

THE ECONOMIC DIMENSION OF MONEY LAUNDERING

UIAF DOCUMENTS





The economic dimension of money laundering

2014

This publication was written by the Financial Information and Analysis Unit (UIAF, for its Spanish language acronym), Special Administrative Unit ascribed to the Ministry of Finance and Public Credit of Colombia.

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This text was produced with the support of UIAF public officials, the assistance of an editorial coordination team and the guidance of the General Director and the Under Director of Strategic Analysis. A UIAF public official translated the document into English from its original version in Spanish. Although it is a direct translation, some paragraphs contain minor modifications in order to communicate ideas more effectively in the English language.

DESIGN, DIAGRAMMING AND PRINTING

García Solano y Compañía SAS - Caliche Impresores
Impresores Molher LTDA

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ISBN:
978-958-58773-2-0

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THE ECONOMIC DIMENSION OF MONEY LAUNDERING

“Money laundering transfers economic power from the market, government and citizens to criminals, and the same magnitude of the economic power accumulated by those who launder money has a corruptive effect on society” (Perotti, 2007).

INTRODUCTION²

Money laundering gives legal appearance to the proceeds from the illicit activities of criminal organizations, which need to integrate their dirty money into the legitimate economy in order to hide the traces of its origin.

This is a crime that generates economic distortions and imperfections, mainly in the financial, goods and services markets. Indirectly, it generates imperfections in the labor market, which in turn causes macroeconomic fiscal and currency exchange imbalances, distorting the results of the economy's real activity and affecting social wellbeing. The State must correct these market flaws in order to minimize the macroeconomic effects and costs of such distortions to achieve better economic growth rates and social development.

One of the most important negative impacts derived from money laundering are the great social and economic costs that are reflected in perverse effects over public spending and over the income of businesses and households in sectors that are vital to the economy and therefore to people's quality of

² This text was produced with the assistance of various UIAF public officials. For their feedback and comments, a special thanks to Alfonso Amaya Parra, Coordinator of the High Governance Program at Universidad de los Andes in Bogotá, Colombia, and to the UIAF's Under Director of Strategic Analysis from 2011 to the present. Thanks as well to the UIAF's General Directorate Legal Advisor for his contribution to the fifth section of the document. Second edition.

life (less employment generation and less poverty reduction).

examines how the State can intervene to alleviate the situation.

Given the influence of money laundering on market failures, this crime mainly harms ordinary people, behaving as a regressive informal tax. As such, the State's intervention must focus on guiding and instructing vulnerable sectors in order to combat this phenomenon and redistribute social benefits to the population.

By virtue of the aforementioned assertions and for the consistency of the reflection herein, this document is organized in five sections: the first briefly reviews national and international literature concerning estimates of the volume of criminal income and the amounts susceptible to money laundering nationally and worldwide; the second calls attention to the fact that economic discussion has lagged on the subject of illicit finances; the third describes the effects of money laundering and its links to market failures; the fourth analyzes and interprets the impact of money laundering as a generalized cost for citizens, similar to an impositive load on society, mainly on lower income populations; finally, the fifth



01

APPROXIMATIONS TO THE MAGNITUDE OF ILLICIT MONEY

Although calculating illicit financial flows is a complex task given the nature of the criminal phenomenon, the effort by different entities, multilateral organizations and academia to carry out estimates, has represented a significant progress in this area, the study of which is still growing and where comparisons imply a high degree of difficulty.

The report, *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes*, published by the United Nations Office on Drugs and Crime (Unodc) in the year 2011, states that one of the first measurements of illicit financial flows associated with money laundering was done by the Financial Action Task Force (Fatf-Gafi) at the end of the 1980s. The findings obtained from this study indicate that the total amount of money laundering is approximately 2 percent of the global Gross Domestic Product (Gdp). Meanwhile, in 1998 the International Monetary Fund (IMF) referred to a “consensus range,” in which it warned that the possible volume of money laundering transactions was somewhere between 2 and 5 percent of global Gdp.

In addition to these estimates, some studies have approached the issue by calculating [shadow or underground economies](#), defined widely as the set of legal and/or illegal activities that escape official observation in Gdp calculations, given that they intentionally hide in order to elude regulation, controls, taxes, contributions to social security, compliance with minimum requirements of labor law and/or specific administrative procedures.

