Money laundering: Its economic consequences and the policy response

Annual address by Tom Alweendo, Governor of Bank of Namibia

2006

==========================

Hon. Members of Parliament present,
Members of the Diplomatic Corps,
Members of the Board of the Bank of Namibia,
Media Representatives,
Distinguished Guests,
Ladies and Gentlemen,

Allow me to extend a warm welcome to all of you for honouring our invitation to our annual address. This annual event has been organized to serve as a platform for the interaction and sharing of economic information between the Bank and our stakeholders. This year the topic of my address is focusing on money laundering and its consequences.

We all agree that money is the lifeblood of legitimate business. What is not always understood is that money is equally the lifeblood of organised crime, including money-laundering crimes. The proceeds of crime in its diverse forms flow through the international banking system in an attempt to provide criminals with the new capital needed to buy goods and services.

Earlier on it was thought that money laundering is only confined to the developed economies, and that money launderers do not target developing economies. It was also thought that necessarily money laundering proceeds are always to do with drug related crimes. The truth of the matter is, however, that money laundering can originate from anywhere in the world.

Money launderers allocate dirty money around the globe, not so much based on economic fundamentals. Rather, they take their decisions as to where to launder the money on the basis of ease of entry into and exit from the financial system and on differences in controls and regulations, which make money laundering a safer activity in some countries than in others. For example you might have an economy with well-developed financial market infrastructures, but because of its poor controls such an economy will be a perfect destination for money laundering.

You will be familiar with a number of examples of sources of laundered proceeds. One can think of dealings in illicit diamonds and other precious gems and metals. The infamous rhino horn and ivory trafficking is still emerging occasionally, while car theft syndicates continue operating throughout the Southern African region. Then there is the dilemma of weapon trade in certain war-torn parts of our region, which carries on despite strict controls and international embargoes. Of late, we have also witnessed a renewed wave of drug trafficking using Namibia as route into the Southern African region. Financial scams, such as pyramid schemes and illegal deposit taking, continue where people are robbed of their savings. We are also aware of situations where governments in developing countries, desperate to attract foreign direct investments and foreign participation in their economies, have been duped into what appears to be irresistible investments, except that the investments turned out to be highly sophisticated financial scams, where the aim was to launder money.

The extent to which money is laundered globally is estimated to be between $500 billion and $1 trillion. This wide range of the estimate highlights the difficulties associated with obtaining accurate data on this problem. This is the case because only a limited number of countries have set up anti money laundering regimes that are up and running and therefore able to provide appropriate statistics. The problem of lack of accurate money laundering statistics in Africa is compounded where the setting-up of anti-money laundering regimes is only gaining momentum now. It will take some time for Africa to build up accurate statistics on money laundering as this would have to be sourced from actual cases investigated and finalized.

The globalisation of economic activities and of financial markets has had many positive impacts on the world economy, but it is also true that globalization has introduced unintended risks. That is probably why when liberalizing their economies, governments are equally concerned about the possible conflict between liberalization policies that are meant to prepare their economies for the global environment, on the one hand, and, on the other, the need to step up anti-money laundering efforts. It has even been suggested that the liberalisation of financial markets, particularly for cross-border capital flows, may unintentionally promote money laundering. An added concern is that most efforts to deepen and broaden financial markets and to modernise domestic and cross-border payment systems could make it easier for criminals to transfer funds within emerging economies.

As regulatory institutions and agencies have stepped up their controls, the money launderers have also become progressively more sophisticated in their approaches and schemes. The problem is compounded by the much larger volume of legitimate capital moving at any one time in the world. Because of the relatively limited official controls on such movements, it is easier for money of questionable origin to enter this huge money stream without attracting much attention.

It is important to acknowledge the fact that money laundering is a crime like other crimes, and therefore it affects all of us. The consequences of crime, including money laundering, are bad for business, development, and the general rule of law. Governments have therefore got real reasons for spearheading the combating of money laundering. Another reason why money laundering should be combated is that if left unchecked, it would lead to the accumulation of economic power to organized crime. This development has the potential of eroding our political and social systems based on elected representation as we know them today. In other words, the social consequences for allowing money launderers to operate unchecked could spell disaster for stability and the rule of law.

Without a doubt, money laundering has a negative impact on any economy. Generally the money launderer will target an environment that most easily allows the recycling of the illegally obtained money, even when this requires accepting a lower rate of return. Money may move from countries with good economic policies and higher rates of return to countries with poorer policies and lower rates of return, thus seeming to defy the laws of economics. This implies therefore that, because of money laundering, the world capital could be invested less optimally than would be the case in the absence of money laundering activities.

As a consequence of these counter intuitive capital movements, policymakers may get confused as to the policies to be pursued, because of wrong signals that may emerge from financial markets. Large capital inflows and outflows could significantly influence variables, such as exchange rates and the interest rates, or even the prices of particular assets in which laundered money is invested, such as fixed properties. In free-flowing exchange rate economies, the inflow of large amounts of laundered money could lead to an exchange rate appreciation and/or to an expansion of the monetary base. In response, economic policymakers may therefore wrongly respond by adjusting fiscal and or monetary policies, thereby eroding the effectiveness of both monetary and fiscal policies.

