

## 14. Crime-money in the financial system - What we fear and what we know

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### *Abstract*

In this article the authors investigate the role of the crime-money in the legal financial system and upperworld economy. They analyse critically the various theses concerning the threat of the crime-money and laundering to the integrity of the financial system. In the first place they conclude that the theory and conceptual framework of most economic research is too weak and inconsistent to allow any conclusion about threats. In addition, surveying the historical and present evidence they found much unsound methodology and little supporting evidence for the generally accepted threat imagery. The researchers investigated the Dutch confiscation databases of more than ten years. Though this allows only a partial view on the world of criminal finances and assets, it is hard basic material and the best proxy there is. They focused on the sensitive under- and upperworld interactions in which crime-money was involved. An extensive cross-break and analysis of the data showed that the potential financial and economic impact on a whole economy was negligible. Also two sensitive sectors, real estate and the financial industry seemed less affected than is generally assumed. They conclude that the most important influence is of a social nature: showing off illicitly acquired wealth has an eroding and attracting influence of other people, some may be seduced to cross lines towards crime-for-profit.

### *Résumé*

Dans cet article, les auteurs étudient le rôle du crime économique à la fois en droit financier et dans la haute finance elle-même. Ils analysent de manière critique les diverses théories relatives à la menace que le crime économique et le blanchiment présentent pour l'intégrité du système financier. Ils concluent tout d'abord que la théorie et le cadre conceptuel de la plupart des recherches économiques sont trop faibles et inégaux pour que l'on puisse en tirer la moindre conclusion relative à de telles menaces. De plus, en étudiant les recherches passées et présentes, ils se sont aperçus que nombre de recherches reposaient sur des méthodologies douteuses et que finalement peu d'éléments permettaient de tenir pour établi le mythe généralement accepté de cette menace. Les auteurs ont enquêté auprès des bases de donnée hollandaises

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portant sur les confiscations, ce, en couvrant une période de plus de dix ans. Bien que ceci n'offre qu'une vue partielle du monde du crime financier et des actifs, ceci fournit des données matérielles concrètes de base et la meilleure source possible de données reconstituées. Les auteurs se sont penchés sur les interactions entre la haute finance et le monde ordinaire où le crime économique pouvait être impliqué. Une analyse croisée des données a montré que le risque financier et économique potentiel sur l'ensemble de l'économie était négligeable. Par ailleurs, deux domaines sensibles, comme l'immobilier et l'industrie financière, semblaient moins affectés que l'on ne le suppose généralement. Les auteurs concluent que l'impact le plus important est de nature sociale : faire un étalage de richesses acquises de manière illicite génère à la fois un phénomène d'érosion et d'attractivité sur autrui, certains pouvant être séduits au point de passer la ligne jaune menant à la délinquance d'acquisition.

### 1. Introduction - Credit crisis and new questions

With the present knowledge and against the background of the financial crisis after 2007, the proclaimed spectre of laundering of the past two decades is a justified, but easy target for criticism. The pompous claims about the extent and threat of money-laundering, all these supposed hundredfold billions of crime-money pale into insignificance in comparison to the thousands of billions Euros, pounds and dollars that evaporated due to financial recklessness of the top management of the financial system. In the end, who did really threaten the integrity of the financial system? For good reasons, looking at the literature after 2007, we hardly find the previously repeated resonant warnings about the threat of crime-money and its laundering. Does this relative silence mean that money laundering has become an irrelevant issue? No, this silence is deceptive. As a matter of fact, the claims and theses about the threat of crime-money are still there, together with the whole anti-laundering regime: the conventions, laws, international and national institutions. In short, the whole anti-money laundering complex (Verhage, 2009). As soon as the crisis has ebbed away, the old imagery of the crime-money will come to the fore again, irrespective of (the lack of) corroboration or refutation.

What does that corroboration or refutation – rather ‘*conjecture* and refutation’ – look like? There are many conjectures, but few attempts of refutation. Moreover, conjectures are usually worded as firm beliefs. And when beliefs are strong, facts recede to the background. That is normal: true believers do not need facts and do not raise questions and do not doubt their tenets. Still, the same believers advocate an ‘evidence based policy making’. Therefore, it is appropriate to take that seriously and to continue to test the claims about crime-money and laundering against a background of collected evidence. Of particular relevance is the collection of indices concerning the effects of crime-money in the financial system. This is relevant as the basic doctrine concerns the purported undermining of the integrity of the financial system and all the consequences ensued.

Apart from morality, there are two empirical sides to this issue. Thus far the question has always been: ‘What do the launderers do in and to the financial system?’ In addition to this question, one should also find out what the role of the crime money in the financial system looks like, which depends on its observed volume and distribution in this system.

What launderers ‘do to the financial system’ has been elaborated by various authors, some of them researchers, many of them from respectable institutions like the International Monetary Fund, the World Bank, the OECD and the FATF. Their unanimous message is clear: crime money and laundering do pose a threat to the integrity of the financial system and the welfare of whole economies. But how solid is their evidence? Let us do a short stock taking of the state of the art.

## 2. Searching for the threat of crime-money and laundering

While we are not short of apologists of the fight against the evil of crime money and its wicked money laundering, we are still lacking a clear and simple fact based explanation which transcends the basic moral foundation: 'crime should not pay'. So, apart from morals, what is threatening about crime money and its derivative—laundering?

The question contains two elements: crime money and laundering. It is difficult to address these separately: if there is laundering, then there is crime money—though not the other way round. This presupposes a non-ambiguously delineated concept of laundering. But what if the concept of laundering is not properly delineated? It can be formulated so broad, that the mere having of crime-money is tantamount to laundering. This is more in accordance with the Council of Europe delineation, particularly if one includes *self-laundering*. One can also chose a narrow, strict meaning: making black assets *white* in the sense of 'white washing' as it is aptly called in French, German and Dutch. As the very broad interpretation leaves little differentiation, we first look at the narrow meaning first: 'white washing'.

## 3. Laundered and unlaundered – where is the threat?

Let us assume a finalised act of laundering: crime-money has been deposited in a bank account and it has been accepted as licit alongside a number of electronic transfers from the same source. There are no reasons for suspicion. Now the bank proceeds within its 'financial veins' stemming from this and a range of other inconspicuous customers: some salary men, others entrepreneurs depositing their purported savings, all earned legally plus illegal 'extras'. The question now is: where is the threat to the financial system with this discrete accumulation of proceeds?