In this context, it is notable that although the solely criminal component of underground economies is a minor part of them, their estimates are commonly accepted as a measure of the product of organized crime. In fact, works by Schneider (2005), Walker & Unger (2009), suggest that nations with high levels of shadow economies are more vulnerable to being used by criminal organizations in order to “camouflage” the money obtained from their illicit activities.

Schneider (2005) has produced one of the most representative works in the international literature on the topic, in which he estimates the size of the shadow economies of 145 countries worldwide during

the period 2002-2003. The results show that the average share of the illicit economy, as a percentage of the official Gdp, was greater in African countries (43.2 percent) and in Central and South America ones (43.4%), while for 21 member countries of the Organization for Economic Cooperation and Development (Oecd), it accounted for 16.3 percent. The author notes that while countries in Africa and in South and Central America have hidden economies that are more than double the size of those in the Oecd nations, the growth rates and income inequalities in those countries are also much higher than in the wealthy industrialized countries. It might be concluded that nations on the development path have larger underground economies than the already developed countries.

Next, Schneider (2010) attempts a delimited quantification of the size of money laundering for 20 developed member countries of the Oecd between 1995 and 2006, finding that it has increased from USD 270 to USD 614 billion, respectively. Likewise, the author indicates that in 2001 the amount produced by organized crime was approximate-

ly USD 595 billion, ascending to USD 790 billion in 2006, out of which he estimates that USD 338 billion correspond to the product of total sales of illicit drugs. These data, even with their wide margin of error, clearly reveal that the volume of wealth produced and laundered by organized crime is considerable.

UNODC's [meta-analysis](#)³ finds a compelling convergence of the data of the available studies and other estimates despite their obvious differences. Consequently, an average was obtained indicating that the total income generated by some of the main businesses of transnational organized crime – drug trafficking, smuggling, counterfeit medicine, arms trafficking and illicit trafficking of migrants and humans, trafficking of natural resources, corruption, extortion, among the most prominent, reached 3.6 percent of global Gdp, which in absolute terms corresponds to an average of [2.1 trillion dollars](#)⁴ for the year 2009, with drug trafficking occupying the most profitable source of income for organized crime.

³A meta-analysis is a study based on the structured and systematic integration of information obtained from different works about a defined problem, with the intent to identify and review said contributions, in search of a synthetic quantitative estimate from all of the available ones. In this case the meta-analysis refers to *Estimating illicit financial flows resulting from drug trafficking and other transnational crimes* (2011).

⁴For Spanish language speakers, this amount would be read in billions given that in Spanish speaking countries the numeric scale 10¹² is read as billions, not trillions.

Moreover, the report highlights that according to original calculations by the Fatf-Gafi (1990), the total available amount for money laundering through the financial system is approximately 70 percent of the income derived from the crime. As such, the best estimates fluctuate around 2.7 percent of global GDP (USD 1.6 trillion) in 2009, a figure located toward the lower end of the IMF's consensus range.

Previously, Masciandaro and Barone (2008) had inquired into the value of money laundering worldwide, based on a multiplier model that associates the income of criminal markets and money laundering activities with data corresponding to the year 2004, determining that the amount susceptible to the latter equals USD 1.2 trillion (2.7 percent of global Gdp), a proportion not distant from the one calculated by the Fatf-Gafi. Meanwhile, the maximum theoretical benefit in the fight against money laundering through financial regulation – in a state of equilibrium – corresponds to USD 280 billion (0.6 percent of global Gdp in 2004).

Locally, Schneider and Hametner (2007) developed an estimation model of the underground economy for Colombia spanning from the year 1976 to 2002, concluding that its size in terms of Gdp fluctuated between 20 and 50 percent from the 1970s to the 1990s, respectively, with unemployment, as well as direct and indirect taxes, representing the most influential factors.

