

# Keynote Address on Money Laundering : The Real Estate Bubble<sup>1</sup>

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Earlier Invited to be delivered as the Guest of Honour address at the Fourth (4<sup>th</sup>) International Finance Conference on "Investments, Information Technologies, Value and Control" organized by the Ministere de l'Enseignement Superieur, de la Recherche Scientifique et de la Technology (Tunisia), REMEREG (France), University of Cergy-Pontoise (France), ISC Paris (France), University de Sfax (Tunisia), Thema (France), AMFAM (France) in Yasmine-Hammamet, Diar el Medina, TUNISIA [March 15<sup>th</sup>-18<sup>th</sup>, 2007].

This is an ongoing research and an extension of our earlier works on Black Money and Money Laundering of 1988-89, 1994-96, 2004 and 2006.

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# Money Laundering : The Real Estate Bubble

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## Abstract

The Real Estate has been the most common and one of the simplest means to launder money for over a century. In the last two decade (1995 onwards) it has been seen that there is leaps and jumps in the real estate markets globally. This has been fueled by the Generation of new ideas and their application for productive uses as an important component in the engine for growth and development. Human talent has paved the way for high economic value creation, behind the generation of ideas, innovations, new technologies and robust financial systems. Emergence of electronic finance has on one hand benefited growth, development and inter-regional trade. On the other hand it has made the possibility to trace movements of suspect funds and in identifying the real ownership of suspicious assets behind shell companies or offshore bank facades an enormously difficult task for the enforcement bodies, the intelligence agencies and the government. Estimates indicate that globally Money Laundering amounts to more than US\$ 2 trillion to US\$ 2.5 trillion annually (i.e. about 6-8% of World GDP 2006 [44.444 trillion] ), through formal channels. Various IIF<sup>6</sup> Studies and joint research findings have been given due attention resulting in decision and formulation of regulations by GOI and international agencies – IMF, World Bank and ADB in the last 20 years. We have suggested the formulation of the “Economic Intelligence Units” and “Economic Investigating Agencies” as an independent body to combat economic offenses with the objective to flush back swindled funds into the economic system and trace the culprits involved. People in general are God fearing, honest and want to lead a simple peaceful honorable life, which they rightly deserve, that should not be taken away as a result of acts of poor governance and ill-elements in the society. In most cases or applications in India which are handled at governmental level, they follow the **CD-ROM principle** irrespective of the merit of the case, where, C (pay Cash Carry Certificate); D (Delays, Deficiencies & Denial of certificate); & ROM (Rest on Mat [never taken up & piles up dust]).

JEL Code:

Keywords: Money Laundering, Real Estate, Financial Crimes, Black Money, Capital Flight, Kick Backs, Socio-Economic Development,

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<sup>6</sup> See Indian Institute of Finance ([www.iif.edu](http://www.iif.edu)) and Finance India ([www.financeindia.org](http://www.financeindia.org))

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The theme of AFFI’s Annual Meeting Conference – Ethics and Governance - has been rightly chosen by the organizers. In my address on “Money Laundering : The Real Estate Bubble”, I have tried to focus on issues like - How its done, Who does it & What law enforcing bodies need to know about to effectively counter money laundering and inhumane terrorist acts. Money Laundering is generally characterized by the intensity of fluctuations affecting the price in financial markets and generation of illegal money and a facilitator breeding terrorism in the long run. In a global financial environment of global imbalances, economic sluggishness/slowdown in Developed regions, Pension Problems, Un-employment on a rise the buoyancy in the Real Estate Market, The Capital Markets and the Bullion Market are a cause of concern and are required to be checked. We have made an attempt to address to some of these finer issues and outline as to how cases have been handled at governmental level where they follow the **CD-ROM principle** irrespective of the merit of the case, where, C (pay Cash Carry Certificate); D (Delays, Deficiencies and Denial of certificate); and ROM (Rest on Mat [never taken up and piles up dust]). The Real Estate has been one of the most common and the simplest means to launder money for over a century. In the last decade (1995 onwards), it has seen that these has been leaps and jumps in the real estate markets globally.

I wonder as to what extent I would be able to justify this great responsibility of delivering this Keynote address. It is a very difficult task and a great responsibility. However, it would be my endeavor to be up to the mark as far as possible or to the expectations of the organizers and galaxy of practitioners, judicial members, bankers and members of financial institutions, and the intelligentsia.

## I. Introduction

The Real Estate has been one of the most common and the simplest means to launder money for over a century now. The last two decade (1995 onwards) has seen leaps and jumps in the real estate markets globally (Banker, 2005; Baker and Rosnick, 2005; Schneider, 2005; FCEN Report, 2006; The Economist, 2007) to the tune of over 300% increase<sup>7</sup> in the real estate prices in prominent urban cities and about 100% as an average of the global economy in general. Is this rise in tune with a fundamental basis for the Real Estate price increase is a question to be asked. Also it is interesting to note that this steep rise in the Real Estate markets has been coupled with a high degree of correlation with the sharp rise in capital markets, the bullion markets and the international flows globally particularly in the last 3 years. These have been fueled by the generation of new ideas and their application to productive uses as an important component in the engine for growth and development. This is also an area where the developing and the developed world have been moving at a very fast pace in the last three decades over a span of 200 years. Behind the generation of ideas, innovations, new technologies and robust financial systems, human talent<sup>8</sup> has paved the way for high economic value creation. The development of the financial markets has brought forth maturity in the institutions, regulatory norms and the modern financial architecture. Ideas and systems which were not given allowance in previous frameworks have found a suitable place in later periods. Be it the creation of derivatives products, financially engineered structures or growth strategies having an organic or in-organic nature the regulatory framework has developed faith in their relevance within the socio-economic setup. Creativity towards the generation and implementation of newer ideas in enriching economic value creation has either led to creating enormous wealth or losses thereof for the initiators. This has been observed as an outfall of norms or systems, which have been disallowed by the regulatory frameworks in their initial phase of introduction and practice in all economies, without exceptions. The “human factor” in understanding and adapting has been the critical component for success or failure of generation of creative ideas/systems. Money Laundering and the origination of unlawful structures of commerce and trade have served to be the birth child of such irregularities. Trends have been reinforced with greater informational flows, larger economic opportunities, improvements in life-styles across cities and countries getting reflected via differentials in standards of living, lower transportation costs and high degree of talented workforce in an inter-connected globalised World Economy.

Money Laundering is generally perceived to be a criminal offence due to its origination being primarily for criminal activities. Most regulations globally are hence tuned to frame and develop necessary regulations in this direction. It is “*We who launder and We who are victimized*” playing the role as bankers, lawyers, car dealers, real estates builders, accountants, workers and others who allow their businesses to be used to launder the

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<sup>7</sup> Conservative estimates on the US Housing markets show that they have increased by 45% after adjusting for inflation since 1996 (Baker, 2005). This unprecedented run-up in housing prices has generated more than US\$ 5 trillion in the housing bubble wealth.

<sup>8</sup> An inner capacity of individuals to develop ideas and objects with high economic value.

proceeds of a crime or an un-official economic transaction. Every country has its criminal underworld. The biggest organizations and the ones that have been active and have had long standings can be found in the hubs of capitalism: the United States (Cosa Nostra), Europe (the Sicilian Mafia) and Asia (the Chinese Lriads and Japanese Yakusas). It has been observed that groups engaged in money laundering are by nature "*criminogenic*" and "*regulatory resistant*". Emergence of electronic finance has been to their advantage. This new mode of fund movement has contributed in-accelerating the growth and magnitude of such crime and economic frauds. Given the staggering volume of such socio-economic criminal offences, broad international cooperation between law enforcement and regulatory agencies is essential in order to identify the source of illegal proceeds, trace the fund to specific criminal activities and confiscate criminal's financial assets. The tragic event of September 11 and the Enron debacle, have demonstrated that all the efforts to improve financial transparency in order to better track criminal money or un-lawful activities have achieved a limited result. Due to extensive use of electronic movements of money, the possibility to trace movements of suspect funds and identify the real ownership of suspicious assets behind shell companies or offshore bank facades is an enormous task which the enforcement bodies, the intelligence agencies and the government has been subjected to.

Money-laundering as a term brings to our mind those nefarious activities of the criminals who provide an envelope to "slush funds" in order to exhibit those as genuine money. In the current economic framework, money-laundering has emerged to be a process by which criminals give the color of legality and legitimacy to slush funds, as against the observed phenomena in the 1900s. Ignoring economic vandalism, most crimes have economic benefits as their backbone. In Black's Law of Lexicon the term laundering is being referred to as investment or other transfer of money flowing from racketeering, drug transactions and other sources (illegal sources) into legitimate channels so that its original source cannot be traced. Apart from the traditionally known activities for laundering of money via drugs, racketeering, kidnapping, gambling, procuring women and children, smuggling (alcohol, tobacco, medicines), armed robbery, counterfeiting and bogus invoicing, tax evasion and misappropriation of public funds, the law enforcing agencies are confronted with the creativity of human talent in flowering newer markets for such non-desired socially-ill activities. The newer markets in the last three decades to hold grounds in trade in R&D of highly strategic nature such as nuclear technology, smuggling, illegal labor and refugees, computer piracy, trafficking in works of art and antiquities, information thefts, trade of species and human organs, forgery in arms, capital market scams, toxic and nuclear products and others (Agarwal and Agarwal, 2004 & 2006).

The prime factors for the illicit economic benefits, emergence of black money and money laundering has been people's lust, greed for more money/wealth, power and influence in society resulting in the tax evasion, violation of government regulations and control, bureaucratic practices, political activities, growth of government expenditure, decline in social and moral fabric of the society and lastly, no or extremely low degree risk of being caught, convicted and punished (Agarwal, 1991). The prime factors outlined above have

led to disturbance in the structural balance of economic frameworks, planning processes ineffectiveness and distorts in macro-economic growth components such as output, employment, investment, consumption, saving, spending and others.

An outcome of the prime factors is well evident from the recent events that show that terrorist groups have built financial empires. The purpose of such empires is specifically to undermine public safety and international financial stability. International efforts to combat money laundering since the beginning of 1980s are built on strategies aimed to attack criminal organization through freezing of financial movements and commodities in trade. In the early 1980s the law enforcement was faced with the growing threat caused by the Columbian drug cartels (like the Cali and Medellin cartels), which had emerged to be threat not only towards public safety but against the state itself (Thony, 2005). A series of international conventions have come in force since the 1980s to strengthen the efforts for combating money laundering and its ill effects namely

- the 1988 Convention (against illicit Traffic in Narcotic Drugs and Psychotropic substances);
- the 1989 G-7 Summit FATF 40 Recommendations;
- the 1990 Strasbourg Convention (towards the Council of Europe's Convention on Laundering);
- the 1991 and 2001 European Directives by the EC and EP;
- the Naples Action Plan (based on the World Ministerial Conference on Organized Transnational Crime);
- the 1997 OECD Convention on Corruption
- the 1998 New York Action Plan (based on UN General Assembly session on Narcotic Drugs and Psychotropic substances)
- the 1999 French Convention for Suppression of the Financing of Terrorism.
- the 1999 Money Laundering Bill in India (followed by FERA 1973 and then FEMA 2001) as a result of IIF-FIU study
- the 1999 G-7 Financial Stability Forum (to promote international financial stability through exchange of information and international cooperation's)
- the 2001 USA Patriot Act (to counter money laundering and terrorist movements)
- the 2002 Money Laundering Act (framed from ML Bill 1999 as outlined above)
- the 2004 IMF-World Bank decision to combat Money Laundering (this was greatly influenced by the keynote address<sup>9</sup> on 26<sup>th</sup> March 2004 delivered by Prof. J. D. Agarwal

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<sup>9</sup> The media - Press Trust of India [PTI] (news agency), The Hindustan Times (India), The Sierra Times (USA), The Business World (Philippines), The Deccan Herald (India), The Manila Times (Philippines), Bursa (Romania), The Hindu (India), RBA (Philippines), Indiathisweek (India), India Journal (India), Asia Business Report (World News Network), India Cause (India), Headline News (India) and others worldwide has given the keynote speech and the paper a positive response by giving it a wide coverage from 26th March onwards. In a recent news flash of 3rd April 2004 it was notified that "The IMF and the World Bank have agreed to adopt a more comprehensive and integrated approach to conduct assessments of compliance with international standards for fighting money

in Manila to Banker’s, which was covered internationally via news agencies and papers. The IMF-World Bank took decision on 3rd April 2004, ADB on 6th June 2004 and RBI on 12th November 2004.) (see Agarwal and Agarwal, 2004 and 2004a)

In India, to combat money laundering and black money issues we have had the Benami Transaction Prohibition Act 1988; the Prevention of Money Laundering Act 2002 (Bill 1999) to cover Income Tax, Customs, Excise and Sales Tax; the Income Tax Act 1961; the Customs and Excise Acts 1962 and various others. The requirement of the Corrupt Public Servants (Forfeiture of Property) Act as suggested by the Law Commission is pending with the government since the 4<sup>th</sup> of February 1999. It is of immense importance that the Corrupt Public Servants (Forfeiture of Property) Act is framed to reduce corruption, generation of black money, curbing channels of money laundering facilitators and bring order to the house. I am happy to note that after the delivery of my earlier talk on Money Laundering to the senior officers of the government, the judiciary, the intelligence agencies and the enforcement bodies on 18<sup>th</sup> November 2007 at the ISV Forum in Chennai, there have been actions on our suggestion and that there is debate to bring the Corrupt Public Servant’s (Forfeiture of Property) Act into functionality.