This is an important question as most criminal income is generated by economic and fiscal crime, not being the bag-with-money economy (Reuter and Truman, 2004; Van Duyné, 2007). If only to blend into the entrepreneurial landscape, the proceeds of these predicate crimes flow through banks from the very beginning. For example, VAT fraud is not a cash based fraud scheme. Assuming their lion's share in the crime economy as plausible, these bank based proceeds should be the main threat component. But how? Because of their laundering? No, these monies are laundered as soon as they are acquired. For example, they are handed out by the tax inspector through a bank account, incorporated in the balance of enterprises and then recorded by the bank; they are listed as a component of the GDP and are further subjected to the normal taxes. What kind of threat do these bank accounts with 'proceeds of crime' pose? After all, launderers do not rob banks but bring or wire money *into* the banks. So in what sense are the banks 'victimised'?

If *laundered* money supposedly poses a threat (apart from the predicate offence), does *unlaundered* money also pose a threat to the integrity of financial system and if so, in what way? To answer this question we must first ad-

dress a preliminary question: what does *unlaundered* money mean? Is it cash, not being in the bank? Cash in the safe deposit box in the vaults of a bank? Or the bank accounts of which the criminal origin has not yet been proven?

Assuming an *unlaundered* money volume we must again raise the question: where is the threat? Is hiding crime-money something like hiding a gun? Hiding crime-money in a bank deposit box is little different from burying it in the garden, the difference being that one does not have to pay rent for one's own garden. But in both cases the assets are hoarded and remain for the time being out of circulation. And buried millions of money, if found, make nice headlines in police reports, but are economically sterile. Buried money does not threaten as we know from ancient history: the excavated Viking silver hoards in Britain were less threatening than the Vikings themselves.

The above situations concern monies of which the bank can have no knowledge. But providing banking services, accepting *unlaundered* money for deposit in an account or for conversion into cheques or to be wired to another bank account, is tantamount to condoning at least an unusual, if not a suspicious transaction. That is the threat of *abetting* laundering. However, is that a threat posed by crime-money itself or a threat stemming from negligent management and failing supervision? With the wisdom acquired from the credit crisis it is fair to say that defective supervision has affected the financial system more serious and deeper than crime money itself, stealthily entering the financial system. The money in the account or the convertible value bearer will function in the bank no differently than an account or cheque acquired with legal money. This leaves us again with the unanswered question: 'Where is the threat?' We left out the addition 'integrity': if we cannot properly locate the general threat, then the special threat cannot be located either.

#### 4. *The wall-to-wall concept*

The difficulties for our search for the threat increase when we search within the perimeter of the *broad* definition of laundering. This encompasses virtually all the subsequent acts concerning the criminally gained money (or illegal advantage): namely not only the hiding or disguising of the origin or the transfer of proceeds, but also the bottom line: using and possessing. Having crime-money in a bank safe or burying it in the garden is then also laundering, in addition to using it in any sense. The question which then arises is: 'where is the *unlaundered* money left?'

Here we hit upon a real problem for our search: the legal and economic construction of the laundering concept. Above we referred to a narrow conception: laundering is pretending a legitimate source of criminally acquired assets (including savings): in short, 'white washing'. Within that conceptualisation there may only be a part of the volume of crime-money that is really laundered. However, most legal texts follow international conventions almost verbatim, and these use to encompass any consequential act after the criminal acquisition of proceeds (Van Duyn, *et al.*, 2005). Though the texts of the penal clauses were clear about this potential extension from the onset, it took some

time before this 'wall-to-wall' interpretation crystallized out (Gelemerova, in preparation; Van Duyné, 2003).

As all crime money is eventually spent under the pretension of legality (however thin) this wall-to-wall concept leads to a wall-to-wall application. This looks like a clear and simple stand, but it still leaves uncertainties about tax evasion and economic crime when the underlying goods and services are legal. This uncertainty can easily be solved by applying the broad laundering concept: deliberately concealing income, reducing contributions or saving prescribed expenses is a criminal offence and results in a criminal advantage. The fruits of that offence are then proceeds and their concealment by fraudulent accountancy and possession is laundering.<sup>2</sup> This not only enlarges the volume of laundered money, it solves also the problem of *unlaundered* money: there is none! The threat of laundering becomes equal to the threat of the unrecorded economy: the 'wall-to-wall' concept leads to a 'wall-to-wall threat'. However, what is explanatory value in relation to its threat?

### 5. Economic threats

If the analysis in the previous section has a puzzling outcome, we may rather address the financial and economic threat issue from the broader angle: crime is bad, therefore its fruits must have a negative impact on our whole economy.

Let us repeat our ground-level exercise and depart from the successfully accomplished laundering activity: dirty money being placed stealthily in a licit account in the name of a legal or natural person. The owner enjoys these proceeds and declares these assets to the tax authorities.<sup>3</sup> Therefore this crime money is part of the official GDP. As many economists state that money as an unobserved percentage of the GDP poses a threat (Unger, 2007), all these 'whitened' monies must be considered harmless even if the acquisition is morally reprehensible.

Taking this argumentation concerning the unknown slice of the GDP seriously, let us now follow that track. The most serious concern is that crime money (including all the proceeds from fiscal offences) leads to a distortion of the national accounts and other macro-economic consequences (Tanzi, 1996; Barlett, 2002).<sup>4</sup> The reason is that there is more money in circulation than is officially known. In its turn this could lead to either higher taxation – because the financial burden of the government will be based on a narrower monetary

<sup>2</sup> This deviates from Schneider's (2007) point of view. There is indeed a danger of mixing up if one equates the hidden wealth or income with illegally saved tax monies.

<sup>3</sup> In many countries the financial institutions already communicate saving accounts and other financial assets of clients to the tax authorities.

<sup>4</sup> Tanzi provides a whole list of negative macro-economic consequences, which have been cited, re-cited and re-re-cited until the last publications (e.g. Unger 2007). Tanzi's (1996) study – using a poor proxy laundering variable (Interpol figures, *sic!*) and hardly analysed concepts – cannot be qualified as an empirically founded research. Therefore it would be appropriate to test which of the many threats have been realised after 15 years using a more rigorous methodology.

basis – or else the government must borrow money on the financial markets. If these alternatives are not acceptable the government has to economise even if much money is circulating in society. Either way, crime money (if not properly laundered) can have a distorting effect of either inflation or deflation.