Conversely, in order to determine the impact of movements in outlawed activities [over the demand for cash](#)⁵, Arango, Misas and López (2006) also estimated the dynamics and size of the underground economy in the country, including as variables drug trafficking and the informal economy that eluded fiscal and labor legislation for the period 1976-2003. The findings demonstrated a strong growth in underground activities toward the end of the 1970s, reaching their maximum potential in the mid-80s, a stabilization period between 1985 and 1996, to later re-emerge with great force in the late 1990s. Such dynamic coincided with the upturn of the fraction of self-employed workers and those below the minimum wage.

⁵According to the authors, the shadow economy is the non-observable variable that interacts with the demand for cash, based on the assumption that most transactions in this context occur in cash.

With regard to calculations of the financial resources that originate specifically in criminal activities, the undeniable influence of drug trafficking in the country gave way to an important number of works, geared at measuring the amounts resulting from cocaine production and trade. According to Rocha (2011), the most meaningful studies that have quantified the size of drug trafficking through the repatriation of illegal proceeds, presented in terms of Gdp, “...have referred to: 3.6% in 1978 (Caballero and Junguito, 1978); between 9.8% in 1982 and 0.9% in 1991 (Gómez, 1988, 1990; Gómez and Santa María, 1994); between 3% and 17% for a minimum and maximum scenario between 1985 and 1994 (Rocha, 1997); between 5% and 2% from 1980 to 1998 (Rocha, 2000; Steiner, 1997); between 2.3% and 1.7% from 1999 to 2003 (Rocha and Ramírez, 2005)...”

From this perspective, according to the results obtained from recent estimates by Mejía and Rico (2010), the **total revenue**⁶ derived from the sale of cocaine in Colombia during 2008 was approximately **COP 13.6 billion**⁷ (USD 6,900 million)⁸ with a minimum value of **COP 9.4 billion**⁹ (USD 4,800 million) and a maxi-

mum value of **COP 18 billion**¹⁰ (USD 9,150 million).

Subsequently, Caballero and Ama-ya (2011) estimate the amount of money laundering (measured mainly as money from drug trafficking), pinpointing two channels through which it gains access into the country's economy: 1) Merchandise and 2) Cash money. The former – consisting primarily of contraband – represented 89.6 percent of the total, adding up to USD 7,747 million in 2007. As a result, the researchers conclude that the possible size of money laundering equals a percentage of the representative Gdp, which could range between 2 and 3 percent.

With regard to financial flows derived from other types of criminal activities, research indicates that there are few studies that have tried to measure them particularly given the complexity of such task in the face of few existing statistics. The available studies, therefore, must be treated with some caution.

⁶ Net cost of transportation in each of the trade routes.

⁷ 2.3 percent of national Gdp.

⁸ All values in US dollars in this paragraph were calculated based on an annual average exchange rate of COP \$1,966.26 per one USD, corresponding to the year 2008.

⁹ 1.6 percent of national Gdp.

¹⁰ 3 percent of national Gdp.



02

LAG OF CRIMINAL FINANCES IN THE ECONOMIC DISCUSSION

As Masciandaro, Takáts and Unger (2007) assert, until recently, economic theory had not placed significant attention on financial crime, meaning that while the monetary and financial branches of economic theory focused on legal financial transactions, economic crime theory overlooked financial aspects; hence, monetary flows linked to illegal or criminal activities fell into this divide. This generated a gap in the literature, given that recently the proceeds of crime have gained relevance and accentuated in the public and political debate, particularly when associated to the financing of terrorism.

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Nonetheless, this gap was noticeable not only from an economic theory standpoint, but also from a normative one. In consequence, over the last 25 years, the global AML system has consolidated itself based on a legal-centered approach, with discussions on the crime focusing on regulatory compliance, while sidestepping analyses on money laundering as a problem for economic security and stability worldwide. Given the above, society's perception of the

crime has lacked reference points to its socioeconomic implications.

Evidence of the preponderance of the legal approach is found in the basic principles of banking oversight set forth by the Basel Committee of Banking Supervision (1975), the United Nations conventions against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) and against Transnational Organized Crime (2000), [Fatf-Gafi's 40 Recommendations \(1990\)](#)¹¹, the European Union's 308 Directive related to the prevention of the use of the financial system for money laundering (1991) and the model regulation on money laundering related to illicit drugs trafficking and other serious crimes, approved by the Inter American Drug Abuse Control Commission (Cicad 1992) of the Organization of American States (OAS), just to name some of the most relevant.