The world today is observing steep rise in the three major markets simultaneously and globally, namely the Capital Markets, the Bullion Market and the Real Estate Market. This is despite the fact that Global economies are not doing so well, there is slow down in most of the Developed world inter-locking the developing region, people are losing jobs (in large parts of developed region) giving rise to Un-Employment of both skilled and unskilled work force and Corporate seeking profits for future sustainability and growth through cost cuttings and movement of bases to cheaper sources of production (Economist, 2007; Guha, 2007). The rise in the international capital flow movements is a matter of grave concern especially when these are being transacted using the Banking and Real Estate mediums (Fabre, 2005; Agarwal and Agarwal, 2006; Chan-Lau and Swinburne, 2007; Pazarbasioglu and Goswami, 2007)

In this paper we lay special emphasis on how laundering is being done through the Real Estate (FCEN RT, 2003; Agarwal and Agarwal, 2004; Banker, 2005; Baker and Rosnick, 2005; Schneider, 2005; Agarwal and Agarwal, 2006; FCEN Report, 2006; The Economist, 2007; FT, 2007). It is very difficult to get hand on information or data on the magnitude of the illegal and black money being utilized for investments in Real Estate for laundering purposes. A random sampling of Suspicious Activity Reports filed by the Financial Crimes Enforcement Network (FinCEN) in their recent report in December 2006 for over a 10 year period categorically described that the commercial real estate transactions reveal property management, real estate investment, and real estate development companies being the most commonly reported entities associated with money laundering and related illicit activity. Professions that customarily collect fees in

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laundering and terrorist financing in member countries, and to step up the delivery of technical assistance to those nations whose financial systems are most at risk.”.

real estate transactions, such as appraisers, inspectors, surveyors, and attorneys, were reported as primary subjects with less frequency and, therefore do not get listed on the charts (FCEN Report, 2006). The current work being presented here is based on our discussions with enforcement officials, intelligence officials, corporate heads and research studies indirectly outlining the usage of Real Estate as an easy soft via media for laundering money globally.

## II. Economics of Money Laundering

Estimates arising from forecasts based on regression lines and those of economic intelligence units indicate that globally Money Laundering amounts to more than US\$ 2 trillion to US\$ 2.5 trillion annually (i.e. about 5-6% of World GDP 2006 [44.444 trillion]) (Fabre, 2005; Agarwal and Agarwal, 2006), through formal channels. Our earlier estimates show that the money laundering magnified with the banking sector along in 2004 was around US\$ 500 billion to One Trillion (Agarwal and Agarwal, 2004). Money-laundering is not only economically destabilizes for an economy but also exposes it to terrorist attacks, threatening the integrity and sovereignty of the nations concerned. It conceals the huge, illegal profits generated by unscrupulous organized criminal groups in various fields of crime. Money laundering generally involves a series of multiple transactions used to disguise the source of financial assets so that these assets may be used without compromising the criminals who are seeking to use the funds via a three stage process or Placement<sup>10</sup>, Layering<sup>11</sup> and Integration<sup>12</sup> (Lal, 2003). The characteristics of organized crime are quite evident in money laundering as it is a group activity which is long-term and continuing; criminal activity which is carried out often by more than one person; an activity which is carried out irrespective of national boundaries at large scale; and generates proceeds, which are often made available for illicit use. Criminals involved in money laundering commit three basic types of crimes i.e. Crimes of passion or honor; Crimes of violence or vandalism; and Economic crimes - crime committed to make money. Most often crimes are committed for two reasons; for kicks (to prove that they can get away with it) and for unscrupulous greed for quick money (that more money can be made from the crime as against what they can from the same amount of legitimate endeavors). We have tried to bring forth the economics of Money Laundering in the following sub-sections focusing on Black Money, the Banking Sector as a medium, regulator and cause, Capital Flights and Kick backs, Black Dollar Exchange Scams, Government Policies, Schemes and Tax Structures (focusing on Taxation Framework, E-Filing Policies, SEZ and Export Incentive Schemes, Amnesty Schemes), Cyber Crime, Currency (INR) and Exchange Controls (Capital Account Convertibility) and the Real Estate.

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<sup>10</sup> Dirty money being inserted into the financial system through a process through deposits wire, transfers, or other means, unlawful proceeds into financial institutions

<sup>11</sup> Separates the proceeds, from their criminal origin by moving them through a series of financial transactions. This makes it harder to establish a connection between them.

<sup>12</sup> Creating a legitimate explanation for the source of funds, allowing them to be retained, invested or used to acquire goods or assets



## 2.1 Black Money

Individuals and institutions globally are engaged in evading taxes and generating surpluses which do not get accounted for in the formal economy. These funds are generated from activities which may be legal or illegal by nature. However the mere fact that taxes have not been paid on such incomes, as per the rules of the land, converts such funds to form a part of the Parallel economy or Black Money generation. The fund generated is normally held as currency notes and/or assets through investments in gold, jewellery, precious stones, art and artifacts, real estates and others (Agarwal, 1991). This menace is observed in both developed and developing regions of the world. Most studies done to understand the cause and concerns to un-earth black money component have shown that these have led to creation of strong parallel economies due to high level of corruption and weak hold of regulatory mechanism in developing regions of the world.

If we take a quick look at the case of Marc Rich, one of the world's leading commodity traders was indicted by a Federal grand jury on charges that he and his partner (Pincus Green) had evaded the US Treasury of US\$ 48 million in income taxes. US Prosecutors in 1983 said it was the biggest tax-fraud indictment in American history (Berg, 1983). Marc Rich had bid for a pardon from President Clinton, which was accompanied by letters of support from dozens of politicians, financiers and officials of charitable organizations, a virtual Who's Who of Israeli society and Jewish philanthropy; prosecutors and former prosecutors renew attack on pardon of Rich and his former Partner, Pincus Green, who for 18 years evaded prosecution on charges of tax evasion, racketeering and violating sanctions against trading with Iran (McGeehan and Cowan, 2001). Despite this act, President Bill Clinton's last-minute pardon of Marc Rich (Newlin, 2001) became very controversial however, clearly showed the failure in observing regulatory prudence in the economy along with the economic loss to the nation and the citizens. Within Europe, the EU institutions are troubled with the way Italy manages its financials. The said economy is known for the *mafia* to run and manage the economic affairs of the country. This is a classical case where the parallel economy is actually the normal economy itself.

In India, Kaldor's estimates for black money generation in 1953-54 were about Rs. 600 crores (i.e. 6% of National Income then) on account of tax evasion only. Some of the other estimates further have been Rs. 700 crores (1961-62); Rs. 1,000 crores (1965-66); Rs. 1,400 crores (1968-69). Other estimates by Dr. Rangnekkar for the same periods were Rs. 1,150 cr, Rs. 2,350 cr and Rs. 2833 cr respectively. The IIF study indicated that the growth rate of black money in 1991 has been at a rate of Rs. 60,000 crores per year (Agarwal, 1991). Black money generated from legal activities accounts for the parallel economy in India, which is considered to be as strong as the normal economy. It is estimated that the yearly growth rate of Black money is a factor to the tune of 40-50% of GDP growth in the Indian economy on a year to year basis (Vittal, 2002). Black money, which is at the root of corruption, in politics business and bureaucracy, needs to be effectively minimized. The framework as outlined earlier exists, however the will to enforce the same needs to co-exist both at the enforcement and political levels.

Some of the Government officials are to be equally blamed for this menace as some of them are highly corrupt and benefit from the loop holes in the system, excessive security of service, lack of accountability and failure of judiciary to expeditiously and rightly decide the cases (ref to Justice Shamikh Mukherjee of Delhi High Court). We have a strong vigilance system, but how many complain and if a complaint is registered against an erring official, then what is his/her fate. In most cases it has been found that the complainant is harassed to death and/or has to be faced with closure of business. Delay in deciding the applications/cases is used as the method to force people to scum to their corrupt practices.

In most cases or applications in India, which are handled at governmental level, they follow the CD-ROM principle, irrespective of the merit of the case

### **"CD-ROM"**

where, C refers to pay Cash Carry Certificate  
D refers to Delays, Deficiencies and Denial of certificate  
ROM refers to Rest on Mat (never taken up and piles up dust)

The CD-ROM principle is quite prevalent in various economies globally. The recent cases of claims on BAE Defence, the Xerox presence in Emerging Markets quite evidently show the principle in-existence globally. The international scenario has come to light post Enron Debacle (Duggal, 2006). What we need is to devise a mechanism that all applications and cases ought to be disposed off within a specific period to reduce corruption to the minimum.

## **2.2 Banking Sector: Medium, Regulator and Cause**

Banks have been widely used for money laundering. The flow of funds via the banking system has been fueled due to secrecy and non-transparency norms observed by large part of the banking systems globally. Banks have a central role to play in curbing the menace, however have fallen to be instruments in the money laundering process. The money laundering activities have been subject of eight prior investigations in US. According to the US Permanent Subcommittee's Report (2001), there are five major factors which create money laundering vulnerabilities: the role of private bankers, private banks as client advocates<sup>13</sup>, powerful customers<sup>14</sup>, and a corporate culture of secrecy<sup>15</sup>, a corporate

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<sup>13</sup> Private bankers are the linchpin of the private bank system. They are trained to service their clients and to set up accounts and move money around the world using sophisticated financial systems and secrecy tools. Private Banks encourage their bankers to develop personal relationships with their clients, visiting the client's homes, attending weddings and graduations, and arranging their financial affairs. The result is that private bankers may feel loyalty to their clients for both professional and personal reasons, leading them to miss or minimize warning signs. In addition, private bankers use their

culture of lax controls<sup>16</sup> and the competitive nature of the industry<sup>17</sup>. In a recent case reported by an online newspaper [moneylaundering.com](http://moneylaundering.com) on the November 10<sup>th</sup>, 2006 "the American Express Co. has said this week that it may face an enforcement action by the U.S. Justice Department related to "concerns" about the anti-money laundering procedures at its Miami-based private banking operation. The giant financial and travel

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expertise in bank systems to evade what they may perceive as unnecessary "red tape" hampering the services their clients want, thereby evading controls designed to detect or prevent money laundering.

<sup>14</sup> Private bank clients are, by definition, wealthy. Many also exert political or economic influence which may make banks anxious to satisfy their requests and reluctant to ask hard questions. If a client is a government official with influence over the bank's in country operations, the bank has added reason to avoid offence. Moreover verifying information about a foreign client's assets, business dealings, and community standing can be difficult for US banks. The Federal Reserve board found in its private banking review that foreign clients were particularly difficult for private banks to assess due to a lack of independent data bases of information, suit as credit reports. While private banks routinely claim that their private bankers gain intimate knowledge of their clients, the case histories demonstrate that too often is not true. For example, in one case, a private banker was unaware for more than three years that he was handling the accounts of the some of the an African head of state.

<sup>15</sup> A culture of secrecy pervades the private banking industry. Numbered accounts at Swiss banks are but one example. There are other layers of secrecy that private banks and clients routinely use to mask accounts and transactions. For example, private banks routinely create shell companies and trusts to shield the identify of the beneficial owner of a bank account. Private banks also open accounts under code names and will, when asked, refer to clients by code names of encode account transactions. In additions to shell corporations and codes, a number of private banks also conduct business in secrecy jurisdictions such as Switzerland and Cayman Islands, which impose criminal sanctions on the disclosure of bank information, related to clients and restrict US bank oversight. The secrecy laws are so light, they even restrict internal bank oversight.