At first sight this looks like an irrefutable truth; a truth as old as there are tax levying authorities. However, are the effects really that drastic? If we set the hidden money volume at a steady percentage of 2-5 % of the GDP (IMF estimates), then the government's budget is every year based on approximately 95% of the national income. But for the financial authorities, oblivious of that hidden part, this 95% has become their 100%. Where does the inflationary effect come from, assuming that the hidden 5% is being spent every year on consumer items which are also taxed? That implies that in the end all the crime-money ends up one way or other in the only one big universal money laundering mill: the tax administration. This implies more income from indirect taxes and if the government does not succeed in collecting these, the threat does not come from crime money but from mal-governance concerning the collection of taxes. As a matter of fact, going through the economic studies of money laundering one is surprised to find a regular mixing-up of causal relationships, next to taken as proven which still has to be proved. In addition to this basic defect Reuter (2007) pointed at the fact that hardly any historical examples of the devastating influence of laundering could be found, with the exception of Latvia in the 1990s and the Dominican Republic in 2002.<sup>5</sup>

Of course, assuming that lost income tax is fully compensated by indirect taxes may be a too simple representation. Governments eschew such compensation and tend to avoid an inflationary increase of VAT and sales tax. In addition, as has become evident, illegal tax savings, whether by crime-entrepreneurs or decent housefathers are frequently shipped to safe tax havens abroad. In the last years this has resulted in an ironic integrity reversal: authorities buying stolen data of their tax dodging citizens from disgruntled, greedy, and at any rate non-integer staff of foreign banks. Crime-money can affect integrity indeed.

#### *6. Using crime-money for doing wrong things*

Of course, economists have expressed more concerns than this abstract issue of state budgets and fiscal income. In these concerns the function of the crime-money mingles with the economic behaviour of the criminal money owners. The attention ranges from the undermining function of crime money itself to the wrong things criminals may do with their wealth. It is particularly claimed that criminals invest their money less efficiently and squander their money on extravagant things and real estate or worse, reinvest it in new criminal enterprises. This combination of money and actors has consequences for the study of crime-money and laundering. It adds an interesting behavioural dimension

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<sup>5</sup> To which Reuter added (p. 2): "Moreover, in each of the two cases it may have been the underlying crimes rather than the laundering which caused the problem."

to the discussion which leads to the question whether wealthy criminals behave differently from other wealthy people.

In order to capture that behavioural element Van Duyne (2003) suggested a rough 'threat scale' for the crime money connected to how it is used. The scale may be read as an ordinal scale ranging from the most harmful top to the not-so-bad bottom.

### *6.1 Corruptive penetration in the upperworld decision chambers*

This is of course the most feared outcome: criminals buying their way into the decision making layers of society. However, this must be approached per country as the differences are huge, while the outcomes may be very surprising. Stock taking examples of grand corruption and crime-money in Europe in the last decades leads to the preliminary conclusion that in all the major corruption cases 'white' money has been involved: from Prince Bernhard of the Netherlands, the mayors of Paris, money for questions in the British Parliament, to the Daimler and Siemens scandals, the upperworld bribed itself with *legal* money. Here we have a reverse money laundering movement: before the white money can be used for corruption it must first be made black, for example by creating phony expenses. The only exception may be the alleged corruption of the Italian Prime Minister Berlusconi accused of having received Mafia money (Stille, 2006).

### *6.2 Criminal upperworld subsidy*

With this we mean that licit enterprises are kept going by means of crime money although they are structurally loss making. This is certainly a seriously wrong use of money, undermining fair competition because of the availability of cheap credits from crime. The thesis is plausible, though difficult to substantiate. No proper empirical study has been carried out, certainly not by economists of the World Bank, IMF or OECD who were the most emphatic on this point. Van Duyne (2003) and Van Duyne and Levi (2005) scraped what examples they could find, but they failed in filling an impressive display case with examples, drawing heavily on Suendorff (2001) and Meloen (2003), who had not much to offer either. The best documented case concerns the above mentioned alleged Mafia financing of Fininvest, again of Berlusconi.

It should be remarked that upholding loss-making enterprises against rational economic arguments is not a distinctive feature of criminal investors: the whole European Union agricultural policy has functioned not much differently, though with far more grave effects on millions of small farmers in Third World countries.



### 6.3 *Once-only investment: diffusion by gentrification*

There is little known of the role of crime-money as an initial once-only investment after which the enterprise must continue on its own in a legitimate and rational managed way. There are anecdotes from the era of the 19<sup>th</sup> century American robber barons and diverted shady monies from the previous socialist Eastern European countries repatriated to take part in the corruption ridden privatisation rounds (Gelemerova, forthcoming, 2011). (Of course whether the privatised firms will continue to operate legitimately is rather a matter of the benefit of doubt). From primary criminal file analysis only anecdotal examples with usually small firms can be gleaned (Suendorf, 2001), though there are monumental exceptions, like the foundation of wealth of the Kennedy clan (Kessler, 1996).

### 6.4 *Re-investment in own criminal enterprise*

Of course, a bad thing is made worse in case of investing crime money for continuing criminal enterprises. But are crime-enterprises really all dependent on such a self-investment and to what extent? This fear does no justice to the broad diversity of enterprises. In general terms one can say that wholesale producing or trading in prohibited substances such as drugs or high-taxed commodities (cigarettes) require an initial capital. This applies particularly to bulky commodities such as cannabis products or cigarettes (mainly transport) or to the production of synthetic drugs (but which require less transport investment). However, investment in economic crime can range from low to nothing, certainly if committed from an existing enterprise. For many fraud schemes the basic requirements are: a telephone line, e-mail address, and with some more sophistication a front firm with a straw man.

### 6.5 *'Rainy day provision'*

Crime should not pay and criminals should certainly not be allowed a 'criminal pension'. However, here we leave the field of economy and enter the domain of morals and sociology: saving (criminal) money for later is not bad in itself, while there is little threat emanating from a retired criminal living from a 'criminal pension', even if it offends our moral feelings. Unfortunately there are insufficient historical biographies of criminals (usually from the underground economy) who died peacefully as a wealthy pensioner (Al Capone (Schoenberg, 1992); Lansky (Lacey, 1991), both with a practically empty heritage) to come to any conclusion: the lethal lifestyle or incarceration rate may be too high to find many examples.

