

Money laundering in the british economy essay

[Business](#), [Accounting](#)



AbstractThis research attempts to examine the role that money laundering plays in the British economy and to define the level to which it hinders the economic development of the country. It is essential to understand that any economy suffers from money laundering to a different extent, but this work will look at the British economy in particular from the perspective of the negative impact which money laundering brings. Money Laundering in the British Economy Money laundering is the world's third largest business accounting for an estimated loss of several trillion dollars per year. (McGill, 2005) Though the legalities of money laundering are well researched, its impact on the economies of many countries remains, for the most part, unstudied. Due to this crime's proliferation worldwide, it is important to diversify our studies of money laundering to include its impact on economies such as that of the United Kingdom (UK).

British financial institutions, as central as they are to the world economy, are particularly vulnerable to use as instruments for international money laundering. In the past, offshore banking facilities which belong to Britain including institutions on the Bahamas, Cayman Islands, and the Isle of Man have served as havens for fraudulent financial activity. However, it is important to note that developments in the field of information technology have made financial transactions easier and faster, not only for honest patrons, but for the criminals as well. Money laundering is no longer only an offshore concern. While British banks are required to report suspicious transactions to the authorities, they tend to instead act in favor of their clients' confidentiality and their institutional reputations, leaving many crimes unreported.

In 2005, only 8 of 500 financial institutions in the UK reported any instance of such suspicious activity. (McGill, 2005) Without immediate investigation into the source of suspicious deposits, the funds circulate back into the British economy, leaving it impossible to trace them back to their possibly illegal origins. It may seem a reasonable diplomatic move on the part of the individual UK bank to leave these transactions unreported, but surely the British economy as a whole ends up suffering from their compounded effect.

Literature review Many literature sources used for this research note that despite realization of the issue's severity and recent efforts at the state level to deter such crime in the UK and internationally, the level of money laundering remains high. (Quirk, 1996) " It is our view that money laundering, and the underlying crimes it reflects, including corruption, pose one of the most significant threats to our future prosperity and growth, and that more fundamental action must be taken to bring its proliferation under control". (Quirk, 1996) In considering economic effects of money laundering in Britain, it should be noted that the tools of economic analysis, through the connection of economic theory, banking regulation, and criminology are a useful combination for the acquisition of reliable research results, and Hinterseer (1997) has been able to use these tools to define the major economic factors involved in money laundering: " First, macroeconomic analysis considers the hypothesis of a multiplication effect of money laundering, assessing the relationships between financial structure and real criminal businesses; then we show the micro effects of money laundering caused by the presence of asymmetric and incomplete information in the

banking industry and highlight the role of intermediaries and of the central bank.

" (Hinterseer, 1997) While this paper intends to examine the criminal phenomenon of money laundering from a purely economic standpoint, it is still useful to look at the positions traditionally taken by other authors. Some of the reviewed work does make speculations as to the negative economic impact of money laundering, while others make different conclusions central to their research. For example, Masciandro (2001) looked at consumer-bank relations, which are integral for effective economy from the viewpoint of their depending on anti-laundering regulations' efficiency and banks' compliance costs. The author has been able to design work in the economic frames, coming to the conclusion that with respect to money laundering in the UK, the bank, as an intermediary, " has an information advantage." To demonstrate that, through the use of the principal-agent model this advantage can be used for the production of collective advantages " in the war against money laundering only if the regulations take the problem of compliance costs into due consideration." He has been able to analyze 11 banks with respect to their perception of customer relationships and obligations required by the UK's anti-laundering legislation.

He also concluded that effective framework chosen by banks in the case of such a triangular situation should lessen the potential negative effects the British economy faces from the increase of the money laundering activity. Quirk (1996) looks at money laundering from a macroeconomic viewpoint, which broader economic research must certainly take into account. The

author was able to provide the reader with an experimental method for measuring money laundering to aid in studying the phenomenon. He also reports cross-section economic estimates of monetary displacement due to money laundering within the monetary channels of industrial countries: “ the economic literature suggests that money laundering can distort economic data and thus distort macroeconomic analysis and policymaking. In addition, there may be direct effects on saving resulting from induced changes in income distribution and from the erosion of confidence in financial markets.” The research of Quirk (1997) is especially beneficial to research from an economic standpoint via its data representing the effects of money laundering on various economic policies.