<sup>16</sup> In addition to secrecy, private banking operates in a corporate culture that is at times indifferent or resistant to anti-money laundering controls, such as due diligence requirements and accounts monitoring. The problem begins with the private banker, who, in most private banks, is responsible for the initial enforcement of anti-money laundering controls. It is the private banker who is charged with researching the background of prospective clients, and it is the private banker who is, asked in the first instance to monitor existing accounts for suspicious activity. But it is also the job of the private banker to open accounts and expand client deposits. According to John Reed, Co-chairman of Citigroup (with 30 years of banking experience), private bankers tend to become advocates for their clients and has lost the detachment needed to monitor their transactions. He also observed that private bankers often don't have the temperament or discipline needed to ask clients detailed questions about their funds and transactions and to record the information provided in a proper form.

The fundamental problem is that private bankers are being asked to fill contradictory roles-to develop a personal relationship with a client and increase their deposits with the bank, while also monitoring their accounts for suspicious activity and questioning specific transactions. Human nature makes these contradictory roles difficult to perform, and anti-money laundering duties often suffer.

Private Banks have dealt with this problem by setting up systems to ensure that private banker activities are reviewed by third parties, such as supervisors, compliance personnel or auditors. The subcommittee staff investigation has found, however, that while strong oversight procedures exist on paper, in practice private bank oversight is often absent, weak or ignored.

<sup>17</sup> Another factor creating money laundering concerns is the ongoing competition among private banks for clients, due to profitability of the business. A Federal Report on private banking states. : "As the target market for private banking is growing, so is the level of competition among institutions that provide private banking services" [FRB, 1997]. Private Banks interviewed by the subcommittee Staff confirms that the markets remain highly competitive; most also reported to have plans to expand operations. The dual pressures of competition and expansion are disincentives for private banks to impose tough anti-money laundering controls that may discourage new business or cause existing clients to move to other institutions.

services company said in a quarterly regulatory filing on Thursday that federal investigators are seeking more information about certain client accounts at American Express Bank International, which also has an office in New York". Another interesting case reported by the Washington Post on May 21<sup>st</sup>, 1997 outlined that the US Justice Department had begun to investigate allegations that top officials in former president Carlos Salinas de Gortari's administration used the state food distribution agency Compania Nacional de Subsistencias Populares (CONASUPO) for criminal activities, including laundering drug profits through US bank accounts and contracts.

It is clearly visible in these two cases as to how vulnerable are the Banks and how they turn to becoming the medium and cause for money laundering. Cases before enforcement agencies have shown that some of the more common laundering methods used are: the Black Market Peso Exchange, cash smuggling (couriers or bulk cash shipments), Black dollar, gold purchases, structured deposits to or withdrawals from bank accounts, purchase of monetary instruments (cashier's checks, money order, traveler's checks, etc.), wire transfers, purchase of derivative products (as seen in September 11 attack) and forms of underground banking, particularly the Hawala system.

Recent IMF estimates on money laundering by the drug traffickers to introduce the proceeds gained through the sale or distribution of controlled substances into the legitimate financial market amounts to between 2 to 5 percent of the world's GDP, about US\$ 600 billion annually (US-DEA, 2005). In our opinion this is a very conservative estimate and far lower than the actual money laundered (i.e. 2-3 times of the DEA projections – US\$ 1.5 trillion) within the drug trafficking business. Money laundering allows the true source of the funds gained through the sale and distribution of drugs to be concealed and converts the funds into assets that appear to have a legitimate legal source. The need to launder conspicuously large amounts of small-denomination bills renders the traffickers vulnerable to law enforcement interdiction. Tracking and intercepting this illegal flow of drug money is an important tool used to identify and dismantle international drug trafficking organizations.

In addition to the general factors cited above, the actual products and services offered by the private bank also tend to create opportunities for money laundering - Multiple Accounts<sup>18</sup>; Secrecy Products<sup>19</sup>; Movements of Funds<sup>20</sup>; Credit<sup>21</sup>; Development of Off-

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<sup>18</sup> A striking feature of the private bank accounts examined is their complexity. Private bank clients often have many accounts in many locations. Some are personal checking, money market or credit card accounts. Others are in the name of one or more shell companies and multiple investment accounts are common, including mutual funds, stock, bonds and time deposits. The reality right now is that private banks allow clients to have multiple accounts in multiple locations under multiple names and do not aggregate the information. This approach creates vulnerabilities to money laundering by making it difficult for banks to have a comprehensive understanding of their own client's accounts. In addition, it complicates regulatory oversight and law enforcement, by making it difficult for banks to have a comprehensive understanding of their own clients accounts. It also complicates regulatory oversight and law enforcement, by making it nearly impossible for an outside reviewer to be sure that all private bank accounts belonging to an individual have been identified.

Shore Banking<sup>22</sup> and others. The famous BCCI case has been given reference to in the Appendix.

### 2.3 Capital Flight and Kick Backs

Capital Flight and kick backs are a major problem facing global economies, including India, as these have severe economic, political and social impact. Capital flight may also reflect money laundering activities resulting from criminal activities such as drugs and arms smuggling and white collar crimes. There are many techniques used to expedite capital flight and a significant amount of research has resulted in detailed explanations of capital flight techniques and in estimates of its magnitude (Walter, 1985; Cuddington, 1986; Varman-Schneider, 1991; Zdanowicz, Welch and Pak, 1995 & 1996; Agarwal and Agarwal, 2004). One technique that can be used to move significant amounts of capital out of a country is the over-invoicing of imports and the under-invoicing of exports. The focus of joint research between IIF and FIU which was projected through the works of Zdanowicz, Welch and Pak in 1995 and 1996 is on the development of a global price matrix that allows one to analyze every India-United States import and export transaction and determine estimates of the magnitude of capital flight from India to the United States

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<sup>19</sup> Most private banks offer a number of products and services that shield a client's ownership of funds. They include offshore trusts and shell corporations, special name accounts, and codes used to refer to clients or fund transfers.

<sup>20</sup> Current account transactions at private banks routinely involve large sums of money. The size of client transaction increases the banks vulnerability to money laundering by providing an attractive venue for money launderers who want to move large sums without attracting notice. In addition, most private banks provide products and services that facilitate the quick, confidential and hard-to-trace movement of money across jurisdictional lines.

<sup>21</sup> Another common private bank service involves the extension of credit to clients. Several private bankers told the subcommittee that private banks urge their private bankers to convince clients to leave their deposits in the bank and use them as collateral for large loans. This practice enables a bank to earn a fee not only on the deposits under their management, but also on the loans. This practice also however, creates vulnerability for money laundering by allowing a client to deposit questionable funds and replace them with "clean" money from a loan. Moreover, as the client loans are fully collaborative by assets on deposits with the bank, the bank may not scrutinize the loan purpose and repayment prospects as carefully as for a conventional loan, and may unwittingly further a money launderer's efforts to hide illicit proceeds behind seemingly legitimate transactions.

<sup>22</sup> Originally, off-shore centers were quite literally islands, hence the expression. Today the term is used rather loosely for financial centers, which operate within a low tax regime; this enables international transfers of money to take place with a great deal of facility and with no hindrance to capital flows.

- The development of the offshore banking sector has made it difficult to prevent money laundering.
- As Helmut Schmidt once observed, central banks "did not see that they were losing their grip over the markets when they allowed commercial banks to establish offshore affiliations."
- Governments regard it as synonymous with enhanced competitiveness.
- Competitiveness is deemed to be inconsistent with tight monitoring and control, and offshore banks and corporations attract funds largely because they promise both anonymity and the possibility of tax avoidance, and in some cases, tax evasion.
- The Cayman Islands, the Netherlands Antilles, Aruba and Cyprus are all examples of offshore banking havens that have been used or confirmed to be used by criminal organizations for laundering the proceeds from their illicit activities.
- Such centers offer offshore attractive opportunities for the transfer and secretion of funds in places where they are relatively safe from identification and seizure by law enforcement.

Most often, offshore corporations are created simply to launder and hide money.

during 1993 due to abnormal pricing. The findings estimated that the capital flight from India to US was about US\$ 4.4 billion (in 1993), US\$ 5.8 billion (in 1994) and US\$ 5.6 billion (in 1995) (Zdanowicz, Welch and Pak, 1995 & 1996). Some of the products taken into study for observing the degree of under/over pricing of Indian exports/imports have been enlisted in the Table I and Table II

**Table I**  
**Under-Priced Indian Exports to the United States – 1993**

<b>Product Description</b>	<b>World/U.S. Average Export Price</b>	<b>India/U.S. Average Export Price</b>
Exercise Cycles	100.39/unit	.51/unit
Industrial Miners Diamonds	19.25/car	.23/car
Diamonds - Unworked	617.20/car	5.51/car
Disc Harrows	3,821.96/unit	13.89/unit
Insulated Electrical Conduit	27.51/kg	.96/kg
Electric Cooking Stoves, Ranges	217.32/unit	5.67/unit
Micrometers and Calipers	29.71/unit	1.99/unit
Silk Handkerchiefs	61.33/doz	2.66/doz
Grantie - Roughly Trimmed	539.34/cbm	166.30 cbm
Ginseng Roots	20.24/kg	1.98/kg
Rubies - Cut, Not Set	31.93/car	2.58/car
Lead Acid Storage Batteries	37.87/unit	.65/unit
Industrial Diamonds - Unworked	11.42/car	.86/car
Radial Bearings - > 100 mm	31.33/unit	16.62/unit
Voltage Regulators	121.19/unit	3.39/unit
Facsimile Machines	447.54/unit	61.33/unit
Insulated Conductors - <1000v	5.94/kg	.59kg
Gloves - Seamless	3.01/dpr	.78/dpr
Sapphires - Cut, Not Set	19.25/car	6.25/car
Coaxial Connectors - < 1000v	1.07/unit	.14/unit
Suspension Shock Absorbers	17.51/unit	3.87/unit
Glass Spectacle Lenses - Unmounted	10.04/prs	1.28/prs
Bananas - Dried	1.36/kg	.16/kg
Emeralds - Cut, Not Set	69.31/car	13.16/car
Tungsten halogen Lamps	4.66/unit	.57/unit
Teakettles - Stainless Steel	7.45/unit	2.37/unit
Transistors - < 30 mhz	.60/unit	.12/unit

Source: Zdanowicz, Welch and Pak, Finance India, Vol IX No 3, September 1995

**Table II**  
**Over-Priced Indian Imports from the United States – 1993**

<b>Product Description</b>	<b>US/World Average Import Price</b>	<b>US/India Average Import Price</b>
Tetracyclines	11.74/gm	1,102.50/gm
Video Cassette Recordings	24.53/unit	1,079.12/unit
Arc Welding Base Metal Cored Wire	3.16/kg	28.22/kg
Tires - Truck/Bus, New	154.21/unit	1,604.88/unit
Fans/Blowers For Motor Vehicles	38.45/unit	2,119.13/unit
Plain Shaft Bearings W/O Housing	26.67/unit	148.73/unit
Chlorine	.98/kg	22.40/kg
Shovel Attachments	1,736.21/unit	32,917.10/unit
Thermometers	70.55/unit	281.16/unit
Fixed Capacitors - < 300v	2.89/unit	46.09/unit

Anthistamines	141.08/kg	1,712.32/kg
Normal - Propyl Acetate	2.00/kg	9.15/kg
Epoxide Resins	4.69/kg	38.31/kg
Dynamite and Explosives	5.03/kg	29.31/kg
Starter Motors and Generators	52.49/unit	394.11/unit
Freezers - < 800 Liters	425.06/unit	2,869.87/unit
Aluminum Oxide	1.09/kg	3.23/kg
Cathode Ray Display Units, Mono.	611.15/unit	2,444.94/unit
Radio Transmitters - < 30 mhz	3,084.00/unit	9,105.50/unit
Sheep - Live	34.35/unit	133.99/unit
Streptomycins	0.08/gm	.30/gm
Nickel Alloy Pipes and Tubes	35.11/kg	405.22/kg
Video Disks - Recorded	180.37/unit	1,072.41/unit
Phthalic Anhydride	.75/kg	3.29/kg
Insulated Coaxial Cable & Conductors	13.02/kg	75.02/kg
Peper Seed for Sowing	7.35/kg	33.58/kg
Paints and Varnishes	5.04/ltr	11.46/ltr
Carbon Black	1.04/kg	3.71/kg

Source: Zdanowicz, Welch and Pak, Finance India, Vol IX No 3, September 1995

In 1993-94 India was seeking FDI and FII investment to spur growth, having opened up the economy to the new Economic Reform Framework. Capital flight at periods of economic reforms is bound to destabilize domestic financial markets, and the efficiency of monetary policy. Also capital outflows may lower domestic investment and erodes the country's tax base which in turn increases the public sector deficit. The effect of the economic impact of capital flight results in the erosion of the country's political and economic system. One can imagine as to how disastrous would capital flight of an average of US\$ 5.5 billion per year to a single trading partner, the United States, would cost to the economy, at the inception stage of the economic reform process and as a critical negative growth factor for the future. With capital flows of just US\$ 1 billion making roars in India, an capital outflow of US\$ 5.5 billion/year to a trading partner having 40-45% of trade component on a select few commodities in the total trade portfolio with US was shocking. It was fortunate that the IIF-FIU study surfaced at the right time and received due attention and was placed as The Day's news in leading newspapers (TOI, HT, Hindu and others), which helped bring attention of the policy makers and parliamentarians. Issues hence were raised in the parliament and the Money Laundering Bill was framed, which later lead to the formulation of the Foreign Exchange Management Act (FEMA) from the Foreign Exchange Regulation Act (FERA) and the Money Laundering Act 2002.