### 6.6 *Life style*

With life style expenses we come to the most visible and for some the most irritating aspect of the criminal social-economic life: criminals conspicuously

rolling in wealth. However, is that a financial or economic threat? After all, their spending is the income of a lot of people. A thrifty criminal saving for his retirement may be economically of less importance than the one who keeps restaurant owners, car dealers and travel agencies happy, if not the beauty farm for his wife and the pony school for his daughter. Moreover, to what extent does his conduct differ from the life style of the bonus hunter of a fallen-down bank? The latter's disproportionate windfall and spending may be just as undeserved. As a matter of fact, there is little difference in the spending of licit wealthy individuals or families described in the *World Wealth Report 2010* and the spending of rich criminals according to our confiscation data base: much tangible 'bling-bling',<sup>6</sup> though our database did not mention aeroplanes and no (tax deductible) philanthropic spending.

Nevertheless, this display of wealth touches on an issue in which morals turn into economy: the emanating effects of sudden riches on economic choices of others. At this point the effects of criminal wealth and financial windfalls from other sources look very similar.

The undisturbed display of criminal wealth is not a marginal matter in the criminal social-economy: it is the only way to show success and thereby to exert influence. In contrast to the upperworld economy, in the underground social-economy it is difficult to demonstrate success credibly while still living modestly. Moreover, unless there is a combination with economic crime, a criminal underground enterprise is not an entity which one owns as a possession with a legal ownership title, which one can sell or leave to an heir. Therefore, one has to appear to the relevant social surroundings as a shining example of material success: display one's wealth and bestow favours on followers (Firestone, 1996). This looks like a primitive economy, not dissimilar to the way a mediaeval monarch had to show his riches from which he bestowed favours to his retainers.

Despite this primitive appearance, the importance of this symbolic function should not be underestimated. Gambetta (1993) referred to this display function concerning the Mafia: of course, the Dons donated money to local charity or the church to demonstrate their 'important being-there'.<sup>7</sup> The Colombian cocaine wholesaler Escobar spent likewise money on public facilities in his town Medellín (Verbeek, 2001). A very emphatic example of presenting oneself publicly on the who-is-who criminal list could be found in Serbia during the Milošević era: criminals draped with golden chains and crosses being inter-

<sup>6</sup> The Dutch confiscation database from 1994 was analysed also for movables. Just by way of an odd selection: 998 rings, 551 watches, 178 necklaces, 761 cars, boats, 234 pieces of crystal (Swarovski), horses, bicycles + lamps, fridges and... 27 fishing rods (Van Duyne, 2007: 91).

<sup>7</sup> But too much display can turn sour too, also within the Mafia. Paoli (2003: 151) describes how the participating in the drug trade distorted the usual distribution of income of the Mafia: Godfathers living relatively modest. The sudden accumulation of blaring wealth at the top level and the neglect of the underlings created envy and resentment, the breeding ground for many *pentities*.

viewed on television. Many Serbian youngsters (still) adore(d) these gangsters as heroes (Logonder, 2008).

For good reasons law enforcement has placed more emphasis on criminal wealth display: in Amsterdam the police confiscates expensive 'shiny gadgets' with which young criminals like to impress their peers, unless they can prove to have acquired them from legal income. In the UK the concept of 'criminal life style' has been coined. What the effects will be is still uncertain: will there be less motivation for profit oriented crime or only less conspicuous display of wealth? In the last case it may lead to more criminal savings and consequently more crime-money in the financial system, unless criminals resort to hoarding. That may be the concern for future archaeologists, when they hit on a hoard with old Euros.

### *7. Differences with other money flows*

Though there is a consensus about the pernicious effects of crime-money, we still have to address the question in what respect its economic role differs from other money flows which are licit. If we abstract from the phony money flows from derivatives, which contributed to the present financial havoc, we can look at various categories of real money flows. We select the revenues from mineral oil or minerals and the remittances from migrant labour to the home country.

The effects of oil revenues are sometimes compared with those of drug revenues because both would distort the financial and economic equilibrium in the producing country (Thoumi, 1995; Keh, 1996). These huge oil revenues do not appear to stimulate the development of a diversified productivity. With reference to countries like Nigeria, Angola authors speak of the 'curse of the oil wealth'. At present one may add the Russian Federation.

However, this is not a natural phenomenon inherent to oil (or other minerals) as some 'natural cause'. It is partly inherent to extracting minerals: the spreading of wealth from this industrial activity is modest as extracting minerals is in many cases not very labour extensive. It is mainly a socio-political 'curse'. As is the case with the drug revenues, oil revenues use to come into the hands of a small elite and are also spent in the interest of that same small elite: reinvestment in a diversified economy or infrastructure on behalf of the population at large is rare. To become a beneficiary one has to elbow or buy its way into these inner elite circles (or have kinship relations). The spread of corruption, abuse of power and other consequences of mal governance constitute an enduring undermining of the rule of law.<sup>8</sup> In this respect the flows of oil monies differ in their effects little from drug money. Also in social terms: what is the difference between a clique of drug barons and a clique of oil barons whose members rotate in government positions? Formulated less abstractly: what is the difference between the Russian oligarchic oil power elite and a Mexican or

<sup>8</sup> Historical comparisons are abundant, from the Mexican silver in the 16th century to the gold rushed in more recent history.

Colombian drug baron? For an investigative journalist to find this out there is none: both kill.

Drug money is often mentioned because drugs are considered as a generally recognized 'evil'. Of course this is not the case with labour, which is in principle legal. Of course, labour, or rather its management can become illegal if fiscal, social or migration regulations are violated. In various branches such violations were the core business of criminal organisations (Van Duyné and Houtzager, 2005). Irrespective of the degree of organisation, the untaxed part of the revenues from black labour becomes crime-money too. Part of the revenues earned by migrant labour are sent home. Abstracting from the crime-money which remains in the pockets of the fraudulent employees in the industrialised countries, the regular money flows to home countries, is partly 'black' too. The question is now: what is the effect of the 'black' (or criminal) part of these remittances on the integrity of the financial system of (a) the sending country and (b) the receiving country? Answering this question becomes even more difficult if we assume (plausibly) that also the legally earned part may not be fully declared to the tax authorities in the home countries. And suppose the whole income, white and black, would be declared, this would imply an act of laundering of the illegal component. Should the receiving countries and their financial institutions be considered as 'victims of laundering'? No, because together with all the other laundered monies, this inflow would be a part of the GDP and no longer a 'threat'. For authors from the worried institutions like the IMF who subsume all this under the denominator 'laundering', this should be a puzzling question indeed. Is it? Similar questions have been raised by Alldridge (2002). The answer is still due.

