THE COSTS AND BENEFITS OF ANTI-MONEY LAUNDERING RULES IN ROMANIA

Corina – Maria ENE
Hyperion University from Bucharest,
corina.maria.ene@gmail.com

Abstract:

This paper purpose is to highlight an economic perspective and prospective of the costs and benefits of anti-money laundering rules in contemporary Romania. Starting with defining and description the stages of money laundering process, the paper provides a panoramic view on the phenomenon stretching and development, as well as on the activities connected with money laundering in Romania. It relies on national and international studies regarding anti-money laundering rules impact on national economic agents (banks, financial intermediaries etc.). We also analyze the conditions of suspicious activities reporting and the existence of government agencies, which use such reports to identify investigations subjects. Moreover, the paper tries to expose the possible reasons of anti-money laundering rules failure. All these aspects could give an idea about the importance of money laundering problem in Romania, as well as the high level of organized crime in our country.

Keywords: money laundering, anti-money laundering rules, black market, dirty money, placement, layering, integration.

JEL Codes: K40, K42, H26, O17

1. Introduction

Whether the approach comes from economic or juridical perspective, the issue on money laundering is quite complicated. As all researchers agree, money laundering is the expression of economic cross-border crime. International organized crime features are high human and financial resources, which demonstrate skill, ingenuity, and professionalism, but a permanent and fast adaptation to market requirements. Such organizations take the advantage of the state institutional authority crisis and bureaucratic corruption. Criminals have always tried to hide illegal activities that generate profits. Using the illegal black market, those organizations incomes become bigger, but more difficult to blind in order to use them on legal market. Globalization gave a very important convenience for illegal activity profits legalizing. It is about the capital movement freedom and the international financial market. As a result, they provide dangerous effects for country and society because dirty businesses have got a worldwide character. The negative effects arising from money laundering to economic development are difficult to quantify, but it is obvious that such a task seriously affects all institutions in the financial sector.

The US authorities that refer to the laundries owned by the Italian mafia firstly used the term of “money laundering”. To become clean the laundry are going through a manual or automatic washing process. Similarly, “dirty money” is converting through a “transformation process” to become “clean money” (Popa, Cucu, 2000, p.59). The term was also mentioning during the Watergate Scandal from 1973, but the legal expression had juridical admittance only in 1982 in the context of a drug trafficking investigation.

The United Nations Convention on Drugs, International Monetary Fund, and European Union Council Directive created a legal definition of legalizing financial sources coming from black market. They agreed that money laundering can be described as ”a process uses by a person in order to hide or dissimulate the identity or illegal origin of incomes so that they appear to have a legitimate source” (United Nations, Office for Drug Control and Crime Prevention and International Monetary Fund, 2005, p.1).

Obviously, the most important goal of the money laundering process is to realize a large number of economic transactions or activities in order to generate individual or groups profits and then to legitimate them. Money laundering is the process by which the illicit source of money or goods obtained or generated by criminal activity is concealing to hide the connection between the funds and the original illegal activities.

From an economic point of view, the definition of money laundering provided by Masciandaro (2007, p.2) seems to be the most appropriate. He statutes that “money laundering is an illegal and autonomous economic activity whose essential function implies liquidity transformation by converting illicit purchasing power into real purchasing power used for consumption, savings, investment or reinvestment”. This definition implies two key features: illegality, because money laundering profits are generating by illegal activities, and concealment, that result from profits illegal source hiding. Using a popular language, the principles of money laundering could be writing as “hide – move – invest in the name of someone else”.

This paper starts by analysing money laundering stages and techniques. After a short introduction on direct and indirect methods, Romania was describing according to the Walker’s gravity theory, which provides the cross-border character of dirty money legalizing. Suspicious activity reports were also analyzing because illegal funds legalisation usually took places far from banking systems.

Introducing income sources to official market is strictly linking with the implementation of anti-money laundering rules. Usually, dirty money is transferring to countries having flexible or liberal rules, and anti-money laundering law implementation depends on particular economies conditions and political willpower. The differences between the anti-money laundering national systems are exploiting by criminals who tend to steer their country toward networks or financial systems, which have not adopted such measures or their measures are ineffective. As a logical result, we think there must be a positive connection between fines values and suspicious transactions volume and a negative report between financial sanctions and the quality of information use by national financial intelligence units.

