

# **In search of crime-money management in Serbia<sup>1</sup>**

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## **The shadows of shady finances**

No household is without its dark sides, corners, corridors and rooms. This applies to its structure as well as to the daily dealings between the members of the household. The extent of this dark side is determined by history and the attitude and opinion of the household members concerning the way in which to handle their affairs. It is also highly determined by the household structure, which partly depends on its leadership. This applies to family as well as to state households, which is the old term to denote the financial and economic management of a country. For obvious reasons, within official papers, this management is presented in bright colours, smoothing over the dark sides of finances, trade and industry. For a long time one could get away with such presentations. However, international pressure has built up to shed light on these dark areas. One of the reasons for this pressure is the global anti-money laundering policy, in which such dark sides of state households are considered the cracks through which money can be laundered. In the present international setting no country escapes this scrutiny.

Among the countries of South-eastern Europe, Serbia in the 1990s, has gone through a period of political and economic upheaval during which the economy was to a large extent criminalised. Popović (2005) speaks of ‘ten lost years’. This has certainly contributed to a state household with many shady economic and financial corners, as alluded to above. Understandably, this raises worries about opportunities for money-laundering and of course the related predicate illegal profit generating crimes, which is the focus of our research project.

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<sup>1</sup> Published in: P.C. van Duyne, J. Harvey, A. Maljevic, K. von Lampe and M. Scheinost (eds.), *European crime-markets at cross-roads. Extended and extending criminal Europe*. Nijmegen, Wolf Legal Publishers, 2008. This paper and the information presented is based on a project on money laundering in Serbia, carried out in 2005/2006 on request of the OSCE Mission to Serbia and in conjunction with the UNICRI. The report was presented in October 2006. All information, statistical data and legal commentary presented in this article is referred up to the date of presentation of the report and does not reflect any subsequent event.

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Comprehensive research on the nature and extent of laundering is an (over)ambitious undertaking in any country and certainly in a country with a large shadow economy.<sup>3</sup> In addition, there are other obstacles, like formulating a proper definition which does more than merely repeating the political and legal wording of the various conventions. Even if one overcomes the definitional obstacles<sup>4</sup>, there is the problem of estimating the extent of the crime for-profit, which continues to haunt money-laundering researcher (Levi and Reuter, 2006). The macro-economic universal approach of Walker (1999), reapplied for so-called money laundering in the Netherlands by Unger *et al.* (2006) is characterized by a shady methodology. It lacks substantiation of its assumptions, coherence in data gathering as well as defects in the validity of its extrapolations (Van Duyne, 2006). A universal study or assessment of this hidden and ill-defined phenomenon is rather an uncertain undertaking based on many debated assumptions, though progress is being reported (Schneider, 2003). These difficulties also apply to national situations, unless proper methodological conditions are met. Thus far many scholars have not come across such enticing research conditions in industrialised countries with proper statistics like Canada (Mirus and Smith, 2005) and the US (Feige, 2005). In transition countries like Serbia, these uncertainties will predictably be much bigger.

For this reasons more modest research questions were formulated:

Is it possible to ferret out parameters with which to approximate the shady economic areas within which the volume of crime-money and its criminal management in the Serbian economy may be projected?

The reader may note that in the wording of this research question we do not use the phrase ‘money-laundering’ about which the authors felt increasingly uneasy. The phrase ‘money-laundering’ expresses a legal conclusion, a construction or an evaluation of certain criminal conduct. However, starting with a conclusion did not appear to us a methodologically elegant approach, though it is not uncommon in mainstream criminological research on money-laundering (and organised crime). Therefore, as the authors looked for crimes-for-profit which requires handling or managing crime-money, we replaced the phrase ‘money-laundering’ with *criminal*

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<sup>3</sup> Or “grey economy” of which there are many definitions and approaches (Schneider, 2003). There are indications in Serbia of a large undeclared, “informal” economy. Activities that would fall within this categories include anything ranging from individual, unregistered businesses and undeclared employment, to criminal trafficking properly. Estimates cited for Serbia are in the range of 25% - 35% of GDP (Djankov *et al.*, 2003). The Statistical Office is currently refining a methodological approach to the issue.

<sup>4</sup> One can define money laundering in a very broad sense, as formulated in the Council of Europe Convention and most of the legislation derived from it and if one also includes the *self* laundering, any successful crime for profit is automatically entailing the laundering offence. From this angle the extent of laundering equals the total of criminally obtained profits, irrespective of any subsequent handling of money. See Van Duyne *et al.* (2005) for a critical review.

*money management*. This is more than a word play, but concerns the heart of the crime-money issue: how do people handle crime-money?