The central point of his work is that large movements of illegal money flowing through the economy distort not only exchange rates, but also the value of assets and interest rates. He relates these factors in terms of their effect on the financial systems of specific countries as well as the economy of the world as a whole. We believe that there is a lot of hype regarding the implications of money laundering for an economy system but this is because non-compliance-phobia is becoming more and more widespread. The commonly regarded claim is that money laundering can have severe - to the negative - consequences for a country, mostly macroeconomic implications. Money-laundering can compromise specific macroeconomic parameters, especially in terms of economic growth, stability and investment. Particularly for investment this is crucial. Investments usually flourish in economically stable and healthy systems, but then again that is not always the case. There is also the potential that money-laundering can distort statistical

indices and at an international level cause instability to the world economy if large sums of money move through integrated financial systems.

Mostly for developing countries, the fact that money-laundering can have a negative impact on productivity has not been well documented in research.”

(Tanzi, 1996)The work of Fiorentini & Peltman (1997) is also interesting in that he describes various methods used for laundering money, applicable to any country in the world.” One of the most commonly used methods (and perhaps the most popular) for money-laundering is called “ smurfing”

whereby many individuals involved in money-laundering, deposit cash into bank accounts or buy bankers drafts in amounts that are a little bit lower than the reporting threshold and hence can avoid being reported. Often financial institutions change those thresholds but the news quickly become known (usually internal leaks) and money-launderers adapt accordingly.

Insiders and tipping-off are turning into a huge headache for institutions and consequently another method for ML is when a bank employee is involved in facilitating part of the laundering process. Equally popular is the exploitation of non-bank financial institutions: money transmitters, cheque cashiers, security brokers & dealers, etc.

” MethodThis research attempts to approach the crime of money laundering from the perspective of its negative effect on the British economy as a whole as well as its separate components. It is necessary to consider the economy as a composite of separate institutions, or “ sectors,” to provide a more detailed look at the negative effects caused by crimes such as money laundering. The review of existing literature on the subject has provided

much background information on the problem and its scope, however to explain the full impact of money laundering on the UK's economy, there is more to examine.

Any statistical data incorporated into this paper will be used in the reported form and no other calculations will be applied to amend it. However, this research is more descriptive than statistical, as the phenomenon of money laundering is difficult to measure exactly, given that it is criminal act that often goes unreported. Because of this, it will be of more use to describe how each economic sector works under the impact of money laundering, to show that, despite there technically being more money in the economic system, this illegally obtained money actually hurts the system more than it helps it. Results It is important, here, to present the statistical data which has been found regarding money laundering in the UK, to at least partially express the hard facts of the damage of money laundering to the British economy. Though one might hypothesize that the origin of money active in the economy is not relevant, only that it is present, it is definite that money laundering, in fact, hinders the UK's economical development. The cost of the economic crimes in the UK was equal to the sum of £40 billion in 2005, (McGill, 2005) which amounts to around £100 million per day of that year. This data reflects the negative effects of not only money laundering as such, but various other forms of fraud and other economic crimes. Economic crime, including money, is the top rated issue for British business and economy at present and the lack of national response to the continually growing issue is the main reason for its ability to thrive there.

82% of respondents asked about the issue said that money laundering poses a threat to the British economy, but only 53% of the respondents understood that money laundering causes financial costs to British business enterprises. Additionally, 53% of enterprises do not inform external auditors of cases of economic crime which accounts for the difficulties in measuring the phenomenon. 17% of businesses don't know about the regulations which exist in regards to money laundering and economic crime and only 2% are aware of the anti-money laundering policies which businesses can adopt to aid in preventing its spread. As a result of the data found, it is necessary to note that the Financial Action Task Force (FATF), created by the G-7 nations, which includes the UK, states that money laundering is a phenomenon which will only grow with time and with the further development of cyber technologies. It will only become easier to transfer money over the internet on an international scale, thus individual countries' financial systems will be undermined and the whole world's economy will be compromised. (Hinterseer, 1997) Only 23% of respondents find corruption to be the most significant agent in the laundering process.

However, it is still evident that the UK approach to such concepts is more dangerous than it is helpful in the fight against economic crime. The damaging consequences of money laundering may not be identified immediately and small enterprises may not even notice the negative effects, or they might turn a blind eye to money laundering as the reason for these economic deficiencies. Several banks which took part in the survey agreed that maintaining the confidentiality of their clients is an essential part of their jobs and the obligation to report suspicious transactions contradicts

that practice. In the UK alone the annual amount of laundered money is estimated at approximately £18 billion, which means that it definitely impacts the whole economy of the country negatively, and banks should consider revising their policies in light of such a high rate of criminal activity.