2. Literature review

Fundamentally, money laundering is naturally relating with the illegal subsidiary activity that generated it. When the funds resulting from offences arise from robbery, swindling, embezzlement or fraud, an investigation regarding money laundering is often the only way to locate the stolen funds and return them to the crime victims. Moreover, the illegal profits usually come from various criminal activities such as drug trafficking, lethal weapons trafficking, human beings trafficking, smuggling etc. Next step, illicit financial funds are included in a complex transformation process. Money laundering is the best way and it purpose is to convert “dirty money” and provide illicit funds an apparent legal origin.

The economic literature shows money laundering had got usually three typical stages. Usually the firstly movement is to transfer the accumulated money from one place to another. We can take account of an extra stage, a preparation of money laundering process that consists of the following methods: suitcase method, cash smuggling, money transfers, luxury goods transfers, electronic funds transfers, havala, hundi etc.

Next step is the placement that legalizes financial sources coming from black market. The placement stage involves a physical movement of funds generated by illegal activities to financial system. The goal is to cover up a possible confiscation or one’s trail. This stage is very important for money laundering detection because it is the best moment to identify the money placed into financial system and to localize dirty money source.

Layering is the next stage of money laundering process. This supposes many transactions from an account to another, banking accounts opened in different national or international banks. Obviously, the goal of this stage is to hide source of profits.

The last stage of money laundering process is integration, meaning the legalization of profits generated by illegal activities. The whole money is moving in a single account. Dirty money becomes completely clean and gains an apparent legal origin. This stage can’t offer any detection possibilities because it is almost impossible to prove the illegal funds background.

Concerning the techniques used in the context of money laundering process, the economic literature provides the following systematization (Figure 1).

Placement

Double invoicing; Mutual compensation;
Documentation counterfeit; Fraud;
Bribe financial employees; Smurfing;
Buying cash substitutes; Structuring;
Documentation counterfeit; Using company accounts;
Using safe deposits; Blending funds;
Buying companies with good reputation;
Loan repayment; Currency smuggling;
Currency exchanges; Gambling;
Buying a lot of tokens and return with payment order into indicated bank account;
Buying winnings; Cheque-

Layering

Making a chain of no transparent transactions;
Documentation counterfeit;
Gaps in keeping the books of account;
Mutual related bank accounts;
A lot of transactions without economic reasons;
Electronic form of remittance;
Using bank account in off shore zones;
Buying precious stones and metals;
Insurance policy;
A lot of transfers with using Standing orders;
Instrument box–supplying a bank account by amount of money below registration threshold and transfer money on other bank account or accounts;
Buying financial instruments;
Cashing traveller’s cheques;
Buying life insurance with investment funds;
Transfer money into an account of non-existent client.

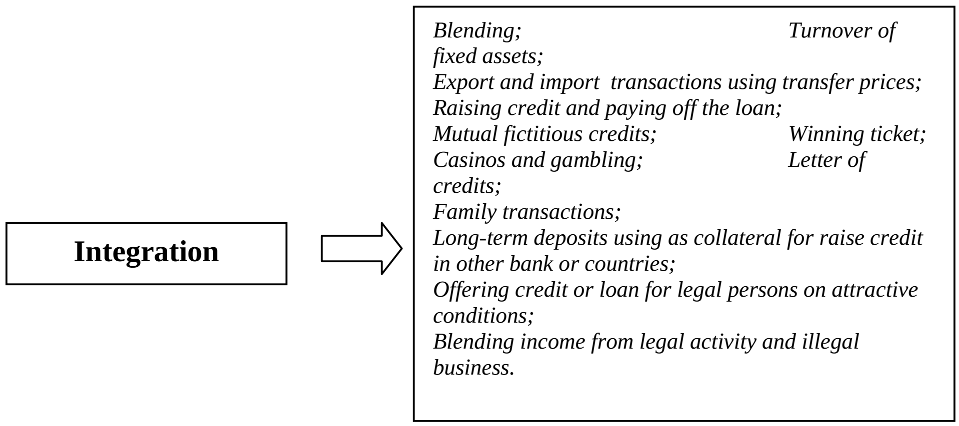

Figure 1. Techniques used in the context of money laundering process

Source: adapted from Chodnicka P. (2012, p.1015)

The three steps listed above are showing as separate phases, stand alone, but they can be implemented at the same time or, most often, may overlap. The distance between them depends on available money laundering mechanisms and on the goals providing by criminal groups.

