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E.N. Egbuna

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PETER J. QUIRK, 'MONEY LAUNDERING: MUDDING THE MACRO ECONOMY', FINANCE AND DEVELOPMENT, MARCH 1997.

BY

Mrs. E.N. Egbuna

This article is based on a 1996 study by the author on "macro economy implication of money laundering" IMF working paper 96/66.
The article established that money laundering exists and threatens the macroeconomic and financial system of many countries. It then proposed that it is time the international financial community strongly support anti-laundering efforts.

The article is divided into four parts; part one, is the introduction and framework; part two, examines how big the problem is - the macroeconomic effects; while part three, focuses on policy implications; finally, part four, concludes the paper.

In the introduction, the author recounts the experience of a group of IMF staff who went to an island to assess its economic development. The group noticed that a large number of small banks, about 100, were operating in a population of less than 100,000 people. But soon after, it was discovered that most of them had no legitimate banking business and thus most of them were shut down. From this the author made two vital points (1) that offshore banks have been an important and visible vehicle for money laundering, (2) that there is need for an established framework for international cooperation in order to combat money laundering.

In 1996, the Paris based Financial Action Task Force (FATF) on money laundering asked the IMF to study the macroeconomic implications of money laundering. This was primarily because the IMF promotes liberalization in the international financial market. This was perceived as dangerous because liberalization gives more room for laundering 'dirty' money. Thus, most governments could not implement the "40 recommendations" for fighting money laundering since it was contradictory to the IMF's advice for liberalization of financial markets.

Mrs. E.N. Egbuna is a Senior Economist in the Research Department, Central Bank of Nigeria.

In the framework, the author sought to rebut the following arguments (1) that recommendation 23 implies that monitoring money laundering requires only information, and the type of information is not for control of foreign exchange transactions but for exchange control. The author proved this by stating that monitoring is focused on identities of transactions; (2) that money laundering has a significant negative impact on the macro economy and, therefore, the need to adopt anti-laundering measures.

The afore- mentioned rebuttal was proved by the second part of the article which stated that there are many approaches to prove the significance of laundering in the economic systems. The first is to show that it involves large sums relative to overall economic activity. This can be done indirectly using the displacement in time-series for currency demand associated with, for example, higher taxes and thus tax evasion. Another approach used by law enforcement community was to build up estimates by crime category (a micro economic approach) based on street knowledge, e.g. sampling and detailed medical, social and financial/tax records. The result is a very wide range of estimates of the size of underground economies as a percentage of GDP.

The author (in his earlier work (Quirk, 1996)) differs from the macro work in two respects. (1) It is cross- sectional for 19 industrial countries. (2) It uses Interpol crime data and data on labour participation as proxies for non-criminal informal markets, to explain currency and money demand across industrial countries. However, he states that there is need for better data. While macroeconomic data can provide indications of both direct and indirect influences of money laundering, the inclusion of indirect influences creates uncertainty as to exactly what is being measured. On the other hand, a micro-based approach requires the creation of a large amount of data specifically for measurement purposes.

Sampling and survey approach offers an extrapolative means to unobservable aspects of money laundering, but care must be taken to ensure that a comprehensive methodology is applied in the sampling and in-depth follow-up of transaction.

The second part of the paper explains that because laundering is hard to measure, it distorts economic data and complicate government efforts to manage economic policies. The macroeconomic effects are; (1) it results in misleading monetary data because it is hard to measure, thus, it has adverse effects for interest and exchange rate volatility, particularly in dollarised economies as the tracking of monetary aggregates becomes uncertain; (2) it has income distribution effects to the extent that the underlying criminal activity redirects income from high savers to low savers or from sound investment to risky low quality investment; (3) it has indirect macroeconomic effects in that illegal transactions can deter legal ones by contamination; and (4) accumulated balances of laundered assets are likely to be larger than annual flows, increasing the potentials for destabilising, economically, inefficient movements either across borders or domestically. These balances could be used to corner markets or even small economies. The author stated that the above effects are to some extent speculative. However, the Quirk study (1996) also conducted empirical tests on the relation between GDP growth and money laundering in 18 industrial countries and found that significant reduction in annual GDP growth rates were associated with increases in the laundering of criminal proceeds from 1983 - 1990.

In the third part of the paper, the author mentioned some macro policies that must play roles in anti-laundering efforts. These are in the area of:

(1) **Exchange control** - the author suggested the extension of the reporting and monitoring framework for money laundering to less formal body like bureaux de change. Also needed is the provision of adequate information and training on anti laundering surveillance to foreign exchange dealers through channels like the 'foreign exchange codes of conduct' that are drawn up by national associations of foreign exchange dealers or banking institution. Some could have technical assistance from the IMF.

(2) **Prudential supervision** - the absence of money laundering laws and measures makes it very difficult to combat the crime. However, bank supervisors' cooperation

with law enforcement agencies in identifying customers and keeping relevant records will go a long way in the anti-laundering drive. However, the author cautioned that law enforcement efforts should not crowd out the traditional responsibility of bank supervisors.

(3) **Tax collection** - Tax evasion has the most obvious macroeconomic impact, thus, efforts should be made to improve the tax collection capabilities of countries.

(4) **Statistical Reporting** - Concise efforts should be made in the use of good statistics as estimates eg. use of flows of laundered money. The author suggested the use of macroeconomic estimates of misinvoicing which can be made by comparing domestic trade data with partner-country data from the IMF's Direction of Trade data base after factoring in errors and omission in the balance of payment.

(5) **Legislation**- the author also suggested reformulation of laws governing financial systems and setting up separate banking laws and regulations covering reporting requirements for non-prudential purpose instead of including such in core banking laws and regulation. Provisions covering banking confidentiality and treatment of offshore banking are particularly relevant to money laundering.

In conclusion, the author remarked that fears that anti-laundering laws and regulations will undermine efforts to liberalise financial markets, or that opening up financial markets will promote money laundering are unfounded. Thus, efforts to combat money laundering should be intensified.

COMMENTS AND CONCLUSION

The strength of the paper lies in the use of practical results of studies which the author carried out to show how money laundering threatens economic and financial systems in many countries. The paper also showed that accumulated balances of laundered assets, if properly monitored, may likely be larger than annual flows, with serious macroeconomic implications.

The magnitude of the significance of money laundering is in the estimation of size of underground economies as a percentage of GDP, which the paper gave as 4 - 12% for Australia, Germany 2 - 11%, USA 4 - 33% and UK I - 15% etc.

In the box information the author also explained how money is laundered eg. smurfing, misinvoicing, barter etc.

Despite thc seriousness of money laundering to domestic and international financial systems, the author did not provide an insight into the reasons why both the Financial Action Task Force (FATF) and the Basle committee on banking have not come up with practical and universal approach to solving the laundering problems. He also did not provide concise definition of money laundering and also failed to state categorically in the second rebuttal of his framework that money laundering is a 'derivative crime' which makes it hard to established.

Most of the data and statistics in the paper are proxies and assumptions owing to the nature of money laundering. The author should have made use of some statistics on international banking and capital accounts of the balance of payments from the IMF to practically evaluate the devastating economic consequences of money laundering.

Finally, the Nigerian experience in money laundering is very limited and lack of accurate statistics has made monitoring and supervision very difficult. It should be desirable for the IMF to give more technical assistance to Nigeria in this regard.

Mrs. E.N. Egbuna
Research Department Liaison Office
Central Bank of Nigeria
Lagos.