The macroeconomic policy variables and conditions have a significant influence on capital flight, even after controlling for country effects and institutional quality. Institutional quality particularly effective institutional constraints on executive power, which has an independent impact on capital flight. There is a strong evidence of revolving door relationship between borrowing and flight as the result of "debt-fueled capital flight" as well as a "Financing need" channel working in a opposite casual direction (Rishi, 2006). While debt tends to stimulate capital flight, the FDI and aid tends to reduce the flight. Short term debt accumulation has the most severe impact on capital

flight. Based on the OLS estimates (Cerra, Rishi and Saxena, 2005), it has been found that 21 cents of each dollar of debt taken by a country, flows back out of the country as Capital Flight. Each dollar of Capital Flight flown needs a further withdrawal of new debt to the tune of 69 cents to fill the gap so created as an outfall of 21 cents per dollar capital flight. Hence, capital flight is identified as a mechanism by which Institutional quality influences volatility (Rishi, 2006). Weak institutions spur capital flight thereby indirectly raises debt accumulation. The loss of domestic savings associated with capital flight is partly offset by increases in foreign financing. The results of Cerra, Rishi and Saxena study presented at IIF has suggestive implications for recent debt relief and foreign aid initiatives. By reducing, prospective taxation to finance debt repayments, relief may reduce capital flight and thereby leverage the impact of such assistance. Foreign aid or debt relief should be complemented by sound macro-economic policies and an institutional environment conducive to allocating available resources to useful projects within the country.

## **2.4 Black Dollar Exchange Scam**

The so-called "Black Dollar" scam entails defacing the US\$ to transfer currency using Hawala. In this the currency is coated with black substance, which can be removed by use of special chemical. The blackened US\$ bank notes are shown to the victim, and the special chemical is ordinary cleaning fluid which reacts with the black mixture of Vaseline and iodine. This is majorly used when there are large number of civilian transporter's involved, who are seeking quick money for holding or transferring the packets of black dollar from one to the other. To prevent one from using the currency during transfer, the intermediaries are told that exposure to air will cause the black substance to ruin the money. After the advance payment has been received, the chemicals are not delivered to the victim, who is left with suitcases full of worthless black paper instead of the US\$ notes. The Black Currency Scam is believed to be based on a centuries old traditional West African con called the "Red Mercury" scam. In a recent news in the Deccan Herald on July 21<sup>st</sup>, 2005 on a 'Black-dollar' gang busted in Goa reported that Five Nigerians and a Liberian were behind bars and the gang had larger operations in other Indian cities. It was also reported that the Bangalore and Mumbai police have detained similar gangs operating in those cities. Goa police has also alerted the Interpol branch of the CBI and has written to the Nigerian Embassy.

## **2.5 Government Policies, Schemes and Tax Structures**

The government policies, schemes and tax structures introduced from time to time have influenced the generation of black money and money laundering needs by traders and business communities at large. We have looked upon four aspects – Taxation framework, E-Filing, SEZ and Export Incentives Schemes, Amnesty Schemes, which are outlined below.

### **2.5.1 Taxation Framework**

Today India is faced with the problems of a strong parallel economy on account of huge



black money reserves in the form of high priced real estates, gold, jewellery and locked up cash in hand. If we go back in time towards independence, we were 100% importing country with an exchange rate of US\$ 2 for every INR 1. We were a highly Motivated Nationalist God fearing nation. However, we started the journey with a 98% tax incidence, which indirectly made the business community not to declare actual profits for their survival and growth in the country. This resulted in declaration of low productivity and low profits on which the taxes were paid to the government. Hence the origination of Black Money, low GDP projections and low Revenue collections was witnessed. From a 98% level we in the last 60 years have moved to be amongst the lowest income tax bracket countries globally with slabs of 10%, 20% and 30% being the highest for individuals and 30-35% for corporations (including surcharge). In recent years, there has been introduction of series of surcharges, which need to be checked and reduced, if we are looking at a consistent GDP growth rate of 8% and above in the years ahead.

Also the introduction of Fringe Benefit Tax 2004-05 (FBT), is against the nomenclature of tax systems. The people will willingly abiding by the norms prescribed by the MoF and DoCA, however the job of the ministry or the department while framing policies is not to look it from short term perspective and/or as a medium for collection of funds, but also to see what may be the effects of such policies in the long run. Also it needs to see that the systems are implemented across board, with no differences between Government and Private institutions. Tax systems which have developed such flaws make organizations and businesses shift their bases to regions/countries where the norms are more harmonious and in tune with international norms. Incase an organization is unable to shift bases, then they are seen to indulge in money laundering issues to protect the interests of the stakeholders in the organization.

### **2.5.2 E-Filing Policies**

E-filing is a broad term that covers online filling of various statutory documents that were earlier filed in paper form. We are happy to see this change as the same have been suggested by various IIF studies in the 1990s to counter black money creation in the Indian Economy. Several arms of the government, which include the Department of Company Affairs (DCA); the Income Tax Department and the Central Board of Excise and Customs, have started making its mandatory for filing of returns. E-filing would serve to be a handy tool for investors in the long run. Now, through the DCA's site one can access information about companies at a very low fee/free, depending on the nature of information. Even grievances can be filed online. Crucially, since company information used to be maintained on a regional basis, a person sitting in Mumbai could get information only on companies registered with the Mumbai ROC. Now, from one's computer, one can get information on any company sitting anywhere around the globe. In the DCA project, online incorporation and registration of companies, filling of forms and charges (created for mortgaging assets), filling of other returns and financial statements is all done on-line. Online income tax return filings by corporate assesses are now mandatory. Service tax, excise and customs departments too are offering options for e-filing by corporate. This is a very innovative step in the right direction to induce

transparency, reduce corruption, reduce black money and smoothen collection processes by the government (Agarwal, 1991).

There has however been a negative response to the system due to requirement of authorized persons for filing the E>Returns and an additional burden of fee on account of purchase of software and filing of E>Returns, which varies from INR 5,000 to INR 15,000 for charges on account of processing, drafting and converting hard copy to e-form, depending on organization and return size. These costs are not an issue for corporations which are mid-size or large having audit fee in lakhs or thousands. However, for small sector operators, *Kirana (grocery)* shops and SME's this is a heavy price and would deter them away from filing for e-returns and hence lead to re-creation of black money in the system. We would like to propose that the regulatory institutions may consider introducing e-filing for Judiciary, Police (lodging of complaints with Police), Government Institutions (for applications for grants, scholarships, funds) and for other services offered to the people at large. This can be done via terminals which may be with Intranet services or through internet based online platforms. In all such filings, the government may want to consider having these as the Citizen's Identification Number (CIN) – PAN number, Passport number and/or Election Voter's ID number. A physical submission of the documents required for such applications would then become subsidiary to the e-filed applications. This would enable smoothening the process of reporting, filing and placing requests/complaints with the regulators, grievance cells and government institutions.

### **2.5.3 SEZ and Export Incentive Schemes**

Units in SEZs are exempted from income tax – 100% for 5 years in a block of 10 years and 50% of the peak rate thereafter (Sikarwar, 2006). The chances of claiming more revenue to earn tax exemption are high. It has been seen in the past that the export incentive schemes have been founded to be mis-used by exporters by transferring profits and consolidating with their holdings setup in the SEZ or Export Free Zones. Transfer Pricing norms to restrict such movements of profits and laundering of profits is vital to enrich exports in the right directions and not in the hands of a select few. Ministry of Finance, is all set to frame such norms to ensure the least possible mis-use of such incentive schemes.

It has been observed internationally that Tax Heavens like Cyprus, Mauritius and others who have offered to be No-tax zones with very basic banking and financial restrictions for financial transactions or operations of foreign business, have turned to be hubs for channeling and housing money laundering funds. It is a step in the right direction that Ministry of Finance has taken for setting up norms for Transfer pricing in SEZ and Technology parks, where tax breaks have been provided on long durations.

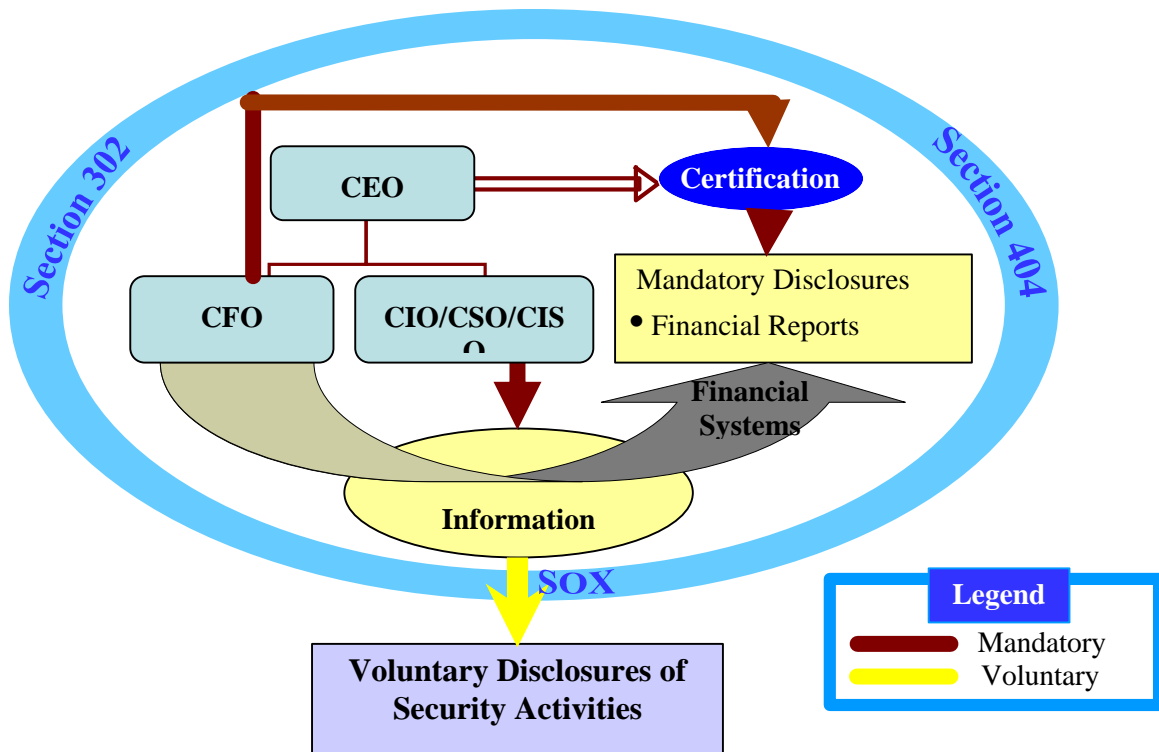
### **2.5.3 Amnesty Schemes**

Amnesty scheme are offered to those who have generated black money as a result of tax evasion over years. These are offered for revenue collection and as a medium to convert

black into green, through voluntary declaration of incomes, which had accrued in the past by an individual or organization. Government has made valiant efforts in the past to tackle the problem of black money mostly in the form of amnesty schemes. The net result of government's effort has been more like trying to use petrol to put out fire. The latest was the VDIS scheme, which added insult to injury by providing for the black money hoarders, a soft 30% rate of taxation (which is effectively less than 10% regressed over years accounting for time value of money), as against the 35-40% for corporate, which an honest taxpayer would have paid. Such schemes act as an insult and penalty to those who are honest and well behaved citizens paying their dues in time. We can well see as to why black money still flourishes in our system and is becoming a cause for people to become dishonest and non-tax payer in the long run. An honest person will find it very difficult to buy even a house/plot in India as 60% of the purchase price on an average is expected to be paid in black (cash).