The fight against money laundering on internationally level become stronger, but it is almost impossible to identify if the implementation of anti-money laundering rules is equal at least to the growth of economic crimes.

3. Data and methodology

There are two types of methods use for money laundering volume estimation. First, it is the direct method based on information about seized, confiscated illegal activities funds, all these provide by national or international public authorities. Usually, this method is using for a deep analyse of the quality and the effectiveness of anti-money laundering policies. It also provides a useful public orientation regarding illegal profits sources. Unfortunately, the data requested are not available because Romania has no databases containing money laundering activities. Romanian public authorities don't collect and publish such information. There are some particular public services as Direction of organized crime and terrorism investigation, Interpol, The National Office for Prevention and Control of Money Laundering etc. that classify as secret most of these data types. Difficulties in data finding are the main reason this method is rarely used. This paper is based on information about suspicious transactions reports published by The National Office for Prevention and

Control of Money Laundering that is the national financial intelligence unit. The paper analysis was done for years of 2009-2013.

The second method is an indirect one. It identifies the money laundering volume activities based on causes and indicators. We didn't use this last way of analysis because our goal was to research the costs, benefits, and effectiveness of Romanian anti-money laundering rules and not to quantify money laundering activities.

Findings

As we have presented above, the most important moment for money laundering investigation and sanctioning is to prove illegal funds at the very first stage. In order to face a better performance of exposing illegal and dirty funds, Romania decided to implement some legal acts, which contain rules mostly directed to banks. We have argued that criminal organizations trade took place in some financial centres but far from official banking system.

In addition, in some developed countries, it is easier to legalize illegal activities funds than in poorer countries that have a small financial market (Mitchell, 2002). As a result, some countries have to reduce anti-money laundering money rules to attract more financial resources for their economies. That is the perfect way to place and increase financial transfers of dirty money. According to Walker's gravity model, capital flows geographically and legalization of profits coming from black market becomes a cross-border problem (Walker & Unger, 2009). International financial organisms make economic pressure on such countries in order to respect international combating dirty money.

Dirty money is usually legalize using banking system. Based on this statement we have analysed Romanian public information about suspicious transactions reports (Figure 2). Usually, the number of these reports depends on financial market development and GDP level but they are closely related to banks. Moreover, level of the reported suspicious transactions are strictly connected with the worth of imposition of the financial sanctions for infringements on anti-money laundering duties (Papp andTakats, 2008).

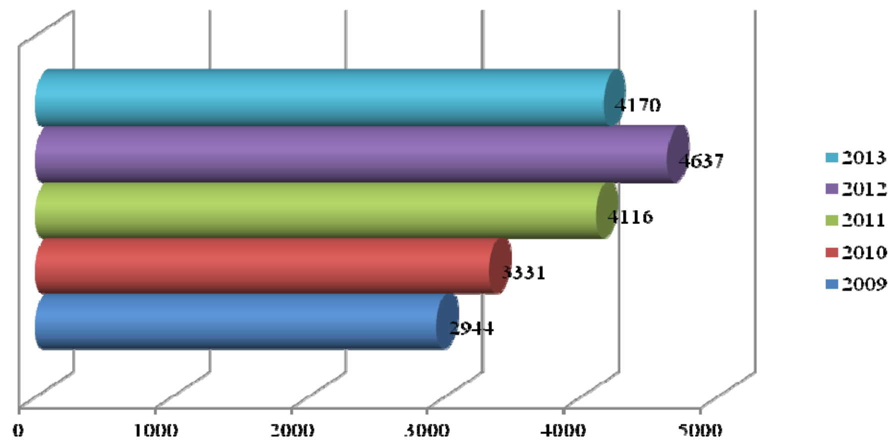

Figure 2. Number of suspicious transactions reports
Source: own calculations based on The National Office for Prevention and Control of Money Laundering Reports (2009, 2010, 2011, 2012, 2013), http://www.onpcsb.ro/

An important number of these reports were received from banks. They are usually more often controlled and give more attention to their clients operation. Banks also offer a lot of information regarding cash transactions using national or foreign currency (Figure 3).