In the national realm, [Act 526 of 1999](#) established a legal framework from which a series of instruments have derived, allowing the Financial Information and Analysis Unit (UIAF), together with inspection, oversight and control authorities, to demand that entities from va-

¹¹ In the year 1996: revision of the 40 recommendations against money laundering. In 2001: inclusion of 9 recommendations to combat the financing of terrorism. In 2003: modification of the 40 recommendations against money laundering and the 9 especial recommendations to combat the financing of terrorism. In 2012: revision and unification of the 40 plus 9 recommendations.

rious economic sectors file Suspicious Transactions Reports (STRs), as key sources of information for the detection of transactions possibly originating in illicit activities.

Given the context previously described, during the last five years much attention has been placed on the economic aspects of money laundering, recognizing that in addition to the government's role in preventing and suppressing the crime, the optimal system requires the participation of society as a whole.





03

THE EFFECTS

OF MONEY LAUNDERING

Numerous negative socioeconomic consequences derive from the amounts of illicit money previously mentioned. The 2011 Unodc report warns that the main threat is the ability that these flows have to promote the economic viability of criminal activities, contributing to their propagation and expansion.

From an economic perspective, the escalation of the different manifestations of crime has an inverse relation to economic wellbeing (growth + development) within any given society, as it is documented theoretically and empirically by diverse authors such as Masciandaro, Arnone, Bornini, Tanzi, Unger, Schneider, Argentiero, Slim, among others. In their assessments, they establish that money laundering, i) **increases the reputational and economic risks for the public and private sectors**, ii) **weakens institutions** and iii) **hinders the operation of markets** – all risks that are aggravated in the context of economic and financial globalization.

From a macroeconomic angle, Slim (2011) indicates that money laundering affects monetary aggregates, the composition of the monetary

mass, as well as real variables such as Gdp, consumer consumption, tax collection and income availability. Simultaneously, the use of international trade and document forgery as support for money laundering operations distort external accounts (current and capital), affecting the equilibrium of the balance of payments. Therefore, the national currency is affected (overvaluation or undervaluation), distorting the actual situation concerning a country's economic growth.

An indirect but worrisome effect also reflects in the design and effectiveness of public policies, given the interferences in microeconomic and macroeconomic statistics.

Another devastating consequence of criminal resources is the corruptive influence on society and its institutions because, as Perotti (2007) argues, the economic power of the market, government and citizens is transferred to criminals. Therefore, it is said that the most successful criminal structures are those capable of using corruption to weaken official controls and law enforcement.

Additionally, in order to perceive the impact on the legal business apparatus, it is fundamental to understand the assumption that a criminal is a maximizing agent (Becker, 1968 – Nobel prize winner 1992). According to Becker, criminals attempt to maximize their profits and to do so, they perform risks, costs and benefits assessments, which suggests that criminals are agents with a rational conduct.

In spite of the above, criminals' economic rationality does not move in the same direction of the choices of legal business agents, considering that their utility function does not pursue the same objectives. Therefore, an illegal businessperson only seeks to launder money without considering financial limitations and the prices and costs in the market, causing legal companies to go out of business easily.

Money laundering also imposes costs on the economy given its ability to:

a

“DAMAGE OR AT LEAST THREATEN TO HARM THE ECONOMIC OPERATIONS OF COUNTRIES,

b

CORRUPT THE FINANCIAL SYSTEM, UNDERMINING THE PUBLIC'S CONFIDENCE IN THIS SYSTEM AND, CONSEQUENTLY, INCREASE THE RISK OF INSTABILITY IN THE SYSTEM AND, LASTLY



threat of monetary instability due to the inadequate distribution of resources as a result of the artificial distortion of the prices of goods and services” (United States Department of State, 2001).

REDUCE THE RATE OF GROWTH OF THE GLOBAL ECONOMY¹² AND THE POSSIBILITIES FOR DEVELOPMENT.

It is widely accepted that money laundering particularly affects economic order, although its consequences extend to the government, institutions and social well-being of countries (Bartlett, 2002; Inter American Development Bank, 2005; Cicad, 2006). Assessing the serious impact of money laundering on the economic system includes defining estimation methods and measuring the size of the illicit resources invested in money laundering operations.