Discussion In the research done by Quirk (1997), it is stated that “ money laundering subverts legitimate financial mechanisms and banking relationships by using them as protective cover for the movement of the proceeds of criminal and corrupt activities as well as for financing terrorism”. With the UK being the largest financial center in the world, perhaps it should address the money laundering problem more carefully, if not only for Britain, than with the thought of the world’s interests in mind. Also, the money laundering issue brings up additional concern regarding the UK’s policies for combating domestic corruption. Though records of corruption in the UK are relatively low, with their lack of concern for the threat posed by money laundering, they may have other domestic troubles to deal with in time.

Previously, not much research has been conducted about how money laundering impacts the UK economy, which only leaves economists at a loss, since their economy is a shining example of a complex financial institution with a developed infrastructure and strict regulations. It serves as the hub for many of the world’s financial transactions and would thus make a fine model for studying the effects of financial crime as the problem spreads to other developed and developing economies. To better understand the full effect of these crimes on the British economy in its entirety, examination from the perspectives of its separate sectors, financial, real and, external is important. Financial sector Money laundering does not require the use of

formal financial institutions to occur (Masciandaro, 2001), but they do make it easier. Banks, non-bank financial entities, and equity funds often become the means for money laundering. Banks and similar financial organizations are the basis for financial flows in any country. Britain is known to be the banking center of the world's financial system and this is why its financial institutions and economy is often the target for money laundering. In the British economy, the effect of money laundering is best illustrated in three ways.

Money laundering itself is a danger for any financial institutions which participate in this process. This point of view is logically followed by another assumption: elimination of money laundering, and, as a result, development of healthy financial entities, is absolutely favorable for the economic situation of the country. The third point, however, is divided into two separate parts connected with the development of anti-laundering policies. On the one hand, such policies are necessary to fight against money laundering; while on the other hand, the policies might work against the British concepts of customer trust and confidentiality, which often become the basis for their good reputations." Financial institutions are at the forefront of the battle against the money launderers.

It is not only their institutions that the money launderers target to use in their various nefarious schemes but under current legislation they are responsible for policing the financial dealings and reporting any suspicious transactions and also transactions over a reporting limit of £10, 000 (In the UK)." (Masciandaro, 2001)From the legal viewpoint banks and other financial

institutions are negatively impacted by money laundering because they have certain obligations; from the financial viewpoint they need compliance, and Money Laundering regulations 1993 make financial institutions install the systems which trace and deter money laundering. In this sense there are also costs which are caused to business, and which have their origin in money laundering. In order to comply with various legal obligations the financial institutions have to experience compliance costs, and the regulations appear to affect all financial sector.

It is required that financial institutions install systems which deter money laundering and assist the authorities to detect the cases of money laundering; it means that financial institutions have to attract additional finances and to carry additional costs for the installation, administration of these systems and for training personnel to work with them. The costs which business acquire due to the legal obligations in money laundering, are various and cannot be counted on any typical basis, but it is clear that additional costs reduce the amount of the profits and thus make the whole economy less profitable as a result of money laundering. Average costs for the revision of the existing computer systems to adapt them to the new money laundering tracking software for the 500 largest enterprises have been estimated as £40, 000 for each; ten percent of this sum should be directed at maintenance of these systems. According to regulations every enterprise (except for the smallest ones) had to produce manuals for detecting money laundering by the workers, and the total cost of these manuals has been evaluated at the level of £3 million. These are the negative effects of money laundering viewed through the additional costs

the financial sector and other firms have to carry. Much has to be said about consequences in terms of reputation of banks, which determine their performance and efficiency for the benefit of the economy as a whole.

Professionals define reputation of financial institutions as the leading factor in promoting their soundness. " A reputation for integrity... is one of the most valued assets by investors ... Various forms of financial system abuse may compromise financial institutions' and jurisdictions' reputation, undermine investors' trust in them, and, therefore, weaken the financial system". (Tanzi, 1996) The reputation effect is very serious for the financial sector, and, as a result, for the economy in general. Reputation problems on the highest economic level can have their negative effect through the smaller investors, who when even careless about the reputation of the institution or unaware of its negative reputation, will be reluctant to do business with such financial institution for fear that their own reputation will be damaged.