## **Groping in the dark**

Addressing the research question requires the analysis of a minimum of data from supervisory and law enforcement agencies, ranging from the National Bank of Serbia, to the Serbian Financial Intelligence Unit (Administration for the Prevention of Money Laundering) the police, the tax inspectorate and the courts. This implies the availability of reliable databases, which must be based on transparent information management. However, on this point the researchers encountered no such transparency and few tokens of a proper information management. Indeed, it proved to be extremely difficult to obtain data about the functioning of the authorities concerning law enforcement, whether in economic, civil or penal law matters. In the surveys of the social and economic situation, various authors of (unpublished) reports regularly indicate that the reliability of presented data of Serbia (and Montenegro) is very variable.<sup>5</sup> More important, there is no key to determine the level of (un)reliability of the various databases. In addition, focussing in this report on Serbia, much of the macro data do not (yet) differentiate between Serbia and Montenegro, though they are now separate countries while their economies have already been separate for almost half a decade.

Because of this lack of empirical data, approaching the shady or criminal side of the Serbian economy to shed light on the issue of crime-money and criminal money-management by means of macro studies will be somewhat speculative. However, going into more individual details will make the study anecdotal on the other hand.

For this reason the researchers broadened their focus and exploited any opportunity to get data which could shed light on the non- or badly recorded economic criminal state of affairs and the exploits of the authorities. They were well aware that the present social, economic (and criminal) landscape of Serbia has been shaped in years of political turmoil and governmental neglect. When Milošević was ousted from power in 2000, the economy in US-dollar terms was about half the size it had been ten years before.<sup>6</sup> The combination of the embargo during the wars in former Yugoslavia and mal-governance brought the economy down. Though

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<sup>5</sup> In publications about the informal economy in South and East Europe studies from or about Serbia (and Montenegro) are missing, though the other countries are properly represented (Belev, 2003).

<sup>6</sup> For example, GDP in USD terms decreased from 13.889 billion in 1998 to 8.603 billion in 2000 (- 44,1%). Similarly, Purchasing Parity (PPP) per capita GDP decreased from 4.365 USD in 1998 to 3.795 in 2000 (Source: IMF World Economic Outlook)

empirical data are lacking, the black or informal economy thrived, providing a means of survival to many and a lavish income to a smaller group of criminal and political entrepreneurs.<sup>7</sup> The corruption index of TI was (and is) high<sup>8</sup>, which naturally correlates highly with the above indicated lack of transparency in economic regulations, law enforcement and the records thereof.

Given these methodological constraints, we ended up with a quest for the unrecorded wealth and incomes of Serbia. Not all these moneys stem necessarily from criminal activities and not all crime-money will be laundered in the strict sense of the word: made 'white'. We tried to penetrate the various information gaps to find out what is officially known about damage and income from crime. In addition a comparison was made between what is known about the household income and spending. If households spend systematically beyond their means there are reasons to speculate about how they make up for the deficit when they are not depleting their savings.

We continued our reconnaissance by mapping the money flows into and out of Serbia to find out whether and to what extent these flows balanced. The background philosophy is that large volumes of unrecorded financial assets must leave some trace and/or yield some imbalance. In addition we took stock of what is known about economic and fiscal crime and other criminality-for-profit to which we had to add many methodological annotations, due to the inconsistency of the database formats of the various law enforcement agencies that deal with economic, fiscal crime and corruption.

## **Assessing material damage and proceeds**

Estimating the profits from crime or the even broader phenomenon of the informal economy is in all economies shrouded in clouds of uncertainty. The ranges within which the estimated illegal incomes are related to the GDP vary enormously, depending on the parameters selected (for example currency demand, use of energy, mixed models. Scheider, 2003). Such estimates usually cover the whole unregistered economy, of which crime-for-profit is just a subset.<sup>9</sup> Apart from that, crime-for-profit itself is not a clearly delineated subset either, encompassing a wide variety of criminal conduct: 'traditional' property crime as well as all forms of economic crime, including tax evasion, which as an illegal activity on its own. For this

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<sup>7</sup> According to the Worldbank 10 % of the population lived under the poverty threshold of € 60 per month, while 2 % found it difficult to pay for the basic foodstuff (EU report, 2004).

<sup>8</sup> Serbia and Montenegro TI Corruption Perception Index for 2005 is 2,8. TI considers a score of less than 5,0 as an indicator of a serious corruption issue.

<sup>9</sup> See O. Lippert and M. Walker, *The underground economy. Global evidence of its size and impact*. The Fraser Institute, Vancouver, 2005

reason, we only differentiate between forms of crime-for-profit and unregistered economic activities in cases in which the underlying evidence provides justifications to do so.

It is perhaps best to begin by trying to give a first general estimate of the dimensions of crime, or at least what is reported as such. The following step would then be to try and detail the overall figure according to the different types of crime and understand which are the most relevant in the Serbian context during the period under examination. The following tables 1 and 2 illustrate statistics on crime for the period 2000-2005 as reported by the Serbian Ministry of the Interior. Before the data is analysed in greater detail two important *caveats* need to be made:

1. The statistics relate to reports made by the police, which neither reflect the full picture of real crime occurring (crimes may be undetected or unrecorded) nor do all reports necessarily relate to crimes that actually occurred or which led to indictments and/or convictions.
2. The monetary values reported for *material damage* and *crime proceeds* need to be treated with care as the Ministry did not provide the authors with accurate definitions and methodologies utilised for calculating these figures.