Due to their nature, the insertion of illicit flows in the economic system acts as an externality that distorts production and consumption behaviors, as well as growth and development levels. Additionally, it passes additional costs onto the market, through distorted prices: *“Money laundering can increase the*

Concerning the economic system’s behavior, it can be inferred that money laundering affects the information held by market agents and sends altered signals regarding the market’s situation, thereby affecting decision-making on production and investment, as well as the efficient allocation of resources.

From a conditions of competition perspective, a money launderer can operate even in unfavorable economic conditions, inefficient or unprofitable economic activities and prices below production and trade costs. Meanwhile, the sectors that depend on legally-obtained resources face credit restrictions (adverse selection and other imperfections), high opportunity costs, external negative shocks (international prices, climate conditions, unstable political relations, among other factors), and the payment of legal contributions that impact economic activity overall and long-term development (IDB, 2005).

¹² See Vito Tanzi, “Money Laundering and the International Financial System,” May 1996, FMI - Working Paper, pg 2; also see William F. Wechsler, “Follow the Money,” Foreign Affairs, July/August 2001, pg 41 and sts.; William C. Gilmore, “Dirty Money The evolution of money laundering counter-measures,” Council of Europe Press, 1995, pg 25 and sts. Cited by Perotti.

In this context, money laundering has a negative effect on the economy by altering the benchmark prices system. With regard to productive assets, such as land and credit, the scarcity or abundance of illicit money flows modifies the way local producers can access them. The injection of illicit-origin capital in some economic sectors, such as construction, exports and securities, has facilitated artificial wellbeing conditions that are unsustainable.

Another important aspect to mention is the massive entry of capital and its impact on the currency exchange rate and on the competitiveness of locally produced goods, which are traded abroad via the appreciation of currency exchange.

The massive entry of capital of illicit origin can take place through different economic activities, such as *“smuggling, over and under invoicing of exported and imported merchandise and the use of international financial markets,”* where Salama¹³ (1999) refers to the second mechanism as follows:

“Under invoicing permits the acquisition of a larger quantity in local currency for each dollar that is laundered, in which in order to carry out the estimate, the prices declared by companies that export to Colombia are compared against the prices of the imports, adjusting by a correction factor that takes into account the FOB price and the CIF price¹⁴.

Although fluctuations and estimates vary depending on the author, the transferred sums sometimes reach elevated levels (with a peak of more than 1,700 million [US] dollars in the year 1992 in Colombia (CID, p. 28).”

¹³ Professor of the University of Paris III Greidt-Cedi, winner of the Julio Cortázar prize. He has published numerous books, most of which are translated into Spanish and Portuguese. A member of the editorial board of various foreign magazines, he previously worked as the scientific director of Third World magazine and the Investigation Group on the State, Internationalization of Technology and Development (Greitd).

¹⁴ In economics, FOB stands for “free on board,” while CIF refers to “cost insurance freight.”

On the other hand, lesser quantities such as remittances presented a “median annual evolution (...) of 12% between the years 2001-2007, becoming, according to Cardona (2008), the second source of income derived from foreign exchange after petroleum,” reaching USD 2,021 million in 2001 and USD 4,490 million in 2007. Although no precise percentage of the participation of remittances as recycling-laundering of money is known, in his document, “*La economía de los narcodólares*,” Salama states that *“when comparing, the amounts sent to Colombia by Colombian residents in the United States before and after the year 1980, a very important rise is observed that cannot explain the improvement in their way of life”* (available in <http://pierre.salama.pagesperso-orange.fr/>).

As previously mentioned, money laundering also affects the integrity and stability of the financial system. One of the risks identified in this realm is the reputational risk, which the Financial Superintendence of Colombia defines as the *“possibility of loss assumed by an entity due to the loss of pres-*

tige, bad image, negative publicity, truthful or not, concerning the institution and its business practices, resulting in loss of clients, income reduction or judicial proceedings” (Financial Superintendence of Colombia, 2007). Given the above, it is evident that it is in a country’s interest to rely on a financial system that preserves its integrity and prevents the influence of factors that can negatively affect its reputation.