## **2.6 Cyber Crime**

The electronic age has spawned a cadre of global electronic payment systems that customers can navigate with the click of a mouse, the push of a cell phone button, and little, if any, face-to-face contact with companies providing these services. But those emerging payment systems – prepaid cards, online banking services, mobile payments and digital precious metals – are more susceptible to money laundering and terrorist financing than the traditional banking system, the Financial Action Task Force (FATF) confirmed in a report on new payment methods. Modern bank managers need to protect their assets from both traditional security threats but also from cyber security threats. Information security isn't a problem solely for banks, however—in this age of digital information and interconnected networks, every organization needs to be concerned with cyber security. Stealing from a bank used to involve weapons, getaway cars and high-speed police chases. These days, a criminal can steal from a bank from the comfort at his own home while sitting at their laptops (Gordon and Loeb, 2006).



Source: Gordon, Loeb, Lucyshyn, and Sohail, 2006.

**Figure 1**  
**Impact of Sarbanes Oxley Act of 2002 on Information Security**

In the last decade it has been observed that a series of Internet Frauds have spurred up the capital market, brought forth the lacuna in the regulatory prudence and had generated loss of investor’s confidence. SEC sweep nets another 23 Internet fraudsters by March 2001. On March 1, 2001, the United States Securities and Exchange Commission (SEC) announced its latest success in a continuing crackdown on Internet securities fraud, bringing 11 enforcement actions against 23 individuals and companies. While regulators in Canada, including the Ontario Securities Commission (OSC) and the British Columbia Securities Commission (BCSC), devote some of their scarce resources to monitoring Internet chat sites and reviewing suspect websites, the SEC has been far more aggressive and successful in pursuing Internet scams than its Canadian counterparts. The SEC has a dedicated corps of more than 200 enforcement staff, known as the CyberForce, specially trained for Internet surveillance. The OSC and BCSC rely on a relative handful of enforcement personnel, many of whom count Internet monitoring as only one of several duties. The latest SEC enforcement actions are the result of its fifth Internet sweep, bringing the number of Internet-related enforcement actions to more than 200, involving more than 750 named individuals and entities. The Sarbanes Oxley Act of 2002 is expected to take care of the above cited situations and specially those like the Enron-Arthur Anderson case. We have seen similar actions being taken up by enforcement agencies in India, however SEBI still needs to play a pro-active role in curbing such

menace's in the Indian capital markets.

## **2.7 Currency (INR) and Exchange Controls (Capital Account Convertibility)**

There has been a tremendous increase in demand for INR to emerge as freely floating currency and also become Reserve Currency in the neighboring countries and Arabic Region. This has been seen as a result of extensive rise in expats wanting to send part of their earnings back to their families in India. Hawala transactions have been the main facilitator in the past for such movement of funds. These are observed due to monetary regulatory norms of the host countries where the expats worked and extensive restriction on INR till the 1995, when the process of capital account convertible (CAC) began. Even though the CAC has been partially introduced, the hawala transactions have been on a rise. CAC certainly does facilitate reduction in such movements of funds however is not the main cause. The need for sending money back home creates extensive demand for INR hence raising the level of money laundering in host country and generation of black money in India. The move of India for CAC, was brought to a stand still given the SEA Crisis in 1996-97, with minor expansion in the new millennium.

For the large number of low-skilled expats from India, the combined lure of making more on the exchange rate and using the INR to do their high-value shopping is irresistible (Bhattacharjee, 2006). Also the presence of a large number of Indians in several markets abroad has raised their profile and the tacit acceptance of Indian currency by local shopkeepers, more true of bargain markets has brought forth the need to have INR as reserve currency (Agarwal, Agarwal and Agarwal, 2006; Bhattacharjee, 2006). The Indian currency INR is freely accepted in the neighboring region (Nepal, Bangladesh, Sri Lanka, Burma), in the Arabic region and now in Mauritius (under special arrangement with the Reserve Bank of India). The acceptability is there both at official level in certain countries and market/trade driven in the others. With the move for various Indian organizations increasing their international presence with takeovers and formulation of MNC for trade and services. RBI needs to initiate necessary actions as an immediate responses, else as reported in ET, it has been found that some Mumbai based operators are reported to have placed orders on Dubai-based operators for supply of fake Indian currency notes (Bhattacharjee, 2006). Hence the currency crunch in the market would get financed through fake currency. Federal Reserve Board is faced with similar challenge and has no solution to this problem, which surfaced before the FRB 2 decades back.

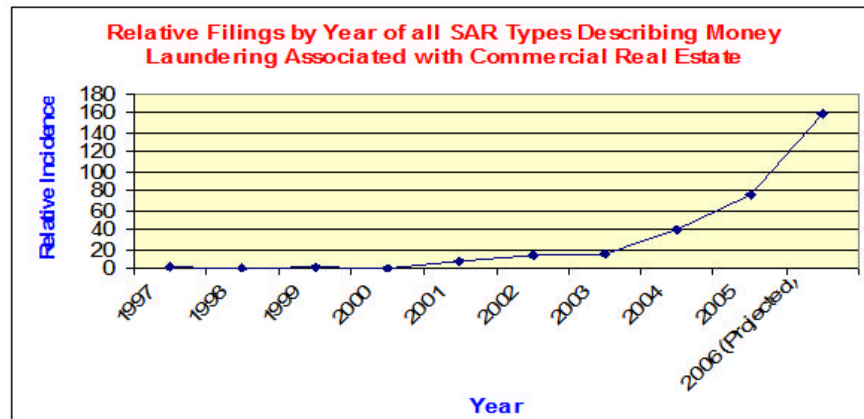
## **2.8 The Real Estate**

It is fascinating to note the ingenuity of human brain to create mediums of defrauding governments and societies to laundering money using creative means. The FinCEN Suspicious Activity Report (SARs) and other studies on specific countries highlight some of these means based on their trend lines associated with potential commercial real estate-related money laundering having risen steeply since the 2003 and some over last decade, having considered a 10 year period (See Figure 2). Different studies have shown that the real estate has seen an estimated 300% rise in the last one decade. Unfortunately, this is

no where near the fundamental basis (Baker and Rosnick, 2005) for increase in the real estate prices which is

- increase in disposable incomes and capital formation
- shortages of land
- environmental restrictions on buildings
- population growth
- reduced interest rates (over long periods)

For a short period between 2001-2005, the increase in filings has closely tracked similar trends seen in FinCEN’s recently issued mortgage loan fraud assessment. The increase is likely attributable to the steep decline in interest rate charges on real estate loans at the turn of the century, which occurred contemporaneously with the increase in filings. It remains to be seen whether this trend in relevant suspicious activity reporting reverses as rates on real estate loans rise and the real estate markets cool (FCEN Report, 2006).



Source : FinCEN Suspicious Activity Report

**Figure 2**

### **FinCEN SARs findings for Money Laundering in Commercial Real Estate**

The FinCEN SARs has used a Bank Secrecy Act (BSA) database analysis tool to obtain SARs of all types filed during the period January 1, 1996 through August 31, 2006, with narratives containing one or more key words generally associated with the commercial real estate sector. Searches isolated 9,528 SARs that involved commercial real estate-related transactions or activities. Of these 9,528 SARs, 9,191 were filed by banks and other depository institutions, 271 were filed by securities and futures firms and 66 were filed by money services businesses. From this grouping, 960 SARs were randomly selected for review. The narratives identified 393 filings referencing commercial real

estate-related transactions specifically. Using this same sample of SAR narratives (393 SARs), 260 (66.16%) identified transactions or activities that at a minimum involved suspected money laundering, structuring and related illicit financial activities. Of these 260 SAR narratives, 47 (18.08%) strongly suggested money laundering and related illicit activities. These 47 SAR narratives represented 11.96% of the total 393 narratives that referenced commercial real estate activities. The 260 SAR narratives reviewed were found to fall into five categories: structuring, money laundering, international transfers, tax evasion, and miscellaneous illicit activity. The in-depth study of the 260 SARs, the largest set of filings (132) reported suspected structuring of deposits and/or withdrawals is shown in Table III giving the breakdown (in descending order of incidence) of the sampled SARs describing commercial real estate-related businesses, professions and individuals potentially involved in suspected structuring.

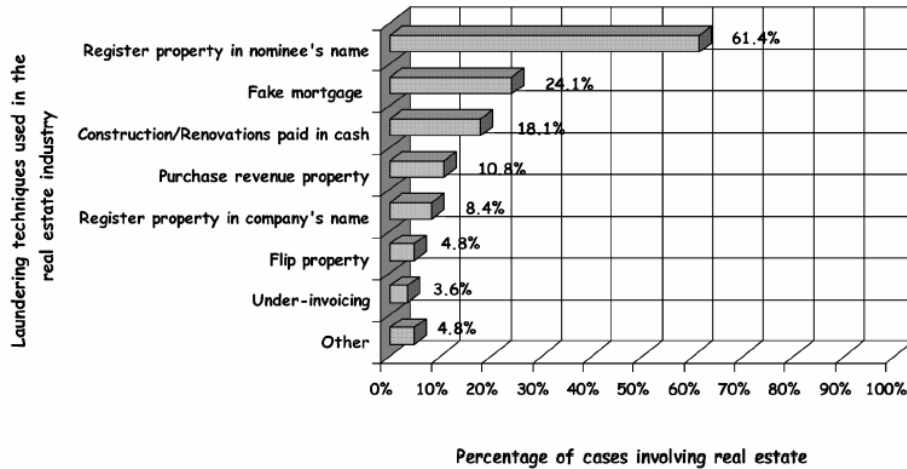
**Table III**

**Companies suspected of involvement in Structuring Money Laundering Proceeds**

<b>Primary Subject Entity Potentially Involved in Structuring</b>	<b>Reported Occurrences (#)</b>	<b>Percentage of Total Occurrences (%)</b>
Property Management Company	59	44.70
Real Estate Investment Company	40	30.30
Realty Company	11	8.33
Development Company	7	5.30
Real Estate Services Company	3	2.27
Title Company	3	2.27
Individual	2	1.52
Mortgage Company	2	1.52
Real Estate Agent	2	1.52
Escrow Company	1	<1.00
Loan Broker	1	<1.00
Real Estate Holding Company	1	<1.00
<b>TOTAL</b>	<b>132</b>	<b>100.00</b>

Source : FinCEN Suspicious Activity Report

In Canada, in the early 1990s the police in British Columbia observed a marked rise in the use of homes and rural properties for marijuana cultivation and laundering funds for financing the criminal proceed and purchase of land. This has now blossomed into a multi-billion dollar industry that has spread throughout Canada. The nation-wide series of police raids targeting marijuana grow operations that took place in 2002 (between January and April), over 417 people were arrested on 877 drug charges and police seized 116,329 marijuana plants, worth approximately CDN\$116.2 million (Schneider, 2005). Amongst the raid, in one of the cases the Royal Canadian Mounted Police (RCMP) investigation focused on one mortgage lending company that has been accused of breaching mortgage broker regulations by fabricating employment records, with inflated incomes, to help some clients qualify for financing (Sun, 2004; Schneider, 2005).



Source: Schneider (2005) “Organized crime, money laundering and the real estate market in Canada”, Journal of Property Reserch, June 2005, Vol 21, No 2.

**Figure 3**  
**Techniques observed to be used for Money Laundering through Real Estate in Canada**

Some of the well defined and common means used for laundering money through the real estate have been

- *Cash to purchase Cashier's checks*<sup>23</sup> of similar and lower denominations payable to same Payee.
- *Real estates are purchased by Individuals/companies with Cash-Cheque compositions* at reportedly low prices, which are resold within or to other organizations at 4 times or more the purchase consideration within spans of few days to 2-3 months.
- *Funds transferred between several real estate-related accounts in a circular fashion*<sup>24</sup>
- *Multiple cash deposits within short periods and Wire transfers*<sup>25</sup>.