Currently there is little empirical work on the macro-economic impact of money laundering because of the difficulties associated with measuring money laundering. What is important, however, is to acknowledge the potential damaging impact on financial systems and on the real economy. When designing policy responses to money laundering, such policy measures must take into account issues such as the liberalization of exchange controls, the role of prudential supervision of the financial system, and regional and international co-operation.

Although I have mentioned exchange controls being one of the areas to be considered carefully when designing anti money laundering measures, exchange control in itself is not a measure to combat money laundering. Exchange control requires information on the economic function of the transaction for enforcement, while monitoring for money laundering is focused on establishing the identity of the individual and the pattern of his or her transactions. Moreover, exchange control is more concerned with controlling the outflow than with inflow of capital. Still, in cases where exchange controls have been abolished, more opportunity could have been provided to disguise sources of funds. Many countries that have abolished exchange controls, had therefore to strengthen their cooperation with their banking sectors in anti money laundering monitoring.

With regard to prudential supervision, commercial banks in a growing number of countries are subject to official monitoring to ensure prudential operation. They have also become subject to prudential regulation, for example, compliance with capital-to-assets ratios and foreign exchange exposure limits. There have been global efforts to adopt uniform licensing and prudential policies and requirements by institutions such as the BIS and IMF.

The financial sector, and the banking sector in particular, needs to operate in a crime and money laundering free environment. Banks deal with other people's money and therefore rely heavily on reputation for probity and integrity. Without the necessary public confidence it would be difficult for banks to conduct business in the form they do today. In instances where banks may condone and are active parties to money laundering, the end result is that legitimate business would avoid such banks. It is also conceivable that money laundering, if perpetrated on a high scale, would complicate the ability of banks to manage their operations and risks. This is so because banks will not be able to predict the movement of laundered money.

The prime responsibility of most central banks is to maintain financial stability. This responsibility can be divided into three large areas, namely (a) to analyse financial system developments and determine early signs of possible financial difficulties; (b) to design and develop financial system safety nets; and (c) to regulate the banking system.

Within the framework of these responsibilities, central banks are adequately empowered to make a meaningful impact on monitoring and combating money laundering. However, central banks alone cannot be effective without the support and co-operation from other national institutions. What is required therefore is a national effort designed to co-ordinate actions on various levels of the public and private sectors.

The Bank of Namibia is committed to ensure that the integrity of the Namibian financial system is not in any way compromised by money laundering activities. That is why, in the absence of anti-money laundering legislation, the Bank of Namibia in 1996 issued guidelines, requiring banking institutions to identify and verify particulars of their customers, and to report suspicious transactions. The guidelines require banking institutions to determine the true identity of customers opening accounts and to develop a "transaction profile" of each customer and setting document retention policies.

It is also important to note that the legal framework with regard to money laundering is about to change, and this will increase our effectiveness in combating money laundering. The National Assembly has already debated and passed the Financial Intelligence Bill and it has been forwarded the National Council. The Financial Intelligence Bill establishes a Financial Intelligence Centre that will be hosted in the Bank of Namibia. The main responsibility of the Centre will be to receive suspicious transaction reports from accountable institutions and supervisory bodies. Such reports will be used to compile intelligence packages that will be disseminated to law enforcement authorities for investigation and possible prosecution.

In the process of implementing the laws to combat money laundering, we also need to be careful not to worsen the situation where many Namibians do not have access to financial services. Take for example the requirement that banks must verify the true identities of their prospective customers. In many countries the verification of the identities of prospective customers includes details such as registered residential addresses and proof of payment of services such as water and electricity. While these are good criteria to use, we are well aware that most people that do not have access to financial services, are not likely to be in a position to provide such details. We therefore need to show some flexibility in the implementation of the legal framework.

The combating of money laundering presupposes the existence of capacity and resources at national level. In developing countries, this is a real challenge in that there are competing demands for financial resources. This challenge will be more experienced by the law enforcement agencies. In many developing countries law-enforcement agencies lack the necessary capacity to enforce laws against economic crimes. Not only do they lack the necessary capacity, many a time they are also overwhelmed by the demands to enforce other national laws. It will be a pity, therefore, if we fail to build the necessary capacity to enforce the anti-money laundering law.

I would like to conclude by emphasizing that money laundering is a crime that affects every individual, business and government. It creates an important concern in that if unchecked it has the potential of fuelling crime and ultimately erodes the individual rights of citizens and affects national and international economic performance. Money laundering on a massive scale can, as I have indicated earlier, leave a lasting dent in a country’s macro-economic performance and may even lead to wrong policy responses.

The combating of money laundering requires first and foremost the drafting of appropriate laws and the creation of national and international capacity to implement such laws. Namibia is now ready to deal with money laundering and prevent its the harmful effects on the society. The legal foundations and institutional structures are being finalised and, I believe that we have the necessary commitment from all role players to make a success of our determination.