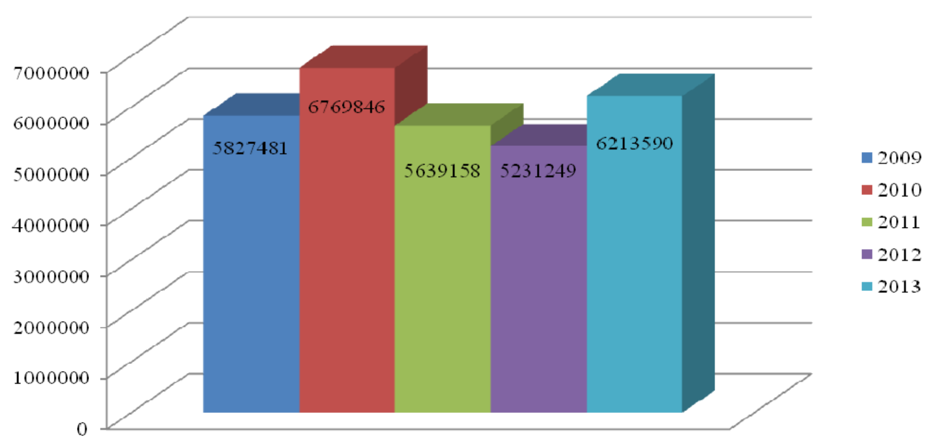

Figure 3. Number of cash transactions
Source: own calculations based on The National Office for Prevention and Control of Money Laundering Reports (2009, 2010, 2011, 2012, 2013), http://www.onpcsb.ro/

Another important indicator is value of cash deposits and withdrawals (Figure 4).

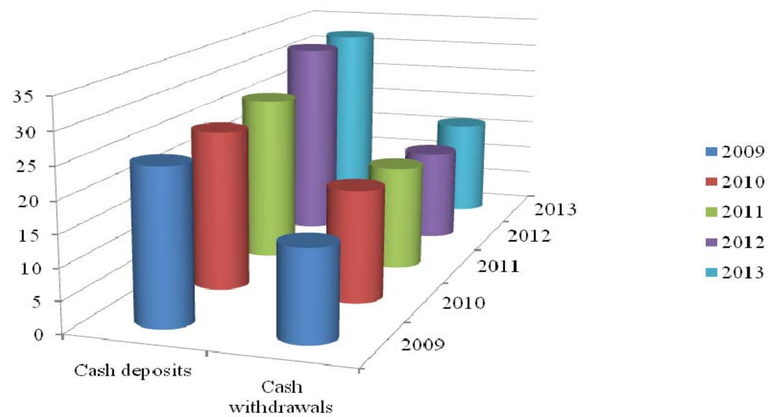

Figure 4. The value of cash deposits and withdrawals (billions Euro)
Source: own calculations based on The National Office for Prevention and Control of Money Laundering Reports (2009, 2010, 2011, 2012, 2013), http://www.onpcsb.ro/

Regarding the costs and benefits of anti-money laundering rules, we have noticed a large number of the received information by the national supervised entity. They can't assure a quality checking notification. As a result, we think anti-money laundering policy can't be efficient. Banks have to report too much data and information and The National Office for Prevention and Control of Money Laundering has no ability to check all notifications about legalizing profits coming from black market. Moreover, low fines, high monitoring, and reporting costs reduce the tendency to observe financial market in respect of introducing dirty cash to legal trading and transferring remarks to financial intelligence units (Chodnicka P., 2012).

In order to improve anti-money laundering policy it should be make a comparison between value of fines and monitoring/reporting cost. If the last is overly cheap and fines are strong enough, it will force banks to report all the suspect signals.

Romania has imposed low fines for anti-money laundering policy infringements (Figure 5). Anyway, the value of financial sanctions could be a decrease quantity of the transferring information regarding dirty money that is a very good thing.

Romania implemented anti-money laundering policy that gives the possibility to frozen the identified dirty money (Figure 6). Obviously, the value of frozen dirty money depends on the identified legalized funds coming from black market, strongness of national regulations and rules, and samples generated by investigations. Anyway, the confiscated funds could not improve economic and social welfare because the costs of investigations are usually higher than cash generated by confiscations. Despite of all these facts, money laundering phenomenon brings negative efforts for entire romanian economy.