What is the conclusion of these comparisons? Though we may feel there is a difference because of (il)legality, there is no satisfactory financial or economic operationalisation to differentiate the threat of crime money from that of licit money used either rationally or in economically wasteful or corrupt ways. While searching for the contours of the threat of crime-money and laundering, closer analysis makes the picture increasingly evasive.

### *8. Looking back: historical evidence*

Though the differences between the financial and economic effects of the various 'colours' of money tend to blur, crime money may still affect the financial system because of their potential pernicious influence on the institutions themselves. A major damaging effect that is mentioned is the loss of good reputation. Banks which become publicly known for their involvement with the financial dealings of criminals would lose their trustworthiness, the axes around which the whole financial sector turns. Investors and depositors would subsequently withdraw their money and the disreputable bank could collapse. A face value truth, but is it a real life one? No, as Harvey (2009) made clear, public awareness of laundering is not big. Actually, Swiss, Luxembourg or Liechtenstein banks have never been eschewed for this reason by depositors eager to hide money for whatever reason, until... some of these banks became untrust-

worthy because diskettes with the names of customers became for sale to various European tax services. As a matter of fact, off-shore savers, respectable as well as law breaking have two common concerns: (a) can the bank be trusted to return the deposits and (b) 'Is my name not on a stolen list of some disgruntled ex-employee?'<sup>9</sup>

Nevertheless, the argument that money-laundering within or by financial institutions leads to instability and eventual downfall is put forward too often to ignore it. Studying the historical examples which are presented as support for this thesis, Gelemerova (in preparation) concluded that these had either little to do with money laundering or the causal relationship with laundering was less than self evident. Altogether, even if they would support their point, it is still a rather short list of cases, thinly spread over time and space.

An often quoted example is the *European Union Bank*, based in Antugua (1994-1997), and which was the more 'hot' because it was also allegedly an example of laundering through the internet (Schudelaro, 2003). However, this 'bank' was rather an institution any launderer would eschew, because no money was 'whitened', but simply embezzled: \$ 10 million disappeared with the owners.

Another bank sometimes put on the laundering list is the respectable Baring Bank. However, this institution was not brought down because of laundering but because of the badly supervised financial manipulations of one and only one banker incurring huge losses, which he tried to hide.

Two banks that undeniably offered laundering services are the BCCI-bank and the Banco Ambrosiano (Adam and Franz, 1992; Cornwell, 1983). But was their demise caused by their laundering services? The financial tragedy of both banks did not start with laundering, but with mismanagement followed by huge losses due to currency exchange operations and bad loans. Craving for deposits, the banks were ready to receive money of any colour. It was of little help, though and the General Director of the Banco Ambrosiano, Calvi, was found dangling from the Black Friars Bridge in London, 1982. Calvi's erstwhile associate was Sindona, a Vatican banker. He left a track of fraud and collapsed banks (one in the US and others in Italy), one murdered curator and in the end, himself poisoned in prison (1986).

The bank that came closest to a launderette was the Nugan-Hand Bank in Australia, in the 1970s, of which the Australians and the US do not like to be reminded. There was evidence that high-ranking US military and intelligence officers were implicated in the bank's highly questionable dealings (Kwitny, 1987; New York Times, March 8, 1987). One of the main organisers committed suicide or died under suspicious circumstances.

This short history suggests that laundering can be more dangerous to bankers than to banks. Like ordinary savers, criminal account holders have everything to lose with bad banks, while swindling bankers have everything to

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<sup>9</sup> Another concern of hidden savers is: will these countries not come to an agreement with their home countries to hand out names, as has been agreed upon between the Swiss banks and the US government.

fear from criminals whose money they have lost. Whether and to what extent this also applies to the Russian banking sector is unclear. Many Russian bankers have been killed in the last two decades, the most prominent one being the deputy director of the Central Bank, Andrei Kozlov. His fight against bad banks (he had 44 licences withdrawn), may have cost him his life. Czech crooked bankers may have (unconsciously) understood this rule: they undermined their own banks by abundantly issuing irreclaimable (friendly) loans: no bad money went into, but good money got out of the banks (Baloun and Scheinost, 2003: 141). Of course, under an all-inclusive definition this qualifies as laundering too, but not as a laundering service to outsiders.

In the end of her survey Gelemerova (in preparation) points at an abundant copy-pasting of texts containing these and similar pieces of 'evidence' within the texts of the IMF, World Bank, FATF and their academic supporters. However, one finds no systematic sifting through original material of 'endangered' national economies. The exception is the study of the Colombian economy by Thoumi (1995).

#### *9. Evidence from macro-economic research*

Despite the importance of the subject, empirical findings from research is less extensive than one would expect. If we leave aside the legal research, which simply takes the integrity-threat assumption as proven, we have on the one hand empirical criminological research and on the other hand economic research. In both disciplines the number of active researchers is modest.

Naturally, money laundering is a financial and economic phenomenon and for that reason relevant for the economic discipline. The focal questions concern the extent of the phenomenon, the financial flows and potential impact on the upperworld economy. Part of these questions have been addressed by attempts to capture the phenomenon in elaborated econometric models. Though these may have sophistication and even an elegance of their own, they tell us little of world where the money rolls. Whether in the end this modelling will be as futile as the economists' modelling of the present credit crisis, is difficult to tell. Maybe such modelling is an autonomous academic process, divorced from reality.

Attempts to determine what is happening on earth have been carried out (among others) by Schneider and Ernst of the University of Linz and Unger of the Utrecht University. Addressing the money laundering volume from an economic angle, they differ substantially.

Schneider addresses the issue of laundering from an old perspective: the assessment of the unrecorded income, part of it stemming from the criminal underground economy. His theoretical and empirical approach of this topic has been innovating. Using a multiple of variables within his DYMIMIC model he has undoubtedly contributed to a better approximation of the hidden or shadow economy (Schneider and Ernste, 2000), e.g. by his comparison of the OECD and transition economies (Schneider, 2002). However, passing over from estimating the hidden economy (containing the subset of the criminal

economy) to laundering proved rather to spoil than to enrich his contribution (Schneider, 2009). The reasons for this is (a) the slippery concepts of crime money and laundering and (b) the empirically and legally incorrect and fuzzy way of differentiating between underground and shadow economy and (c) the assumption that the underground economy concerns only hidden revenues in cash.