It is equally important to note that given its strategic role and its power in the market and the economy in general, the financial sector can suffer significant other impacts from money laundering. For this reason, since the creation of the Basel Committee on Banking Supervision in the year 1975, the principles of banking supervision were established, among them, the *Prevention of criminal use of the banking system for the purpose of money-laundering* (Basel banking supervision document, 2011). On the basis of this supervision, different groups, committees and institutions have been created, which have established restrictions, legislation and monitoring activities to protect the financial system from various risks.

At the same time, money laundering, through its different methods of operation, generates in the global financial system erroneous expectations about the markets, which reflects in situations that can originate in cash flow problems, ascending levels of country risk and volatility in capital and interest and exchange rates.

Financial entities are not the only ones to rely on special measures to control the risks generated by money laundering. Governments, through their oversight institutions, must be at the frontline of financial operations generated by the market, in order to create or adjust controls targeted at the timely prevention and detection of illicit activities.

The anomalies that money-laundering causes on markets, also limiting economic growth and affect tax collection, resource distribution and the income received by the government, thereby reducing income levels and indirectly harming honest tax payers, considering that the above generally translates into increased tax fees.

Given its clandestine character, money laundering promotes the use of the underground economy as a vehicle to evade the controls applied by different oversight entities, polluting compliance with the law. As such, if a part of the legal system is violated, most likely other illegal actions will follow.

Furthermore, money laundering sends the wrong behavioral signals to the market, triggering the passing of inaccurate and inefficient fiscal policies, which cause the deviation of public funds away from priority spending (health, education and infrastructure, among others).

Based on the notion that money laundering generates market failures that translate into erroneous and inefficient allocation of resour-



ces, it is plausible to affirm that the launderer's behavior is a negative externality because the costs of laundering money are transferred to all other citizens who do not participate in the criminal enterprise, as a result of market competition inequalities, greater impositive taxes and the deviation of public funds away from priority spending.

org/blaavirtual/ayudadetareas/economia/econo102.html).

As described above, money laundering becomes a type of government expenditure paid for by all private citizens, vulnerable sectors and small and medium sized companies (Pymes, for their Spanish acronym) that do not have enough financial strength to withstand a market failure, ultimately converging into a cost for the State, which is compelled to fix the market failures bred by money laundering. These costs transfer, as a type of regressive tax, to communities in the lowest income levels, given that by definition, a regressive tax is one that *"is charged equally on everyone; meaning, the rate paid bears no relation to a person's economic capacity...the above implies that the amount of money that the poor must pay for this tax is greater in proportion to their income"* (available in <http://www.banrepcultural>.



04

MONEY LAUNDERING

AN "INFORMAL TAX" GENERATED BY CRIMINALS

As previously discussed, money laundering generates costs that can affect the macroeconomic balance through distortions in the market signals that indirectly impact the social wellbeing of the population and directly impact the finances of companies and households.

One of the most significant macroeconomic examples of this, which has brought about important reactions in the Government and the Bank of the Republic, the country's Central Bank, is the effect on the appreciation of the peso relative to the dollar due to circumstances independent from the economic juncture. This dynamic is observed when, in the foreign exchange market, the offer increases more in proportion to the movement of other economic variables, such as exports and foreign investment.

The appreciation produces a loss in productivity, an imbalance in the current account -given the contraction of exports- as well as a rise in unemployment, destimulating productive chains related to exports.

As a result, the Government must intervene with fiscal and trade policies and offer subsidies and other benefits to the export sector, translating into a surge in public spending. Indirectly, given that the nations' budget is allocated prior to the following fiscal year, it becomes necessary to reduce government spending in specific sectors, increase tax collection (new taxes, higher rates or expansion of the tax base), augment the external debt or issue internal public debt, in order to address market failures disassociated from an economic cycles' regular movement.

Companies that produce goods and provide services, require raw materials, equipment, labor and capital, among others, to perform their activity. These companies incur direct and indirect costs, which they expect to compensate through positive results, based on a cost-benefit relationship. Conversely, firms that build their capital from illicit resources will not be interested, from a financial standpoint, in the result of said relationship. Rather, these companies will participate in the circular flow of the economic activity, seeking to "legalize" a portion or the entirety

of their illicit money, as opposed to generate sustainability, economic growth, formal employment and development.