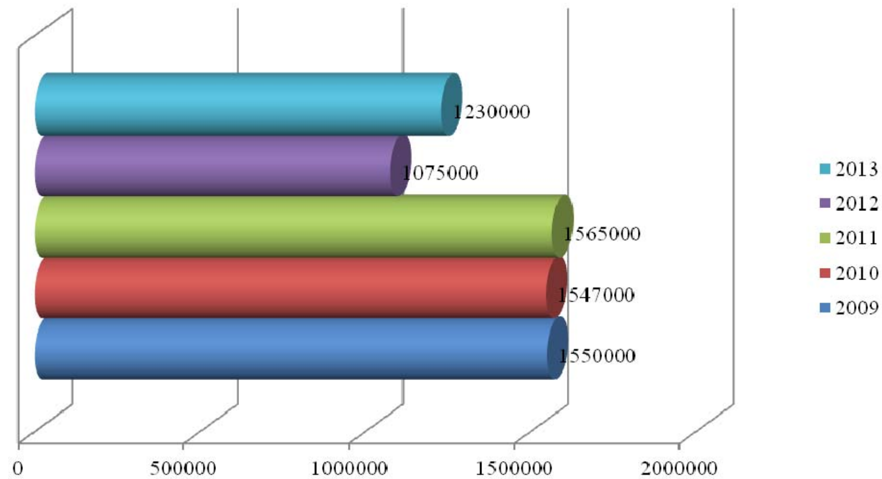

Figure 5. Value of financial sanctions (lei)
Source: own calculations based on The National Office for Prevention and Control of Money Laundering Reports (2009, 2010, 2011, 2012, 2013), http://www.onpcsb.ro/

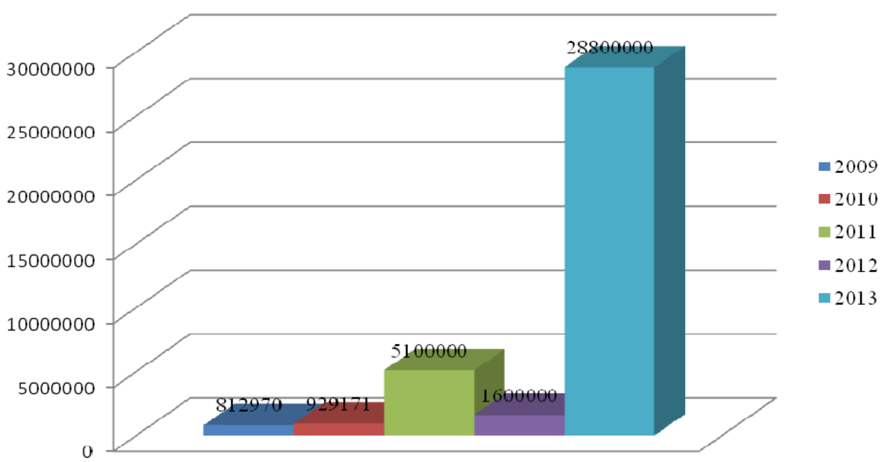

Figure 6. Value of frozen suspicious dirty money (millions Euro)
Source: own calculations based on The National Office for Prevention and Control of Money Laundering Reports (2009, 2010, 2011, 2012, 2013), http://www.onpcsb.ro/

The increasing level of the confiscated financial sources can be a result of effective prevention and investigation of money laundering. Despite this, the particular character, difficulties in identifing and proving the illegal activities raise the economic costs of the romanian anti-money laundering policy.

Implications

The power of money laundering phenomenon generate critical effects on the economic growth, brings a lower productivity for the real economic sector, diverts financial resources, and encourages corruption.

Money laundering is preventing important financial resources concentration. It erodes the structure of financial institutions because they often identify a direct link between this phenomenon and some employees' fraudulent activity. Financial institutions are vulnerable to corruption carried out by criminal elements who seek to acquire a greater influence on money laundering channels. Moreover, the investors' perceived risk concerning fraud and corruption represents an obstacle to institutional trust relationship between customers and financial institutions.

Money laundering carries a negative effect on the real economy. The diversion of financial resources and their orientation to less productive activities by fostering corruption and organised crime, minimize the economic growth rate, placing those savings in contrast with the principles of sustainable growth.