Concentrating on cash money misjudges the biggest crime money generating and mainly not cash based sector: economic and financial crime, tax fraud included. Relocating part of this criminal economy to the 'non-criminal' shadow economy is misleading and arbitrary: organising the violation of labour, fiscal and environmental regulations is equally part of the crime or underground economy. Due to the nature of the crime, it hardly ever has a cash basis.

As far as the definition is concerned, the Council of Europe definition of laundering is used (copied to the EU 1991 guideline). This is a wall-to-wall definition encompassing all criminal earning and consequently related handling. Subsequently one may wonder what explanatory value is left after this 360° inclusion. However, in the writings of Schneider there is little consistency in the use of this, the German or the Austrian definition.

When it comes to economic risks, we do not find a proper answer to the question: what is economically wrong with spending crime money on licit goods and services? Spending implies VAT taxed consumption. Hence, a quick and smooth return of banknotes to the financial system, which may economically be sounder than hoarding or the over-expending on credit card accounts of 'Joe Average' contributing to the national indebtedness.

As remarked, most forms of economic and financial crime do not start or end with bags full of to-be-laundered banknotes. As we have explained in a previous section, this would create much suspicions in the playing field: the upperworld. Transactions are covered by (false) invoices and tax forms, which are often at the same time the instrument of fraud and of laundering. Of course, there are hardly criminal sectors without cash: to interrupt the account trail money has to be withdrawn in cash to be deposited in another bank. But for an on-going criminal business this entails another cover-invoice: 'Cash money paid for...', a kind of laundering within laundering.

As far as Schneider's approach of the hidden economy is concerned, he has contributed to our knowledge. However, he has given in to the lure of the laundering theme. An academic victim of laundering.

The recent work of the Utrecht School of Economics headed by Brigitte Unger is another story. To capture the phenomenon of laundering Unger developed a questionable model. Modelling is a good method to approach reality if a number of requirements are met. The first requirement is a non-ambiguous definition; otherwise the model stands on a wobbling leg. If the model wants to be empirically relevant, a second demand is a proper definition of valid data input: no valid data input, no valid output. Thirdly, there must be a criterion variable to test the output. Fourthly, there should be no flaws in the internal 'logic and grammar' of the model, a demand to which economists use to pay painstaking attention, judging the deduction of long strings of formula.

The first leg of the model is the definition, but it is uncertain which one has been chosen. In Unger *et al.* (2009) a number of definitions are discussed in chapter 2, but no proper analysis nor a choice from one of them is been presented. This means that of the legs of the model one leg is missing, unless it is the little leg offered by the Australian researcher Walker (1995; 1999) in his 'pioneering' work. The definition which Walker adopted comes from a 1990 news letter *Trends in Money Laundering*: 'the process by which illicit source moneys are introduced into an economy and used for legitimate purposes'. This very broad definition is subsequently narrowed by limiting it only to those dealings with crime money which are intended to make the money licit. We agree with this restriction, which then should have been adopted as a working definition. We add the annotation that vast sums of crime money enter the upperworld economy without any intention of being made licit. It is telling of the loose way of doing research that in the subsequent 'fact finding' chapters definitions hardly play a role. But still, we find a rough scale of (ill-defined) laundering from various forms of crime: 0%, 10% or 80%. Hardly a leg to stand on.

Let us assume that like a table, a model can stand on three legs, wobbling a bit. It is not really solid, but three legs can do. Now let us look at the second leg: the empirical input. At this point the model hinges again on the 'pioneering' work of Walker (1995; 1999). However, applying any basic standard from the behavioural science makes it clear that the instrument designed to provide the basic input is seriously flawed:

- the questionnaire consist of intuitive (gu)estimates, hardly representing an ordinal scale;
- 'experts' are asked to tick boxes on a rough scale derived from these intuitive (gu)estimates;
- it is far from clear whether the experts are qualified or 'calibrated' to make estimates;
- as central tendency arithmetic averages are used instead of the median which would be appropriate for an ordinal scale and a skewed distribution.

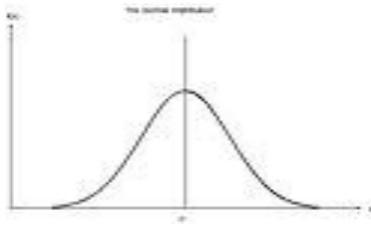
Does this look like a methodology which purports to take a global problem seriously? To proclaim practitioners like police officers qualified 'experts' for making money laundering estimates, is as valid as to proclaim an Englishman a 'weather expert' for estimating the percentage of sunny or rainy days for the whole country. Such estimates are notoriously biased and correctly criticised by Reuter (2007).

Using the arithmetic average as the central tendency is an equally grave error in view of the crude instrument and the nature of the usual frequency distribution in this field. If the authors were appropriately updated, they would not have used the mean with the connected normal distribution assumption. According to Walker and Unger (2009) the statistical world of laundering is like:



Figure 1

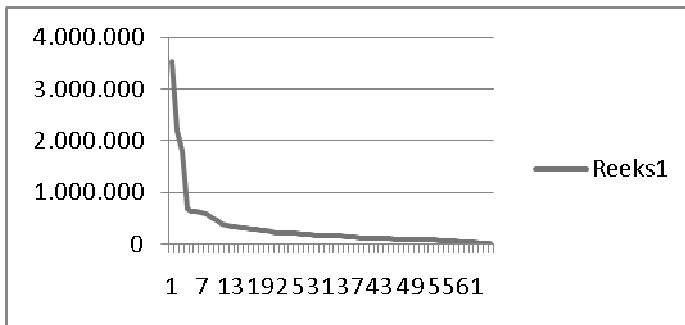
The hypothetical frequency distribution of criminal income around the average: normal distribution



This is misleading and a basis for persistent overestimations. In our research we found a systematically leftwards skewed distribution, with a few extremes pulling the average strongly upwards. Concerning the handling of criminal incomes Van Duyne and De Miranda (1999) already observed the bias of the distributions: 'Many move few and few move very much'. The next figure presents the real distribution of criminal wealth, as we will elaborate in later sections.

Figure 2

Automated output of raw frequency distribution of illegal income: Confiscated bank accounts and cash.



