is not surprising that the G8 leaders' support the idea to increase the international control and cooperation in preventing money laundering. The European countries, especially EU, have become undesirable for a long time for the world 'machinators' and their operations of money laundering. From time to time, some financial affairs of the European ministers and high officials break out, especially with anonymous bank accounts, mostly in the countries formally not the EU members (Switzerland, Monaco, and Lichtenstein). International efforts to stamp out this phenomenon got their institutional framework in 1991 when the **Financial Action Task Force on Money Laundering (FATF)** was established. One of the functions of this body is the annual report of the 'black list' and the sequence of states where money laundering is present, as well as the introduction of economic and political sanctions against them. It is interesting to note that the Cayman Islands have become the fifth world financial center (after New York, London, Tokyo, and Hong Kong) just by carrying out big operations of illegally acquired money received in the local banks from all over the world. On the Cayman Islands, with only 30,000 inhabitants, there are about 34,000 registered companies, 590 banks and 500 billion dollars on the bank accounts. In Belize, the Caribbean country, an anonymous account can be open for only 500 US dollars; for additional 500 US dollars, even a fictitious name of the depositor can be got. These favorable conditions in the row of countries, hardly visible on the map, where the Caribbean Islands are most popular, these island countries hardly inhabited and extremely exotic names are scattered in the Pacific Ocean. There, anonymous stock companies can be established and where the owner is unknown or the company having only the post box in its ownership. In fact, the Caribbean Islands are only one station in the long way where illegal profits pass from drug trade (or any other illegal activity) to the legal source.

Example 1: The physical persons A, B and D are nonresidents who opened non-resident bank accounts in three domestic banks. The physical person C is the resident, authorized to handle resources from the accounts of physical persons – nonresidents A and B. The physical person E – resident is authorized to handle resources of the foreign exchange of the nonresident D. For every influx, it is a joint thing that they originate from the countries, which do not apply standards in the field of preventing money laundering. The physical person C is an authorized person of the physical persons of A and B and the C withdraws the cash from their nonresident foreign exchange accounts. Besides, the physical person E withdraws the cash from the foreign exchange account of the physical person D. Taking into consideration that all the companies appear as the senders of resources for all the three nonresidents, it puts them in touch.



Source: Ministry of Finance and Economy, 2010

Within the cooperation for preventing money laundering and terrorist financing, the Egmont group was set up as an international network of national agencies specialized for preventing illegal resources laundering including 101 national financial intelligence units. The Internet Egmont's secure web system enables the members a mutual communication by means of protected e-mail, making easier practical and fast data exchange in the struggle against money laundering.

To prevent timely money laundering, capability of the employees in financial and non-financial institutions is necessary to recognize and report suspicious money transactions. There are a number of indicators pointing to such transactions, where general indicators are of special importance as:

- Existence of accounts of the same person in many financial institutions without any rational reasons,
- Address manipulation for sending information – statement of account abstract,
- Sleeping bank account that is activated suddenly,
- Some transactions in bulk cash are done as it has never been done before and are not adequate to the client's business activity. (Ministry of Finance and Economy, 2010. p. 13-14.)

Money laundering has a wide specter of feedbacks on the economic, political and social structures of any country. The most significant consequences of money laundering are business decline of the legal private sector, the influence on foreign exchange rates and interest rates, economic disorders and instability, decrease of government revenues and reducing control of economic policy, endangering the reform programs or privatization, as well as the country's reputation fall. Participants in money laundering use specially selected companies in order to divide resources acquired based

on criminal activities and the process of concealing illegally realized income. As these companies possess bulk cash, they have the possibility to offer their products and services at prices being under cost-based prices and therefore they are more competitive in relation to other companies doing business legally and collecting resources on financial markets.

Money laundering participants reinvest resources there where they do not expect the origin of money to be revealed, not in the activities with the higher return rate. The consequences of this can be the decrease of monetary stability because of inadequate resource allocation, unexpected change in money demand, increased instability of exchange rates, interest rates and international capital flows. These are the reasons why it is difficult to carry out stable and efficient economic policy. At the same time, as participants of money laundering are not interested in profit increase in investing, but for the protection and concealment of the nature of these resources, they often invest in less profitable business, which need not be useful for the country, and, in this way, they reduce its potential economic growth.