The loss of reputation has negative effect on the financial system of the country as a whole, and as the UK works for supporting the reputation of the leading financial system of the world, this issue is especially essential for it; the loss of reputation by the financial institution may have severe effects on the entire nation" s financial system (the research has shown that negative effect of bad financial reputation is not just theoretical, but is clearly proved by practice: the scandals with the banks which are suspected in being involved into money laundering, especially with the countries of former USSR, causes public reluctance of the foreign and domestic investors to work

with British financial institutions, causing certain financial crisis of the local level). Financial institutions, in their turn, play important role in economic development; this is why their normal activity is essential. The World Bank has stated that “ developing markets and banking systems is one of the 3 fundamental tasks necessary for economic development”.

(Quirk, 1997) This is why through eroding financial institutions money laundering negatively impacts the whole economy. Maschaiandara (1998) has shown in his research that correctly developed anti-money laundering regulations may positively decrease the costs financial institutions have to bear; however in Britain, with the information discussed above, it is still under question whether the regulations work correctly. Money laundering in the real sector of British economy Money laundering is the phenomenon which first of all negatively impacts the level of investments in the British economy (as any other, though). Investment firms are required to follow the Regulations for anti-money laundering. The case with the Investment services UK which was fined £175, 000 in 2005 for the ineffective application of the anti-money laundering systems of control. This is one of the bright examples - on the one hand, the investments working with the enterprise recognize its lost reputation through the matter made public; on the other hand, the firm itself carries additional costs for the incompliance with the legal requirements, which affect its profitability and reputation.

Simultaneously, money laundering does not allow the economy growing, because the investments made with the use of the laundered assets are not invested into businesses which increase productivity, but they are made through the so-called “ sterile” ways; among the most common targets of

investing laundered money are real estate, art, jewelry, etc – these types of business activity are not productive, and they don't broaden the economy of the country; in addition, they distract financial flows from the other sectors of economy, which means that money laundering hinders economic development.

One of the researches states, that “ criminal organizations can transform productive enterprises into sterile investments by operating them for the purposes of laundering illicit proceeds rather than as profit-maximizing enterprises responsive to consumer demand and worthy of legitimate investment capital”. (Hinterseer, 1997) However, any information as for the possible amount of money laundering flows through such sterile enterprises in the UK is absent; it is yet clear that for Britain financial sector is more related to money laundering and thus represents the biggest threat for its economy, but other sectors should not be neglected. It is difficult to quantify the magnitude of the effects caused by money laundering in the real sector, but it is easily traced through the fact, that concentration of the financial flows on the so-called “ sterile” sectors causes the decrease in the general economic output, and this should also be taken into account when any new anti-money laundering regulations are developed for the UK. It is even more essential not to forget, that real and financial sectors of the economy are closely tied and are thus interrelated; money laundering is often shown as the multiplier of the criminal financial activities; the study conducted by Quirk (1997) in the 17 British cities and towns has shown, that “ transforming potential into effective purchasing power, money laundering allows the reinvestment of laundered illegal funds, thus playing a crucial role

in strengthening ties between the real and financial side of a criminal economy". In this case, and as the research makes comparison between Britain and Italy, it proves that financial sector money laundering is the pushing force for the real sector money laundering. The International Money Fund has defined the two major mechanisms through which money laundering hinders the development of any economy; though these mechanisms are more applicable to the developing countries, this effect should not be underestimated for the developed economies like Britain.

As soon as the first mechanism of money laundering connected with the "investment" into political events is not clearly related to Britain, the second one, which states that due to absence of laundered flows in official statistics professionals are not able to rule economic variables; these economic variables appear to be wrong and misleading. Money laundering and its negative effect on the British external sector. In relation to British economy, external sector should better be viewed through trade, though financial flows constitute the principal source of economic profits, but trade should be taken into account as it may negatively affect the economy in general through its distortion by money laundering. These schemes are often used by the developing countries, which cooperate with British enterprises and use trade as the means for money laundering; such schemes are widely spread using value-for-value transaction. The technique is called "misinvoicing" and implies the use of the inaccurate prices for the goods imported (exported) to hide the transfer of the illicit funds. The amount of such illicit funds in Britain has not yet been estimated and additional research is needed to acquire exact data; but it is stated that with the growth of such schemes the impact

on the economy may be serious. Britain is not involved into such kind of operations, and according to the statistics found in McGill (2005): 83% of money laundering is performed through its financial sector. Regulations in terms of money laundering are not always effective due to the fact that they cause serious costs to enterprises, as well as make it obligatory for the banks and other enterprises to report suspicious operations which are not always desirable for their reputation.