The validity of this observation has not changed, as was borne out in later research (Van Duyne, 2007; Van Duyne *et al.*, 2009). Indeed, the income distribution in the criminal economy looks rather like a Third World economy.

Despite available evidence, Unger c.s. choose an approach which predictably led to distortedly high estimates, apparently to the relieve of the authorities: 'Science has confirmed that we have a serious problem'.<sup>10</sup> Victims of science and laundering.

<sup>10</sup>Government officials well aware of the methodological lack of foundation of Unger research, nevertheless expressed their satisfaction to the authors: 'Even if we know it is not true, we can use figure for priority setting'. The mechanism is the same as when the FATF and associated international organs suddenly posed the € 500 billion esti-

### 10. Behavioural evidence: what do criminals do?

Macro-economic research on the impact of crime-money and laundering can be a fruitful undertaking, if carried out properly. But by itself it fails to shed light on the criterion variable: the financial and economic *conduct* of the owners of crime money. That entails the dual question: what do criminals do with their ill-gotten profits and how does that affect the financial system and the economy. Despite the importance of the subject and twenty years of anti-laundering policy history systematic studies and valid data are still rare.

Van Duyné *et al.* (2009) investigated the financial conduct of convicted criminals in the real estate sector. The basis of their analysis consisted of the Dutch asset seizure database of the Public Prosecution Office and the Central Recovery Office. Though one can argue that this covers only a part of the reality, it covers at any rate an undisputed slice of it in terms of recorded wealth. Another methodological defect we mentioned in our previous reports concerns the serious pollution of the prosecution database which looked like a persistently neglected wild garden. It required much manual restoration: even now every new table still requires visual inspection of the raw data.

The findings did not deviate from our observations above and previous research (Van Duyné and De Miranda, 1999): the distribution of wealth was skewed again. A small minority of the convicts, against whom an asset recovery order was issued, owned a substantial number of money and property. As far as real estate is concerned – ranging from villas, apartments, caravans and sheds – the distribution is represented in Table 3.

Table 3  
Distribution of the number of properties over offenders

N. Persons	%	N objects	Total	N value mentioned	€ Value
269	69	1	269	96	20.990.487
65	17	2	130	36	2.791.077
18	5	3	54	13	4.829.714
12	3	4	48	7	385.248
10	3	5	50	6	463.829
5	1,3	6	30	6	406.500
1	0,3	7	7	0	0
3	0,8	8	24	6	1.275.000
1	0,3	9	9	0	0
3	0,8	10	30	0	0
1	0,3	11	11	0	0
2	0,5	15	30	0	0
1	0,3	25	25	0	0
391		total	717	170	31.141.855

mate (Naylor, 1999). See for similar policy making fraud in the drug money issue: Van Duyné and Levi (2005).

Indeed, also with property: many own little and few very much. Of the 391 offenders 269 (69 %) owned one piece of property (38 % of the objects), while setting the dividing line at six and more pieces of property, 17 offenders (4 %) jointly owned 166 real estate objects (23 %). However, there were too many missing values to determine the total value of the real estate for each multiple owner. Nevertheless, some of the convicted offenders looked like having played 'Monopoly'. One offender owned seven premises in the same street; another four office units with the same number of parking lots; a third offender owned six flats in the same block and a fourth offender 17 garages, a dwelling and office premises. With another co-offender the property was subdivided in a farm, meadow, shed, a reed border and a part of a lake.

This looks impressive and could even be considered a dangerous token of an economic leverage in society. However, these examples are thinly spread over time and space (ten years, the whole country) while it is difficult how to interpret letting a number of flats or parking lots as a social or economic 'leverage' without knowing the socio-economic environment.

Analysis of the total database shows that real estate investment concerns mainly one's own dwelling, ranging from modest four room flats and a caravan of € 20.000 to a few high-priced villas (one of € 953.000 and another of € 680.000). Not all need a villa to display one's wealth. One convict preferred living in a trailer, but had it rebuilt for € 257.000; another trailer dweller owned a plot of land on which he installed a trailer which he redecorated for € 227.000. The category 'business property' ranges from sheds, a share in a greenhouse, to storage facilities, hotels, to a 50 % share in a business complex. It is no surprise that sheds, and greenhouses were owned by cannabis growers (four items).

In 7 cases the database mentioned foreign property, four of which in Turkey (Turkish drug importers); one in Spain and Morocco (owned by hash importers) and an infamous UK citizen (cocaine wholesaler), whose modest £ 15.000 dwelling contrasted with his numerous flats in Liverpool and elsewhere in Britain used among others for money laundering by manipulating the payment of rent. Two million Euros were found buried in the garden of his father.

Abstracting from the 'usual' predicate drug offences, the categories fraud, deceit, money-laundering and the 'rest category' are very heterogeneous and a breakdown leads to small numbers. In two cases the criminal profits to be recovered are well over 2 million Euros. In one case an expensive plot of land, mansion and other facilities such as a swimming pool were discovered: € 680.000. In this mixed category there were only two properties with a commercial function: a café-restaurant with a plot of land facing one of the popular lakes in the province of South-Holland (€ 794.000) and a share in a business complex building (€ 438.000). In both cases it was the second property. Except for one plot in Morocco (€ 29.000), all recorded properties in these two categories were located in the Netherlands.

Of course, criminal money is also to be found within the financial institutions. Its role within the financial system is considered as particularly menacing because of the so often recited financial integrity threat. Before we reach such

a dramatic conclusion we first inspected our database of all confiscated bank accounts. The figures we found are presented in the following table, together with the confiscated cash.

Table 4  
Parameters of the confiscated bank accounts, cash and both:  
Mean, median, maximum value and the high range owners.

	Confiscated bank accounts	Cash money	Bank + cash
	N = 460 (one empty account)	N = 3.027	
Total	€ 121.031.834	€ 104.640.741	€ 225.667.575
Mean	€ 263.113	€ 34.481	€ 69.076
Median	€ 20.000	€ 3.910	€ 4.695
Maximum value	€ 60.749.111	€ 12.600.374	€ 60.749.111
> € 100.000	N = 90	N = 165	
> € 1.000.000	N = 11	N = 12	

Again, the frequency distribution of the raw data proves to be very skewed: this concerned the bank accounts as well as the cash money.