<sup>23</sup> Case 1. A US bank reported that on one day an individual used cash to purchase three cashier's checks, each for an amount at or near \$10,000 at three different locations of the same bank, and payable to the same payee, which was a title company. Case 2. A U.S. bank reported that over a two-week period, a real estate investment company used cash to purchase numerous cashier's checks. Most of the checks were purchased for amounts just under the \$3,000 recordation threshold. These checks were deposited to an account in the name of the check payee at the filing bank. A review of bank records showed that this account also received deposits composed primarily of numerous cashier's checks sold by another bank (most issued in amounts near the recordation threshold). Bank employees reported that at different times an account signer would identify himself by presenting driver's licenses from different states bearing significantly different names, and signatures executed in significantly different handwriting styles. (FCENR 2006)

<sup>24</sup> Funds were being transferred between several real estate-related accounts in a circular fashion for no apparent legitimate reason. The accounts were linked by common account signers. Several businesses were involved, and they were all located at the same address and had the same account signers. Various news articles indicated that these companies had been involved in alleged real estate fraud. (FCENR 2006)



- *Structured cash deposits into the bank customer’s account from unknown source*<sup>26</sup>.
- *Funds transfer via traveler’s checks*<sup>27</sup> to business accounts.
- *Multiple Cash Withdrawals, purchase of Monetary instruments and Re-deposits via Banks and Financial Institutions*<sup>28</sup>.
- *Customer & Fund Orientation*<sup>29</sup> (Know your Customer / Stake Holder)
- *Rental Payments*<sup>30</sup> using Postal and Banking Instruments

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<sup>25</sup> Case 1. A real estate investment company located in the eastern part of the United States made multiple cash deposits within a five-week period in amounts that totaled almost one million dollars. During this same period, the company sent wire transfers to and received wires from a single company located in the western part of the United States. In total, the wires involved amounts that approximated the cash deposits. Case 2. An individual transferred money from his line of credit account, through his personal account, through his property management account, and back to his line of credit account for no apparent personal or business reason. Case 3. Large wire transfer received on behalf of a company registered in the Caribbean, which purportedly developed commercial and residential real estate projects in a Latin American country. The account holder claimed these funds represented a legal settlement with a governmental agency in the Latin American country. The bank transferred the funds to an account in Europe at the account holder’s request. It was subsequently learned from news reports that the account holder had been accused of fraud by a Latin American governmental agency. (FCENR 2006)

<sup>26</sup> Case 1. A U.S. bank reported that during a nine-day period, an associate of a bank customer reportedly made structured cash deposits into the bank customer’s account from an unknown source. The bank customer, who owned rental properties, also reportedly wrote four checks each in face amounts at or near \$10,000, payable to one individual, within a five-week period, which began sixteen days before the first structured cash deposit and ended ten days after the last cash deposit was received in her account. The relevant circumstances included structured cash deposits from an unknown source, followed by checks written in amounts facilitating structured negotiation. In addition, the aggregate amount paid out in checks was five percent less than the aggregate amount deposited in cash. Case 2. Principal of a real estate investment company deposited over \$100,000 in cash into the company’s account. When asked for the source of the funds, the individual stated that they had saved the money from an unrelated business. Much of the currency was in small denominations. (FCENR 2006)

<sup>27</sup> The principal of a real estate investment company deposited a substantial amount of funds in traveler’s checks to his business account. He refused to identify the source of these checks when asked by the bank. (FCENR 2006)

<sup>28</sup> Principals of a real estate investment company frequently withdrew large amounts of cash, purchased monetary instruments, and re-deposited many of the monetary instruments back into the real estate investment account. These activities occurred over a three-year period and involved amounts that totaled in the millions of dollars. The filer believed this activity was inconsistent with the normal operation of a real estate investment company. (FCENR 2006)

<sup>29</sup> Case 1. A US bank reported that one of its business customers, a company registered on a Caribbean island and allegedly involved in real estate sales, was associated with a crime family in a foreign jurisdiction. As such, the bank suspected that the company was used to facilitate the family’s illegal business operations. When the bank proposed terminating its relationship with the customer, bank employees working in the crime family’s home country warned bank personnel that a closure of this account could physically endanger bank personnel working in the crime family’s home country. Case 2. A US Bank reported that a group of customers involved in property management informally admitted to sending large wire transfers to a European country so that the money could be wired from there to Iran. The customers claimed they were sending the money to finance construction in that country. The bank determined that these activities violated the Iranian transactions regulations issued by the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC) and terminated the account relationship. (FCENR 2006)

<sup>30</sup> Account holders, who claimed to own many properties in a Latin American country, was depositing numerous money orders allegedly representing rental payments, into his personal account and sending many wires to the country in which he owned the properties, purportedly to pay employees there. The

- *Real Estate Company Transactions*<sup>31</sup>.
- *Political Exposure & Transfers*<sup>32</sup>

A total of 47 of the 260 sampled SARs narratives reported activities strongly suggesting money laundering. Table IV shows the various illicit activities reported or suggested in some of the above listed 47 narratives in decreasing order of incidence.

**Table IV**  
**Common Means for Laundering Money in the SARs Sample**

Illicit Activity	Incidence (#)	Percent of Total Activities (%)
Tax Evasion	16	28.08
Money Laundering (Layering)	13	22.82
Structuring	5	8.77
Money Laundering for Politically Exposed Persons	4	7.02
Operating Unregistered MSB (Including hawala)	4	7.02
Potential Terrorist Financing	3	5.26
Real Estate Fraud	3	5.26
Money Laundering for a Fee	2	3.51
OFAC Violations	2	3.51
Foreign Exchange Violation	1	1.75
Foreign Tax Evasion	1	1.75
Illegal Lottery Operation	1	1.75
Potential Violent Intimidation	1	1.75
Public Corruption	1	1.75
<b>TOTAL</b>	<b>57</b>	<b>100.00</b>

*Source : FinCEN Suspicious Activity Report*

### III. Money Laundering : Causes and Concerns

A recent paper published in Finance India, theoretically discusses and empirically tests the relationships between specific country features, policymaker choices, toward tax financial regulation and national non co-operative attitude with respect to the international

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filer believed that large numbers of money orders deposited to a personal account followed by large transfers through Latin American transfer companies appeared suspicious. (FCENR 2006)

<sup>31</sup> Case 1. Real estate lease financing company received numerous even multi-thousand dollar checks from individuals and businesses across the country for deposit. Subsequently, the bank paid even multi-thousand dollar checks issued by the company to various individuals who all negotiated the checks in a specific Middle Eastern country. Case 2. US bank reported that the principal of a property management company, who was in the business of administering Section Eight low-income housing, deposited checks to his property management account lacking transfer endorsements and made payable to a different property management company. The principal was determined to be associated with a signer on the account of the other property management company, held at the filing bank. The filer suggested these activities may have represented a tax evasion scheme. (FCENR 2006)

<sup>32</sup> Individual associated with real estate investments in the United States had sent and received millions of dollars in transfers to/from countries in Asia based on the US bank reporting. The bank’s research concluded the individual may have laundered money for politically exposed persons in a particular Asian country. (FCENR 2006)

effort to combat money-laundering phenomena. The results suggest that the non co-operative attitude does not coincide with the offshore tax competition attitude. When the international community points the finger at a given country as a leading supplier of money-laundering financial services, it may also be certifying, to the benefit of the country itself, that that country is indeed specialized in that business. The signaling effect embedded in the "name and shame approach" should not be underestimated (Masclandaro, 2005).

Masclandaro outlined four postulates on the analysis of the phenomenon, which propagate precise indications on the design of regulations aimed at implementing the policy of preventing and combating the phenomenon. The postulates were

- Vulnerability to Terrorism Financing Risk<sup>33</sup>,
- Equivalence between Terrorism Financing Risk and Criminal Capital Laundering Risk<sup>34</sup>,
- Offshore as a Catalyst of Terrorism Financing Risk<sup>35</sup> and
- Equivalence of Offshore Centres as a Catalyst of Terrorism Financing Risk and Fiscal Damage Risk<sup>36</sup>.

Growing attention has been paid to the role of Non-Cooperative Countries and Territories (NCCT) in money laundering and terrorist financing activities.

**Table V**  
**Binary Laxity Index determinants**  
(130 countries and territories)

<b>Dependent variable</b>	<b>Binary Laxity Index</b>	
Landuse	0.007*** (0.003)	0.007**** (0.000)
Gdpcapita	-7.07E-05**** (1.92E-05)	-8.15E-06** (4.36E-06)
Fordepositcapita	3.18E-06**** (1.36E-06)	3.52E-08**** (1.60E-08)
Terrorismorgcrime	- 0.508*** (0.224)	

<sup>33</sup> The world network that today represents the banking and financial industry, beyond the specific awareness of the majority of individual intermediaries and professionals who work in it, is the linchpin of the mechanisms that permit the financing of international terrorism

<sup>34</sup> The mechanisms that facilitate the financing of terrorism are the same that permit the laundering of the illicit capital of transnational criminal organizations, a phenomenon long the subject of concerned attention on the part of authorities and regulators.

<sup>35</sup> The mechanisms of financing terrorism and laundering criminal capital can function in a world financial network because in that network there are “weak” nodes or “black holes” represented by offshore financial centres (OFCs).

<sup>36</sup> The weak nodes in the network are particularly dangerous because they not only facilitate the financing of terrorism and the laundering of capital criminal but also facilitate unfair tax competition among sovereign nations. This last problem is also increasingly a subject of concern to policymakers.

Orgcrime	-0.190**** (0.079)
Terrorism	-0.061 (0.241)

**Note :** Standard Errors in parentheses.

Statistical significance at 0.01 (\*\*\*\*), 0.02 (\*\*\*), 0.05 (\*\*), 0.10 (\*).

The best estimated equation is as follows (Masciandaro, 2005)

$$(BinaryLI)_t = \beta_1 + \beta_2(AI)_t + \beta_3(CI) + \beta_4(EI) + \epsilon_t$$

with t = 1....N

where:  $A1$  = Landuse;  
 $B1$  = GDP per capita;  
 $C1$  = Foreign deposits per Capita;  
 $E1$  = Terrorism and organized crime Index.

Source: Masciandaro (2005), Finance India, Vol XIX No 1, March 2005

**Table VI**  
**Comparing Binary Offshore Index and Binary Laxity determinants**  
 (130 countries and territories)

Dependent Variable	Binary Laxity Index	Binary Offshore Index
Landuse	0.007*** (0.003)	-0.002 (0.005)
Gdpcapita	-7.07E-05**** (1.92E-05)	-2.04E-07 (2.60E-07)
Fordepostcapita	3.18E-06**** (1.36E-06)	1.71E-06 (1.33E-08)
Terrorismorgcrime	-0.508*** (0.224)	-1.888**** (0.448)

**Note :** Standard Errors in parenthesis.

Statistical significance at 0.01 (\*\*\*\*), 0.02 (\*\*\*), 0.05 (\*\*), 0.10 (\*).

Source: Masciandaro (2005), Finance India, Vol XIX No 1, March 2005

The econometric analysis of Masciandaro’s propositions generally confirming that the probability of being an NCCT jurisdiction will depend on specific country endowments (see Table III & IV). His findings indicated that the probability a country will become an NCCT jurisdiction tends to be higher the more it experiences economic growth problems, measuring those problems in terms of per-capita GDP and the level of land exploitation. It was noted that the probability a country will become an NCCT jurisdiction tends to be higher the more it has developed the flow of foreign deposits. Looking at the joint Index of the terrorism risks and organized crime risks it is seen that every national policymaker cares about both risks, and lax financial regulation that benefit in principle either terrorism or organized crime. In fact we note that the probability a country will become an NCCT jurisdiction tends to be higher as the degree of terrorism and organized crime risks decrease. The study also noted that non-cooperation is not associated with tax competition. While there is a theoretical presumption that international tax evasion and money laundering through offshore centres should overlap (Yaniv 1994, 1999; Alworth and Masciandaro, 2004), this is not necessarily the case. It can hence be seen that poorly

regulated financial markets not only open up new opportunities for financial crimes but also threaten the stability of the international financial system.