ImpactThus, it has been clarified that the impact of money laundering on the British economy is negative, and even accounting the opinions of certain specialists, who suppose that additional financial flows are always favorable for the economy, no matter what the source of these financial flows is, and whether it is legal or not, it is clear that money laundering hinders economy, and does not allow its growth. The impact on the financial sector of the British economy is the principal one, with Britain being the center of the world financial system. The negative impact is seen through the damaged reputation of the financial institutions, the result of which is displayed through the reluctance of the investors to work with these institutions and thus making them non-profitable, which ultimately leads to poor economy. Reputation is the key concern in terms of money laundering; the obligation of the financial institutions, and it makes the whole sector effective for the UK economy, while any reputation damage works against it. The negative impact on the British economy is also seen through the fact that real sector is used for money laundering in the area of non-productive businesses; money laundering does not give the economy any basis for growth, with the laundered money being invested into non-productive spheres; even in case

with the productive investments, the earlier profitable enterprises are turned into non-profitable for the aims of money laundering.

External sector of economy appears to be equally influenced by the phenomenon of money laundering. It is done through misleading prices in the invoices in trade, as well as other similar means. The principal negative effect for British economy is seen through the fact that illegal financial flows being out of statistics distort economic variables and thus make governing economy ineffective. Strengths and weaknessesThe project has its strengths and weaknesses which should also be accounted in the interpretation and discussion of the acquired theoretical knowledge and results. The principal strength of the project is in the fact that it has been one of the first attempts to see money laundering not from the viewpoint of its legal basis and implications, but from the viewpoint of its negative economic effects. Strength of the research is in the effects having been considered separately for each of the principal sectors of British economy; with British financial sector being attractive to money laundering, it has been useful to pay special attention to this aspect and to discover, how financial sector money laundering hinders British economy in general. The weaknesses of the research can be seen through the absence of the full data (especially statistical data) in relation to exact amounts of money laundered in the British economy; though some data has been used in the research noting the losses British enterprises experience as a result of money laundering, it is yet insufficient for acquiring clearer results.

Despite the fact that literary sources state, money laundering cannot be measured, it is recommended that more attention be paid to the phenomenon in the British economy, because this data will allow measuring the impact and develop corresponding measures against it. The weakness of the study is the limits of the research, which can be also take as possible bias; money laundering is the topic which some respondents refused to discuss; this is why the acquired results may contain misleading statements. With the account of the strengths and weaknesses of the present research it is still clear that the results suggest some implications for the field as a whole and recommendations for the future studies. The reason for the absence of the statistical data is in the fact that money laundering at present is more researched in the developed countries, while its impact on the developed economies is often underestimated and neglected. Implications for the fieldThe research can and should be used as the basis for the further investigation of economic impact on money laundering not only in Britain but in other European countries which are characterized by developed level of their economies and are often attractive as the means of money laundering.

The principal implication of the study is that the issue is not fully researched, and it can be stated that through the absence of the exact statistical and other related data in the UK it is difficult to speak about the effectiveness of anti-money laundering policies as a whole. It is implied, that organizations and financial institutions should pay more attention to the issue of money laundering, while the organizations which deal with economic research, should clearly understand the importance of the data for the efficiency of the economic performance in Britain. As far as it has been seen that the costs of

anti-laundering programs implementation for the enterprises are too high, and this is why it is implied that these costs should be either optimized or partially compensated by the Government if the enterprise is objectively unable to carry such costs; ultimately it is in the sphere of governmental authority to maintain the reputation of the British economy, making it more attractive for the foreign investments (clean investments). This is why state authorities should closely look at the ways of giving enterprises and financial institutions opportunity to work against money laundering with optimal costs and minimal damage for their reputation. The principal implication for the field, though, is the fact that the economic effects of money laundering in the British economy have not been researched well, and thus need special attention; this implication should become the basis for the research at the state level, which may ultimately lead to the development of the new Regulations, which will satisfy the needs and concerns of all parties; for now the issue of money laundering is seen from the viewpoint of Government only and this is why the requirements often appear discriminative, which should be amended to make the anti-money laundering fight effective.

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