- 50 % of the persons whose *bank accounts* were confiscated had less than € 20.000 in their accounts. Even that gives an inflated impression: 25 % of the account holders had no more than € 5.215 in their accounts.
- 50 % of the convicts with whom *cash* had been seized had less than € 3.910. In 25 % of the cases the amount of confiscated cash was € 1.305 or less.
- The picture does not change dramatically if we add up the confiscated bank accounts and cash money (per person): the median increases somewhat with € 785 and the number of convicts with confiscated assets of respectively more than € 100.000 and € 1 million are now 250 and 25 respectively.

Adding the values of the 67 real estate object (of which the price is known) to the cash and bank assets does not change the picture either: the total asset value is now € 245.099.106 with a median of € 4.725 which is far from redressing the bias in the value distribution.

These findings indicate also that the role of crime-money in the financial system is to be rated as rather modest: 3 % of the convicts have more than € 100.000 in their bank account. However, the picture may become more serious if we look at the *foreign* bank accounts. After all, we live in the era of globalisation and according to the numerous frightful reports, with the proverbial 'one mouse click' billions of suspected monies are supposed flash all around the world. For this reason we paid special attention to the data to single out details of foreign banking: where are the foreign bank accounts, and how much money was involved?

With 38 convicts (1,2 %) foreign bank accounts were observed with total assets held of € 16.209.704. The accounts were indeed spread over numerous jurisdictions. However, do they together reflect the dreaded financial criminal globalisation? Table 5 looks like falsifying this image.

Table 5  
Foreign bank accounts.

Country	Total of assets in banks €	N
Luxemburg	4.964.321	11
Belgium	3.699.597	4
Germany	692.106	7
Elsewhere	6.853.680	16
Total	16.209.704	38

In accordance with the previous findings, the distribution is again skewed: one convict appeared to account for 38% in the total of this subset: his foreign assets amounted to € 6.099.616, spread over banks in Germany, Belgium, Luxembourg, Switzerland and one bank in Spain.

It seems that most convicts in this subset do not go very far to deposit their assets: there is a clear preference for the surrounding countries. Naturally, the category 'elsewhere' contains more remote countries, stretching from Morocco to Hong Kong. However, the choice of a certain country look to be rather determined by the national origin of the convicted person: the Turks deposited their money in Turkey, the Moroccans in Morocco etc. No 'exotic' off-shore banks could be identified.

To these observations we must (again) add a methodological warning: we do not know the existence of suspected foreign bank account if no bank identification was seized during the house search. So we asked for incoming and outgoing judicial requests for financial information. It appeared that this was not systematically registered: it was a pre-computer age manual school notebook with uncertain completeness. Certainly not a reflection of a sense of urgency of the 'global criminal financing'.<sup>11</sup>

Surveying the data over the past ten years and wondering what criminals did with their hard-gained but ill-gotten money in the economy, we can conclude as far as official figures are concerned: statistically very little. This means: the vast majority had their financial assets in banks or cash in a proportion of 1,2 : 1. A tiny minority had assets of more than one million Euros. Banking abroad did occur, but usually just over the border, at any rate mostly in Europe. Foreign or ethnic minority convicts did what the Dutch also do: banking in their own country. It does not reflect a high level of sophistication, corresponding with an observation made by Harvey and Lau (2008) concerning their findings in the UK.

<sup>11</sup>Better registration of foreign assets only started with the establishment of a Asset Recovery Office in December 2008.

Looking for other traces of sophisticated criminal financial management we also scanned the database for evidence of investments in shares which could provide the respectable leverage in the underworld. We identified 15 convicts with whom shares or comparable securities have been confiscated. In most cases the value could not be determined. None of the shares implied a substantial participation in stock exchange registered corporations.

### 11. Conclusion

This is what we found, though we know that there is more. But how this 'more' is spread over time and place and how it is composed, we do not know. The argument that those who remain outside observation are too clever to be caught has been ventured since time immemorial and has the validity of a Loch Ness monster claim. But we think it unlikely that significant socio-economic phenomena would not surface statistically: one or two smart criminal Scarlet Pimpernels can escape attention, not a whole crowd of such individuals. So if the claim of the huge crime money threat is meant to be more than belief and rhetoric, the claimants have the burden of proof: fund research and provide evidence. In this regard we can only rehearse the complaint Van Duyne (2002; 63) made eight years ago: those who believe in the monster of Loch Ness have spent more money on research than the believers of the monster of crime money and laundering.

Let us turn back from where we came. We raised a dual question: What does crime-money do to the financial system? Based on the evidence we collected the conclusion is: much less than is expected. With banking versus non-banking assets in a proportion of 1,2 : 1 the role of the financial system cannot be denied, but is anything but preponderant.

Given these findings, which differ widely from the speculative extrapolations of the economists, what can be said about the threat issue? Must we deduce from the 1,2 : 1 proportion that slightly more than half of the criminal assets are threatening the financial institutions? That may be true, because it is laundering (according to the tautological truth). However, most of the accounts were in the own name (or that of a partner), which is not surprising with 50 % of the account holders having less than € 20.000 in their accounts. And does this constitute a 'laundering threat' or should the account have been put in the name of another person to be called a threat?

The confiscated cash money poses another interpretation problem. Is this *unlaundered* money? Or does this money potentially threaten the integrity of the financial system because it *might* be put into a bank account? This is money 'at risk of being laundered'. Which meaning we should assign to such formulations is quite uncertain. For the Dutch legislator there was little doubt. According to the memorandum to the 2002 bill, there was even a risk 'a criminal might buy an expensive car from a *bona fide* car dealer'. Presumably this was a bigger risk than stealing a car or buying one from a fence.

We realise that the counterargument 'there is so much more we cannot see', should not be passed over lightly. But if this is intended as a serious argument, why has it not been seriously researched?

While we leave policy makers, supported by economists, muse over how much more, we think it more important to hypothesise about the composition of that 'unknown-more'. In particular, does it have the same composition in terms of the categories of predicate crime and does it have the same income distribution? In that case we could conclude: as remarked, yes there is more, but most likely just 'more of same'.

Whether or not 'more of the same', the most important criterion variable – the behavioural variable – has been covered by us, yet only with an abstract statistical description based on insight into individual assets and spending. We think this has to be enlarged and deepened. To obtain real insight into the existential aspects of the crime-economy and finances, we must look at a more detailed level at the criminal *homo socio-economicus* in action and in interaction with his relevant surroundings. That is the level at which we have to start the operationalisation of threat. Money is only money. But it gets significance by the way people live with it.

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