Accordingly, companies that operate with legal money will take on additional burdens in comparison to companies that launder money.

The additional weight on business, generated by those who use the market to give an appearance of legality to illicit money, negatively affects cost-benefit dynamics. Subsequently, the burden becomes a type of tax that legal companies must pay in order to operate in an unfair competition environment.

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In parallel, consumers, who demand goods and services, are affected by the two factors that are discussed next.

1

If illicit money enters the economy via consumers, these will have greater purchasing power¹⁵ to access other goods and services, which they previously did not. Hence, the increase in demand quantities for this type of goods¹⁶ will affect price levels, altering the preferences of consumers who participate in the circular flow of the economy with legally obtained resources.

Additionally, consumers who want to acquire certain goods and services, demanded also by consumers with illegally obtained money, will satisfy their needs by paying a value superior to that of the theoretical price, meaning they will incur an additional impositive load, which resembles an implicit, regressive tax, such as inflation.

¹⁵ An increase in consumer purchasing power expands the boundaries of the budget restriction.

¹⁶ The behavior in the demanded quantities as a result of the increase in consumers' purchasing power depends on whether the good is *Inferior, Normal, Giffen and Sumptuary*.

2

If illicit money enters the economy through companies that produce goods and services, they will be able to offer lower prices as a result of an “apparent” reduction in their costs of production. Subsequently, the offer of such goods and services will derive in the acquisition of demanded quantities at lower prices, spawning variances in the market equilibrium, modifying consumer preferences¹⁷ and simultaneously creating barriers against the entry of new companies willing to participate in the market.

Hence, it can be inferred that one of the effects caused by the insertion of illicit proceeds into the circular flow of the economic activity is the tax that incorporates into costs of production, market prices and individuals’ incomes.

¹⁷ Offer and demand dynamics will depend on the type of market and the characteristics of the good.



05

FORMS OF STATE

INTERVENTION IN THE ECONOMY

The basic functions of the State are performed best when there is adequate articulation among government, society and the market. From an economic perspective, this means:

“... the Communitarian State must aim at the search for balance between the market and the public interest, in a way that its intervention helps correct market failures as well as government failures [sic], reduce the negative externalities that limit the country’s economic and social wellbeing and maximize the positive ones, ensuring equality in the distribution of growth benefits. This equilibrium requires institutions with the ability to focus their work in favor of an effective provision of goods and public services, as well as the promotion, regulation and efficient control by the State to complement the behavior of the markets” (Conpes 3248¹⁸, 2003).

Miranda and Márquez (2004) define State intervention in the economy as the set of acts that the State carries out in order to intercede, mediate or take part in the transactions that are exercised by agents

in a particular time and place. In line with the authors, three forms of State intervention in the economy are identified.

1

The first one is the intervention as a *guarantor State*, meaning it guarantees the rights to property and individual security. In this sense, the State performs a stimulus and guidance task so that all of its participants have access to the rights that a State must guarantee.

2

/31

The second is economic intervention, which means that *the government-State intervenes as an economic agent*, behaving as a producer and consumer of goods and services. The State looks to the factor, goods and services markets as provider and/or consumer. Nevertheless, in contrast to other economic agents (families and companies), it has the coercive capacity to collect taxes.

¹⁸ *Conpes* is the Spanish language acronym for *Consejo Nacional de Política Económica y Social* or National Council for Economic and Social Policy in English. This body, under the coordination of the National Planning Department (DNP for its Spanish language acronym) of Colombia, serves as the government’s national planning authority. *Conpes* documents represent the highest level of policy making.

3

The third refers to the direction of the economic activity through economic regulation and normative intervention. Concerning this concept, *Colombia's Political Constitution of 1991, Article 334*, establishes the ends and instruments of intervention that the State disposes of to attain full employment, redistributive justice and social development leading toward a fair economic, social and political order, for which it must direct, rationalize, plan, regulate and supervise the economic activity. Having said this, the objective of normative intervention is to define the restrictions to business freedoms, meaning not only fixing market failures and seeking an economic order, but also passing policy that suits State interests.