In the banking framework, it is observed that the "fraudsters" use fake certificates of deposit drawn on other branches of an international bank, which can range from US\$10 million to US\$ 25 million. The "fraudsters" also use fund transfers, which involve real dollars, opening up small accounts into which they then pour millions of dollars. "Fraudsters" will also use counterfeit letters of agreement, drawn on bank letter heads, seemingly vouching for a client from another branch of that bank, or confirming a deal has been approved etc. The problem which creates a temptation to approve such transactions, is that these banks may be turning away legitimate business. *Thus there is concern that banks operating overseas may be at a competitive disadvantage* because they adhere to standards for "*knowing your customers*" (Agarwal and Agarwal, 2004) identifying beneficial owners of transactions refusing suspicious or unusual transactions, etc. The banks should be advised informally that the answer is not to lower standards in the home country or abroad, but to intensify efforts to ensure that all major financial centers operate within the limits of an international consensus on counter measures.

It is interesting to observe some frauds and money laundering cases in India to have a better understanding of the cause of concern. We have tried to give briefs on the capital market scams<sup>37</sup> associated with money laundering - IPO issue (with IDFC, Yes Bank and GTB), Ketan Parekh, Abdul Karim Telgi, Harsha Metha, Bofor and Haridas Mundra. It is clearly visible from these cases that there is a nexus of money launderers, politicians and off-shore and/or domestic financial institution/banks which has weakened the role of enforcement agencies to function in the best interest of the society at large. One may wonder the above mentioned cases are simple capital market scams and as to what are they to do with money laundering. We have known that Casino and financing of movies are flooded with money laundered money to convert these funds from black to white. Similarly, the recent IPO issue (IDFC, Yes Bank, GTB), NPA issues (like Mundra) and other capital market scams mentioned above have been utilized for this convergence factor. Not only this, but the above have been due to maligned intension and not because of either change in regulations or as a mere co-incidence (of being at the wrong time at the wrong place).

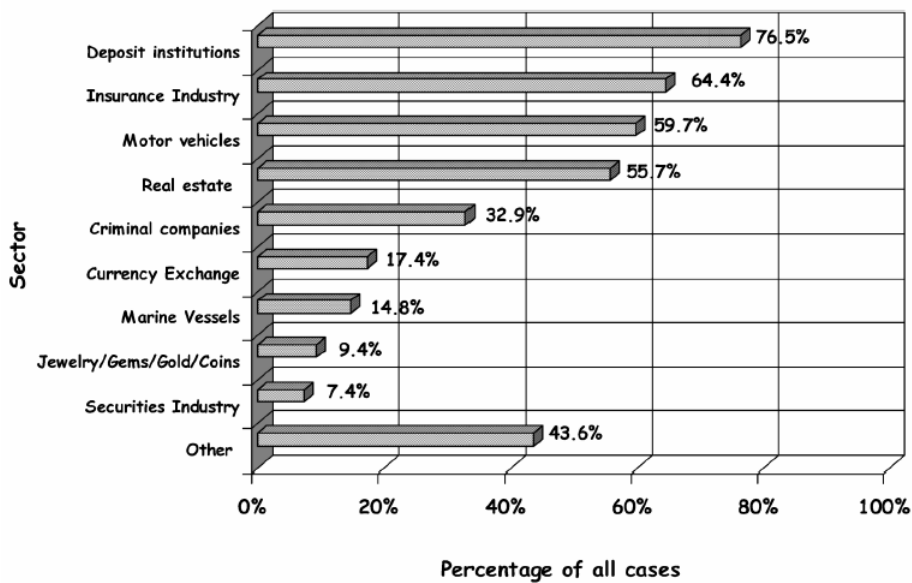
In a short story released by Bloomberg on the 26<sup>th</sup> July 2006, it was reported that Singapore is not fussy about the source of wealth in its financial sector and has been deterring to sign agreements with other countries to share financial/banking information so as to counter money laundering flows amounting out of corruption or criminal activities. Among the Indonesian crooks and suspects believed to be on the run in Singapore are Bambang Sutrisno and Adrian Kiki Ariawan, who were found guilty of embezzling the equivalent of US\$ 162 million from Bank Surya; Sudjiono Timan, who was convicted of improperly diverting US\$ 120 million from a state-owned investment company; Lidia Mochtar, who is wanted over the embezzlement of US\$ 20 million from

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<sup>37</sup> For details on these cases, kindly refer to Agarwal and Agarwal (2006)

Bank Tamara; Agus Anwar, a suspect over US\$ 214 million that's unaccounted for from Bank Pelita; and Pauline Maria Lumowa, who is wanted over US\$ 184 million that's missing from Bank BNI. Others whose whereabouts are unknown are able to safely visit Singapore. Hence Indonesia has been wanting to sign a treaty to tap some of these frauded funds and frauders. However, Singapore according to the Bloomberg report has argued that because its laws are based on English common law and Indonesian law is based on Dutch codes, the two systems are incompatible, making an extradition treaty difficult. But this didn't stop India from signing such a treaty with the Philippines in 2004, or Australia from signing one with Indonesia. Fugitive Indonesian banker Hendra Rahardja, who embezzled almost US\$ 300 million, was on the verge of being extradited from Australia in early 2003 when he died of cancer in Sydney. His funds in Australia were frozen and returned to Indonesia. A corollary of Singapore's reluctance to sign an extradition treaty with Indonesia is its apparent lack of fussiness about the sources of the funds attracted to its banking sector. (Beckman, 2006). Similar are the experiences with the movements of Funds in Swiss Banks and other NCCT countries. There has been repeated request by BIS and other nations to the Swiss banks and NCCT countries to observe secrecy and customer privacy norms as prescribed and outlined by BIS to counter money laundering and terrorist activities in the globe.

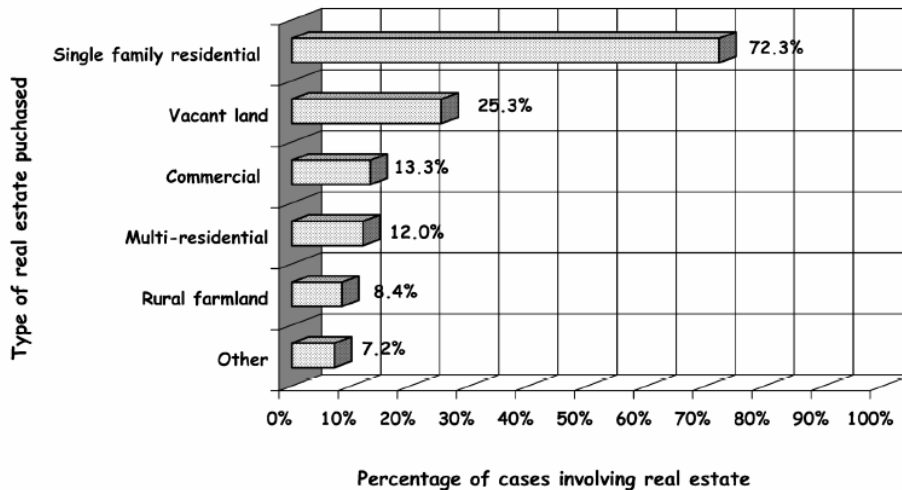
The study by Schneider clearly outlines the sectors and real estate assets utilized by criminal organizations to laundering the criminal proceeds in Canada in the early 1990s from the Police raids conducted in January-April 2002. (See Figure 4 and 5)



Source: Schneider (2005) “Organized crime, money laundering and the real estate market in Canada”, Journal of Property Reserch, June 2005, Vol 21, No 2.

**Figure 4**

**Economic Sectors and Assets used for Money Laundering in Canada**



Source: Schneider (2005), Journal of Property Reserch, June 2005, Vol 21, No 2.

**Figure 5**  
**Real Estate property types purchased in Canada**  
**with Criminal Proceeds for Laundering**

### 3.1 Architectural Reforms

It is vital the way governments and organizations do business. The government and regulatory bodies need to ensure that transparency and international codes on data dissemination, fiscal transparency, monetary and financial policy transparency through Special Data Dissemination Standards (SDDS) (1996), Code of Good Practices and Fiscal Transparency (1998), Code of Good Practices on Transparency in Monetary and Financial Policies (1999), Basel Committee Core Principles on Effective Banking Supervision (BCP) by the IMF, BIS, World Bank and Transparency International are absent. These are needed to induce clarity of role, responsibility and objectives; open process for formulating and reporting decisions; public availability of information on monetary/financial policies and accountability and assurances of integrity. The need for “*Transparency through Law*” is a vital component. Laws are chosen as vehicles for transparency as laws generally reflect the culmination of a process for the executive and legislative branches of governments to reach agreement. Thus, inducing degree of precision in laws to induce transparency and henceforth specifying consequences for non-compliance would set-in accountability within the system

While the above laws and regulatory framework is necessary, the need to have Economic Cells to deal with financial crimes is equally vital. In the cases outlined above, the frauds were dealt by the criminal investigating agency instead of an economic investigating agency/cell. It is vital for the judiciary to charge the financial or criminals with necessary criminal charges; however it is must that the money lost or swindled by the culprits is first obtained and flushed back into the system before the criminals are tried for their dues or interrogated for other’s involved in the scams. Be it Ketan Parekh, Harshad Mehta,

Mundra or Telgi, the amounts swindled were not obtained and the focus was to estimate the magnitude and trace those who were at the support of such frauds. In such cases the society and markets end up bearing the costs with loss of market confidence and deaths of individuals whose money is lost.

### **3.2 Uprooting Money Laundering**

Investigators have been toddled with the puzzle of un-earthing and uprooting socio-economic criminal offenses. With the difficulty posed by criminal organization towards erasing of the links between crime and money, their ownership and the final destination delivering shelter to such acts is like finding the right leaf of the right plant in a thick forest in a new neighborhood. With over 30 years of extensive work on by government agencies and institutions, the given complexity for the enforcement and investigating agencies is not impossible. These institutions are well networked and have a fairly good idea of the housing assets of such socio-economic criminal transactions. It is mostly found that consumption of luxurious assets in large or multiple small quantities like precious stones, art and artifacts, real estates, movie financing, casinos, flesh trade, NBFCs and banking institutions are where the dirty money are mingled and housed. It is more a question of political will in tune with an active society, media agencies and clean regulatory framework.

It is also vital that governments in power and regulators frame economic policies which are not detrimental to market movements and trades. In India, as mentioned earlier, we have found that Economic Policy framework for taxation and trade restriction have lead to the emergence and growth of dirty money and money laundering activities. These can be taken care off, if economic policy framework is well debated and tested for their ill effects in democratic environments, before implementation. To have effective supervision, the following components need to be well addressed in any given regulatory framework for effective reduction of leakages (a) Purpose of Regulation (b) Accountability (c) Market Abuse (d) Due Process (e) Manner of Regulation (f) Cost of regulation (Lal, 2003). International banking continues to grow, developing worldwide connections among banks, as well as the increasing sophistication of banking methods. The constant challenge is to ensure that every bank can account for its customers. Every government has laws which ensure the prosecution of financial crimes, and that every society sets moral and ethical standards for the conduct of commerce. Many important financial centers have now adopted legislation to curb drug related money laundering, and the number of governments which have ratified the 1988 UN Convention continued to increase. But the race between criminals seeking new ventures, and oversight bodies seeking more widespread compliance, still goes to the crooks.

Money Laundering is the biggest Fear for Finance Industry. The entire industry in the world or any separate country must understand that financial crime needs to be understood, analyzed and fought proactively. Banking Industry needs to be one step ahead of money launderers in order to control the menace of money laundering and financial



crimes. Concern regarding financial crime is growing to unprecedented levels amongst UK financial institutions (Logic CMG Report, 2003). One of the best control techniques for the banks to control money laundering is to know your customer (FSA Report, 2003). The consultation paper, published in August 2003, describes the FSA's money laundering directions on two important anti-money laundering controls: One, Issues relating to obtaining and using customer information for anti-money laundering purposes, and secondly on Anti-money laundering monitoring, assessing customers use firms' products and services and how possible money laundering activities can be identified from this. Eleven world money centre banks agreed in October 2000, to a set of anti-money laundering guidelines - for private banking activities. These guidelines state at the outset that "bank policy will be to prevent the use of its worldwide operations for criminal purposes."

With organized crime in control of banks and able to launder huge sums of money not only for themselves but also for other criminal organizations it is a call for concern. Already in Russia it is said that criminal groups control over 400 banks and 47 exchanges. This is worrying bank chairmen in Russia as between July 1994 to 1995, there were thirty assassination attempts against top bank officials, sixteen of who were killed. These killings along with earlier ones were important indicators of the efforts by criminal organizations to infiltrate the Russian banking system. Infiltration of the banking system offers significant advantages for criminal organizations, not least the opportunity it gives to facilitate money laundering for both Russian and foreign criminal organizations. Russian officials have worked with FATF and us government agencies to put into place more effective regulations and proceedings to combat money laundering, in accordance with international standards.