The lack of regulations regarding money laundering affects a country's economy through international trade and international capital flows. The illicit output funds coming from developing countries are facilitating by local or international financial institutions, offshore financial centres, but also by international stock exchanges. The illegal capital outflow diverts resources and reduces developing world economies. In addition, the international money laundering contributes to these economies development discouraging.

Money laundering can be associated with significant changes of a country imports and exports. Criminals often use illegal methods to import luxury goods. They pay using already "washed" resources, or financial resources affected by "scrubbing" process. Such imports do not encourage domestic economic activity and do not create jobs. Moreover, in some cases artificially lowers local prices, decreasing the profitability of domestic enterprises.

Conclusions

Some countries have to reduce anti-money laundering money rules to attract more financial resources for their economies. That is the perfect way to place and increase financial transfers of dirty money. According to Walker's gravity model, capital flows geographically and legalization of profits coming from black market becomes a cross-border problem (Walker & Unger, 2009). International financial organisms make economic pressure on such countries in order to respect international combating dirty money.

Based on this statement we have analysed Romanian public information about suspicious transactions reports. Usually, the number of these reports depends on financial market development and GDP level but they are closely related to banks. Moreover, level of the reported suspicious transactions are strictly connected with the worth of imposition of the financial sanctions for infringements on anti-money laundering duties.

In order to improve anti-money laundering policy it should be make a comparison between value of fines and monitoring/reporting cost. If the last is overly cheap and fines are strong enough, it will force banks to report all the suspect signals.

Romania has imposed low fines for anti-money laundering policy infringements. Anyway, the value of financial sanctions could be a decrease quantity of the transferring information regarding dirty money that is a very good thing.

Romania implemented anti-money laundering policy that gives the possibility to frozen the identified dirty money. Obviously, the value of frozen dirty money depends on the identified legalized funds coming from black market, strongness of national regulations and rules, and samples generated by investigations. Anyway, the confiscated funds could not improve economic and social welfare because the costs of investigations are usually higher than cash generated by confiscations.

Anyway, the effects of money laundering on the economy are impossible to be accurately estimated on the basis of the available information. Official statistics are virtually useless. Considering that the estimated proceeds of crime is very difficult to advance is explicable why interested national and international agencies are reluctant to provide estimates of the proportion of illicit financial flows of various crimes and engaged in money-laundering operations.

ACKNOWLEDGEMENTS

This work was financially supported through the project "Routes of academic excellence in doctoral and post-doctoral research - READ" co-financed through the European Social Fund, by Sectoral Operational Programme Human Resources Development 2007-2013, contract no POSDRU/159/1.5/S/137926.

References

Chodnicka P. (2012), *Money Laundering in the Central and Eastern Europe*, Journal of Modern Accounting and Auditing, July 2012, Vol. 8, No. 7, 1013-1024, David Publishing

Masciandaro D. (2007), *Black Finance: The Economics of Money Laundering*, Edward Elgar Publishing Ltd., Cheltenham, UK

Mitchell D. J. (2002), *US government agencies confirm that low-tax jurisdictions are not money laundering havens*, Prosperitas, 2(1)

Papp T.K., Takats E. (2008), *Tax rate cuts and tax compliance – The laffer curve revisited*, IMF Working Papers

Popa St., Cucu A. (2000), *Underground Economy and Money Laundering*, Expert Publishing House, Bucharest

Schneider F. (2008), *Money laundering and financial means of organized crime: Some preliminary empirical findings*, Global Business and Economics Review, 10(3), 309-330

Vasile E., Croitoru I. (2011), *The Integrated System for Risk Management - Key* Factor in the *Management System of the Organization, Chapter in book* RISK MANAGEMENT, The Publishing House InTech, CROATIA

Walker J., Unger, B. (2009), *Measuring global money laundering. The walker gravity model*, Review of Law and Economics,5(2), 2

*** United Nations, Office for Drug Control and Crime Prevention and International Monetary Fund (2005), *Legislative Model on Money Laundering and Terrorism Financing (for civil law legal systems)* (Report), IMF, UNODC, 1 December 2005

*** The National Office for Prevention and Control of Money Laundering, Report 2009, 2010, 2011, 2012, 2013, http://www.onpcsb.ro/