Money laundering is an exceptional threat to the integration of financial institutions getting companies doing business into an unfavorable position. In general, money launderers do not try to realize the highest rate of profit on the laundered money, but they are mostly interested in the place or investments, which will enable them the easiest and fastest money processing. Therefore, money can travel from the country with good economic policy where higher profit rates can be realized to the country with worse economic policy and lower income rates than it is invested. Therefore, because of money laundering, it can happen that free capital is invested less rationally and it violates the current economic flows. (Marjanovic, 2012, p. 4) The change in money demand as the result of money laundering, expressed in official indicators, can cause instability of interest rates and exchange rates at the national level.

The money acquired by criminal activities usually corrupt the employees on financial markets causing the long-term and hardly reparable damage in market credibility. Money laundering can corrupt parts of the financial system, disable successful bank management, and control bodies. If any bank manager becomes corrupted, non-market behavior can expand to other fields not being connected with money laundering, also endangering security and bank solvency. The people carrying out supervision in the bank can also be corrupted or threatened by threats. It also reduces financial reliability and completely disables the efficiency of supervision. Therefore, it is necessary to strengthen regulations against money laundering, where it does not mean the reduction of traditional banking control. If banks are involved in money laundering, it abuses trust of the public and, if they are connected with organized criminal, it undermines their stability. In spite of the short-term profit, another direct danger of loss threatens them because of fraud, both for negligence in controlling undesired clients or violated integrity of their employees being connected with criminals. In money laundering through the banks, organized criminal often uses the people without criminal past and it makes revealing such activity difficult. Bank accounts are opened through which bulk money is transferred, often with the help of unconscious bank clerks.

How illegally acquired money is spent is best illustrated by the president of INTERPOL on the seventh International Conference on the struggle against corruption, held in Beijing 1995, in his report where he considered four ways:

- Criminals spend illegally acquired income by purchasing goods and investing *resources* in hotel management,
- They invest the ‘dirty money’ in restaurants and taxi services, which give good possibilities for money laundering. To perform these transactions professionally, they engage and corrupt bank officials,
- Criminal provide themselves and their families the high social position, acquiring the possibility to associate with politicians who have influence on legislation activities which is then adapted to their interests.
- Criminal have ‘their’ politicians whom they pay and in this way they take part in the political life of the country, providing their interests at the highest social level. (<http://www.interpol.int>)

3. Money Laundering as Felony in Intenational Law

To make the battle against money laundering better and more efficient, the engagement of all the social factors is required because this criminal activity endangers all other important values of a society. The forms of this organized criminal activity are not always obvious and recognizable; therefore, they make difficult timely taking measures for their prevention and control.

Money laundering is a very dangerous criminal activity with the high degree of social danger so this serious crime is very difficult to reveal and prove. In addition, we have to emphasize that money laundering is the consequence of inefficient functioning the institutions of the system. Therefore, the struggle against of this socially negative appearance also represents the struggle to reform the institutions because we can oppose money laundering and raise the living standard only with better and more efficient institutions. It can be done, before all, by consistent putting the Law into effect, efficient work of the Police, as well as the application of the penal policy.

To prevent illicit activities, the International community has begun to form adequate measures, resources and procedures in some countries with a view of preventing and controlling illicit activities. Therefore, many international laws have been passed where illicit activities and some forms of money laundering are stated precisely, as well as the measures and procedures of national regulation for controlling this phenomenon. Understanding the real danger of organized criminal of the international character, which does not recognize political, state and ideological borders among nations, countries and continents, the International community starts to work on developing and making strategies against the most dangerous forms of crime, drug trade and money laundering, human trafficking, weapons, etc. With all this, money laundering is inseparably connected. Therefore, many international laws were passed at the end of the 1980th and the 1990th of the last century, including new resources, methods and procedures. They are as follows:

- UN Convention against drug trade and psychotropic substances was passed in 1988, known as the Vienna Convention, accepted by over 100 countries. It predicted the obligation for all the signatory countries to incriminate in their national legislature numerous activities relating to drug trade, and money laundering acquired in this way be incriminate as a crime;
- Convention on money laundering, investigation and confiscation of profit from criminal (the European Convention) passed by the European Council on 8 November 1990 in Strasbourg. It issues the obligation of the signatory countries to regulate money laundering as the crime in their national legislature;
- UN Convention against transnational organized criminal, engaged in problems of taking measures for preventing and control money laundering;
- Directive for preventing the use of financial system for money laundering, issued by the European Council of 10 June 1991 in Luxembourg, regulation the obligation for the member countries to issue rules on money laundering as criminal activity;
- Operative body for financial actions, founded in 1989 at the conference of the G 7 presidents and governments, adopted the document the FATS 40 Recommendations on combating money laundering by which the general strategy for combating money laundering was defined. (Financial Action Task Force, 2004, 20-24)

The International Community has clearly determined the way on which the combat against organized criminal should be carried out, adopting the “The Prevention And Control Of Organised Crime: A European Union Strategy For The Beginning Of The New Millennium, published on 3 May 2000. Starting from the generally accepted attitude that the “main motive of organized criminal is to acquire financial profit”, the Document contains the conclusion that the “efficient prevention and control of organized criminal must be based on finding, freezing, as well as temporary and permanent confiscation of the property acquired by criminal activity”. This strategic EU document recommends considering the possibility that, after the verdict for criminal activity is reached, to mitigate the burden of proving the origin of this person’s property. This mitigation would mean that the convict is allowed to prove that the cited property was acquired in the legal way.

The international regulations relating to the control of money transfer is encircled through the Directive of the European Parliament and of the Council on the prevention of the use of the financial system for money laundering and income acquired in the illegal way, 4 December 200. In this Directive, the obligation of reporting any suspicious transactions was broadened on the wider circle of intermediaries in financial, including the so-called free professions, i.e. lawyers, notary publics and financial counselors.

At the international level, it is generally accepted that an efficient combat cannot be made against organized criminal, corruption, money laundering or terrorism without adequate legal mechanisms that enable strict control of suspicious money transactions, an easy way to establish the origin of property and efficient confiscation of illegally

acquired property on behalf of the state. Imprisonment for crime perpetrators, especially if perpetrators are the members of criminal groups or criminal organizations, represents more the “professional risk” than sanction that can prevent further crime until their illicit acquired property is safe and out of the reach of the law.

Conclusion

The development of technology and globalization continually advances the current ways and creates new possibilities for transferring dirty money in different forms of financial assets. The Financial Action Task Force (*FATF*) estimates that money laundering today amounts from two to five percent of the total world production. Because of unreliable data and the nature of money laundering, it is difficult to estimate its real volume, but these data are an indicator of how the problem is big. The financial system is a central point of the combat against money laundering because financial institutions, banks especially, represent usually the channel where this money comes into economic flows. Very often, money laundering, especially in developing countries, causes the budget reduction because of tax evasion and because it makes tax collection difficult, weakening the influence of the state in carrying out economic policy. Privatization programs, i.e. carrying out economic reforms can be endangered because of money laundering, especially in privatization of the state enterprises. Countries risk losing their good reputation if they are connected with the transactions of money laundering. As money laundering and other illicit activities lessen trust in financial markets and economic systems, the country’s economic growth can be undermined.

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Resume

Infiltration of the dirty money is a serious problem for national economies. The purchase of stocks, real estates, establishing the “dirty investment funds” and the use of banking systems to deposit such resources is a danger for credibility of the country, especially to secure the financial and banking sector. Money “launderers” constantly find out new ways to launder money, use new, non-financial channels and broaden the sphere of activity to real estates, insurance, etc. Therefore, it is necessary to follow further the European solutions and recommendations, try to improve laws and system modernization, as well as to pass new regulations in accordance with international standards, especially with the Directive 2005/60/EC of the European Parliament And Of The Council (of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing)

At last, it is worth emphasizing the creation of the “smart obstacles” and cooperation of all authorized bodies in the field of prevention and repression, both inside the country and abroad. It is the key question and one of the best ways to prevent new possibilities of money laundering and terrorist financing.