In February 1988, the OECD's Financial Action Task Force- for money laundering in its Annual Report highlighted the problem in Mexico and stated "One of the most favored technique continues to be out bound currency smuggling, along with electronic transfers, Mexican bank drafts and the parallel peso exchange market. Corruption remains the chief impediments to Mexican's anti-laundering efforts." Under the auspices of UNO, there is an international campaign to crack down on an essential component of the problem of money laundering. Now countries have enacted laws to prevent money laundering and allow closer scrutiny of suspect bank accounts of criminals. SWIFT is the principal international service for wire transfer message trafficking that can initiate funds transfers. In Russia and some East European states, banks can be readily purchased for very little money - though few of them have electronic banking access to SWIFT. SWIFT is a co-operative society located in Belgium having 2600 institutions in 65 countries providing services to security bankers & dealers; clearing institutions; and security exchanges.

#### **IV. Conclusion**

The global world and economies are faced with challenges to counter money laundering and terrorist deeds. Safer estimates indicate that about 2 - 2.5 trillion dollars are laundered

every year. Though it is the responsibility of every citizen of the global world to fight against such socially-ill and un-humane acts, however the duty primarily rests on the shoulders of investigating agencies, the judiciary and the enforcement bodies to play a pro-active role in clearing the menace. In recent years in India, we have seen the emergence of the judiciary playing a pro-active role quite independent of the government in place. This is a positive sign. We need to see similar acts of “*functioning without fear*” to be practiced by the investigating agencies and the enforcement bodies as well. Till the fear of loosing jobs for adhering to bring justice to floor would be there within the system, one will not see the sunlight minimizing financial and criminal ills in the society. We are reminded of a quote of our professor – Prof. Kanti Sawrup often says “*The Law rides the Poor and the Rich ride the Law*”, which is reflection of the functionality of societal setups in general, irrespective of their maturity or being a developed/developing economy. We also believe that people in general are God Fearing, honest and want to lead a simple peaceful honorable life. It is the acts of governance which in most cases has turned them to lead life otherwise.

In most cases or applications in India which are handled at governmental level, they follow the **CD-ROM principle** irrespective of the merit of the case, where, C (pay Cash Carry Certificate); D (Delays, Deficiencies & Denial of certificate); & ROM (Rest on Mat [never taken up & piles up dust]). Unfortunately, least respect for law and maximum violation of law is the order of the day by some of those who are in authority – as they are charged with the responsibility of enforcing laws (guardians of laws) or *mafia* groups, gangs and/or nexus of the two. The former enjoys the constitutional security and later is outside the frame work of law. A common man does not question either of them. Education and economic prosperity can help reduce these disparities and social evils.

The most commonly reported suspected illicit financial activity associated with the commercial real estate sector is money laundering to promote tax evasion. The revealed illicit activity committed or attempted by principals of all types of businesses associated with commercial real estate, especially the principals of property management companies, real estate investment companies, and construction companies indicate that the individuals engaging in such schemes often attempted to cash out checks payable to their businesses, pay cash for construction materials, and trade negotiable instruments with other business people to understate business receipts and actual business volumes as a way to avoid audit trails and evade taxes. There is an increase in the reporting of transactions using real estate-related accounts to launder money for politically exposed persons and for facilitating informal value transfer systems. This is one strong reason for the three major markets (Capital Markets, Bullion Market and Real Estate Market) being on a tremendous boom globally simultaneously post 2004. Electronic transfers and low banking prudence/norms have fueled this activity. Consequently, these conditions generally have not favored the money launderer seeking to layer his funds quickly, moving them from one account or investment to another. It is probable that real estate has been most useful to money launderers in the integration stage where it may serve as both an investment and vehicle to store the value of laundered funds. The need for the age old concept of “Know your Customer” is vital in all kinds of business operations to enable

reduce some of these illicit activities which pose security threats to nations and the society.

In the last 40 years, there has been a dire need for emergence of "Economic Intelligence Units" and "Economic Investigating Agencies". Though these have been formulated as divisions within the existing Intelligence and Investigating agencies, but are neither independent nor have the expertise to handle economic frauds. In India these are handled by the IPS officers using IPC or CrPC, who have been primarily trained to deal with criminal scenarios as against economic. We do not wish to counter or undermine the competence of the officers currently engaged in re-solving some the economic offences, however the need to first obtain the money lost due to economic offenses as against tracing the group/gang involved is vital, and not addressed so far. It is also vital that a specific degree of freedom is granted to these agencies making them to function independently (autonomously) without the interference and control of government like the Election Commission of India. We do have a series of regulatory bodies and enforcement agencies in place in India, however they are also subjected to low degree of independence and seepage of corruption which has resulted in their low level of performance leading to a strong *mafia* for money laundering and terrorist activities. Most of these authorities want more teeth. Grant them bigger teethes but ensure that these teeth are not used to extort money from the honest. A consequence of the current state is already felt in large number of innocent families losing their support life systems due to terrorist activities and poor governance systems.

We are happy to see that Government of India has issued anti-money laundering guidelines even before the introduction of the Prevention of Money Laundering Bill in the Parliament. Indian Money Laundering Act 2002 (Bill 1999) embraces money laundering from drug-trafficking, terrorism, profits from prostitution, extortion, smuggled items like gold, diamond etc. India's security is threatened by the spread of international crime control, free trade, globalization and advances in telecommunications leading to the increased reach of crime syndicates. The Bill in Section 3 deals with the offense of money laundering which states that whenever a person acquires, owns, possesses or transfers any proceeds of crime or knowingly enters into any transactions or deals or aids the concealment of the "proceeds of crime". This means that any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence or the value of such property. The Bill has the schedule offence which lists 16 sections of Indian Penal Code, 6 Sections of Arms Act, 9 sections of Narcotic Drugs Act and 4 sections of the Prevention of Corruption Act. Thus the Bill covers all activities which are capable of producing illegal money. The RBI panel has recommended rules against money laundering through improvement in procedures and policies for preparing appropriate (banks) customer profiles and coordination and cooperation with regulatory and other authorities. The panel said banks operating in India should ascertain the source of funds in deposit schemes offered to expatriate Indians as part of their drive to prevent money laundering. It also suggested each bank appointed an anti-money laundering compliance officer and create profiles of customers. It called for creation of a data bank of suspicious transactions, which could then be circulated to banks to help them

defect patterns of suspicious behaviors. However, the RBI did not say when it intends to implement the recommendations. But technological initiatives in the Indian banking space have gradually gathered momentum ever since RBI announced the policy of privatization of banking in 1993. Infracore Technologies has launched an anti-money laundering software similar to SWIFT in India on the 17<sup>th</sup> of September, 2003. This is a huge development being India's first globally adoptable Anti Money Laundering (AML) Software named OMNI Enterprise. Considering the size and dimension of the problem, and the alarm, Infracore Technologies, a specialist banking product player, is counting on its early mover advantage to make the lead way in the anti- money laundering products sphere that is estimated to be worth close to US\$ 10 billion (Agarwal and Agarwal, 2004).

The United States has desired India to play a more aggressive role in its global campaign against terrorism and terrorist financing by joining groups striving to curb money laundering. The Indian Parliament has passed The Prevention of Money Laundering Bill in 2002, and the country is yet to join the Paris based Financial Action Task Force consisting of 29 nations set up in 1989 to prevent international money laundering. Since the September 11 attack, cutting off money to terrorists has topped the agenda of FATF, which includes the United States, Britain, Canada, France, Brazil and Switzerland. The panel has used FATF rules as a guideline. Alarmed with reports of money from global terrorist organizations flowing into their account, banks across the globe are implementing special anti-money laundering software to detect unusual flow of money.

With the changing structure of world investment, trade, capital flow and the need for deeper integration, the need to strengthen Financial regulatory framework and signaling system is the need. Globalization has altered the economic frameworks of both developed and developing nations in ways that are difficult to comprehend. The persistent rise in the dispersion of current account balances of the world as a whole, wherein the sum of surpluses match the sum of deficits has grown substantially since the World War II. Also the emergence of unregulated global markets appears to have moved towards a more stable and growth oriented economic globe with higher risk to the integrity of the financial systems. The credit derivative market was almost nonexistent in 2001, grew slowly until 2004 and then went into the stratosphere, reaching US\$ 26 trillion this June 2006, which has caused a worry for Securities Commission worldwide. Many other financial instruments are now being invented, and markets for credit derivative futures, credit default swaps<sup>38</sup> and binary options are in the offering (Kalko, 2006). Economies have been hit one after the other with the fashion and need for market driven capitalist and liberalized economic system in the past. The 90's has also seen the emergence of E-finance which apart from the efficiency, product enhancement and lower cost of transaction has facilitated the crisis frequencies, globalization and movement of capital flows internationally without much control. The significant reduction in global trade barriers over the past half century has contributed to a marked rise in the ratio of world trade to GDP. External finance has contributed to the movements for growth in trade and

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<sup>38</sup> The seller undertakes, subject to payment of a surcharge, to compensate the customer in the event of a default on payment or simply deterioration in the quality of its debtors.

development across regional barriers. This has raised concerns and risk of money laundered funds moving into the regularized markets in a smooth and non-surfing fashion. The solution is not by stopping these inter-regional market growth activities, but by developing sensitivity sensor systems within the financial framework as an integrated approach to keep markets from busting and causing socio-economic panics.

Faced with these uncertainties, it is especially important that policymakers undertake the required policy adjustments for a sustained global expansion. As well, supervisory and regulatory authorities need to continue to strengthen financial market infrastructure to underpin the resilience of the financial system. With global imbalances, the entire global financial structure is becoming uncontrollable in crucial ways that its nominal leaders never expected, and instability is its hallmark. Financial deregulation has fueled the concerns for money laundering to flourish and in resolving the problems that have emerged for those who deplore controls on making money. The BIS Annual Report has discussed some of these problems and the triumph of predatory economic behaviour and trends which are difficult to rationalize (BIS, 2006). We hope there is better understanding between nations to combat the emerging crisis that may lead to eradication of civil society and become cause for pain and trauma for honest man to survive in the society. We do not wish to see more farmers and people dying due to drugs and criminal acts in the society due to money laundered money. It is time that the NCCT start working in alliance with other economies and agencies to minimize economic and criminal offence in a growing inter-connected prosperous global village.

Jai Hind.

## **Appendix I**

### **BCCI Case: World's Worst Banking Scandal**

The world's worst banking scandal, inflicting huge financial losses on thousands of people worldwide, surfaced in the media in 1991. This was the Bank of Credit and Commerce International (BCCI). As could be expected, it had heavy ties with the CIA, terrorist organizations, drug traffickers, and any other crooked financial transactions shunned by most other banks. It financed terrorist activities, financial drug trafficking deals, defrauded depositors. Years before it was shut down, Robert Gates, FBI Chief, referred to BCCI as the Bank of Crooks and Criminals.

BCCI started operations in Pakistan in 1972, with much of its funding provided by Bank of America and the CIA. Bank of America claims that it sold its BCCI interest in the early 1980s, but records show that Bank of America continued to control much of BCCI's operations until shortly before BCCI was shut down. In the early 1970s, CIA operative Gunther Russbacher transferred sizable amounts of CIA funds into the bank for the start-up operations.

The CIA knew about BCCI's activities, and found its mindset to be very manipulating and planned its own operations through BCCI. BCCI was customers made for the covert and corrupt activities of the CIA, the MOSSAD, drug dealers and terrorists. CIA operatives used the bank to launder money from CIA enterprises, including drug trafficking proceeds, and from its various financial activities within the United States, including its use of savings and loans, to fund unlawful arms shipments, finance terrorist operations, undermine foreign governments, and other covert activities. Investigating reports showed that BCCI was able to simultaneously manipulate the spy agencies of numerous countries, including the US, Israel, Pakistan, China, Saudi Arabia, among others. BCCI was supplying funds for terrorist Organizations such as Abu Nidal. BCCI rigged international commodity markets that permitted certain insiders to make hundreds of millions of dollars in profits, offset by the same amount lost by depositors. BCCI was laundering money (drug money) for drug cartels throughout the world.

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