As stated in *Act 526 of 1999*, the UIAF performs this type of State intervention given that its “...duties correspond to State intervention to detect practices associated with Money Laundering” and the Financing of Terrorism.¹⁹

This third form of intervention also includes economic regulation, which refers to the regulations that is enforced by the government to create an economic order as set forth in the Constitution, emitting clear and enforceable norms. Additionally, it determines the power to sanction and resolve conflicts (through mediation, conciliation and arbitration). Economic regulation is an important mechanism in the normative intervention, given that it emerges as an expression of the powers bestowed on the Executive branch to direct the economy, within the legal framework determined by the Legislative branch.

Regarding the incidence of money laundering in the open market economy, Caparros (1997) explains the issue with assertiveness, stating:

“In particular, money laundering generates a climate of uncertainty that can affect the stability that the capital market requires for its adequate performance, by potentially subduing it to international discredit. Nevertheless, if it were necessary to determine the most vicious effect caused by recycling

¹⁹ Act 526 of 1999 as amended by Act 1121 of 2006, “By which norms for the prevention, detection, investigation and sanction of the financing of terrorism and other dispositions are dictated”.

processes on socio-economic order, it would be necessary to refer to the enormous damages that, already in the integration phase, they can cause over the free competition regime. In fact, those producers that act within honest traffic find themselves forced to concur with other agents that can act outside of all economic rationality. In this way, they see their position affected severely before their customers, causing them to become marginalized and, ultimately, expelled from the legal traffic, an area in which the enterprise fed with illicit capital tends to become a monopoly.”

According to Hernandez (1998), as the socioeconomic crime that it is, money laundering challenges the State’s responsibility to direct the economy and threatens its duty to safeguard the purchasing power of currency, impedes controlling the quantities, quality and prices of the goods and products available in the economy and, as discussed in chapter 3, generates distortions or market failures.

Overall, money laundering affects a just economic and social order, concentrating wealth in the hands of criminals, affecting methods of

payment and building an unequal and unstable society. Money laundering and the financing of terrorism disregard the principle of solidarity and affect transparency, security and prosperity in general.

Considering the above, the State intervenes reflecting its own policy and interests, establishing authorities and organizations that are responsible for inspecting, overseeing and controlling free competition. Furthermore, when it performs a guidance role, the State also focuses on the efficient allocation of public services, currency and credit, and safeguarding the environment and development. Within this framework, *Article 10 of Act 526 of 1999* states that the entities that perform inspection, oversight and control functions must instruct their entities so that they comply with the instructions set out by the UIAF, which has as its mission the prevention and detection of money laundering and financing of terrorism operations.

The UIAF’s State intervention powers are visible in its capacity to issue regulation geared at obtaining reports of activities by economic sectors, with the purpose of

protecting them from possible money laundering and/or financing of terrorism operations. Initially, and in consonance with the creation of the UIAF, the reports came from the financial sector. Currently, these have been extended to the real sector of the economy, seeking to decrease their vulnerability to criminal use for money laundering purposes. It is notable that up to now the UIAF has partially applied its intervention powers, meaning it can potentially resort to other intervention mechanisms different from the receipt of suspicious transactions or regular operations reports submitted by various economic sectors and reporting entities.

CONCLUSIONS

Money Laundering:

ACTS

as a negative externality in production and consumption, resulting in distortions in economic behavior patterns, as well as growth and development levels; sends misleading signals about market conditions, affecting decision-making on production, investment, consumption and efficient allocation of resources.

GENERATES

imperfections in the markets, in the distribution of the resources and earnings received by government, affecting their collection, reducing income and consequently harming tax payers via an implicit tax.

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PROMOTES

the use of the underground economy as a vehicle for avoiding and evading imposed controls by different oversight and control authorities.



RESULTS

in detriment to citizens through production costs, prices levels and effects over income, in the form of imposed loads.

This situation justifies the State's intervention in order to balance and minimize these effects, a function that ought to be acquired by the institutions that must ultimately envision, guide and instruct for the fulfillment of these objectives. For this reason, one of the UIAF's duties in this context is to detect alterations and distortions, money laundering and/or the financing of terrorism operations, which attempt against economic and social order and generate imposed burdens to market actors within the economic circuit, which finally impacts the countries' development and the wellbeing of its citizens.

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