**Table 1.**  
**Ministry of Interior crime reports and material damage: 2000- 2005**

*a) Material Damage 2000- 2005: all crimes (million DNS):*

<b>Year</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>Total</b>	<b>%</b>
General crime	883	1.353	1.259	1.679	1.253	2.316	8.742	10,2
Economic crime	17.800	9.992	6.736	7.197	6.724	21.272	69.720	81,2
Crime against property	618	1.161	1.036	1.238	1.219	2.169	7.441	8,7
<b>Total</b>	<i>19.300</i>	<i>12.506</i>	<i>9.031</i>	<i>10.114</i>	<i>9.196</i>	<i>25.756</i>	<i>85.904</i>	<i>100</i>

*Source: Serbian Ministry of Interior*

*b) Number of criminal offences reported 2000- 2005:*

<b>Crime category</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>Total</b>	<b>%</b>
Economic	12.792	12.916	13.889	12.017	12.069	13.143	76.826	13
Life and body	3.692	4.011	4.156	4.417	4.976	5.164	26.416	4
Property	70.728	83.247	55.545	45.374	50.703	54.274	359.421	59
Safety of publ. transp.	6.952	8.753	6.637	7.225	7.927	7.594	45.088	7
Civil freedoms	442	438	428	445	474	472	2.699	0
Other	11.560	11.945	14.092	20.119	22.798	21.107	101.591	17
<b>Total</b>	<b>105.716</b>	<b>121.310</b>	<b>94.717</b>	<b>89.597</b>	<b>98.947</b>	<b>101.754</b>	<b>612.041</b>	<b>100</b>

*Source: Ministry of Interior*

Material damage from reported crime in the period 2000 – 2005 amounted to a total of 86 billion DNS (a crude approximation in euro of around 1.200/1.2400

million €). Material damage from crime reported in 2005 was 25,7 billion dinars. By far, the most important category in terms of damage is *economic* crime: close to 70 billion dinars. More than 80% of the total of all damage from crime reported between 2000 and 2005 is attributable to economic crime, while it represents only 13% of reported offences.

The figures would lead to the inference (bearing in mind the preceding *caveats*) that economic crime is the main source of (domestic) illegal proceeds. There also seems to be in Serbia an increasing awareness of the seriousness of economic crime, as is well demonstrated by the following press article:

**Blic Press, 2005 (08/10/2005):** “*Serbia loses 7,5 billion DNS per year because of economic crime*”

*“When one MD from Pancevo issued confirmation to a patient that he needed exceptionally expensive medical drug for treatment of a serious disease, that the patient in question actually did not suffer from, the MD in question had not thought at all that their deceit would be uncovered. Department for fight against the economic crime found out that the false patient managed to get 3,5 million DNS as a refund from social health.*

*This is only one of about 9.459 criminal acts uncovered in the first nine months that cost Serbia about 200 million euros yearly.”*

It must be said that a commonly accepted definition of economic crime as a part of the organised crime phenomenon is still lacking (as is the case with organised crime). Council of Europe Recommendation n.12/81 on Economic Crime may be considered a general guideline as it lists several offences including several kinds of fraud, collusive behaviour and cartel building, tax and currency regulation evasion, bogus firms, stock exchange offences and banking offences.<sup>10</sup> Given the various findings of research in the organisation of crime and the analysis of the definitional issues surrounding ‘organised crime’, there are no grounds for differentiating between economic or organised crime as the focus is the organisation of crime-for-profit and their proceeds as such (Van Duyne, 2006).

In the Serbian penal system, economic crime typologies are included in the categories of ‘crime against the economy’ and ‘crimes against official duty’ of the criminal code as well as in a set of special laws.<sup>11</sup> For 2005 the economic crime frequencies, the estimated damages and proceeds were brought together.

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<sup>10</sup> Also Europol in its Organised Crime Threat Assessment –*OCTA 2007*– pays more attention to organised economic crime.

<sup>11</sup> Up to the end of 2005 the criminal code was based on the old Yugoslav Federal Criminal Code and the Serbian Republic Criminal Code. The framework was overhauled at the beginning of 2006 with the introduction of the new Criminal Code. Penal provisions are included in many other acts, including the Law on Business Companies, the Law on Foreign Exchange Operations, the Accounting and Auditing Law, the old (Federal) Money Laundering Law, and the like

As detailed in table 2, in 2005, proceeds of economic crime were in the region of € 230 million, whereas damage to Serbian Society was above € 250 million.<sup>12</sup> It is interesting to note that the most common crime category –both in terms of number of cases and financial volume– appears to be *Abuse of Official Position*.<sup>13</sup> While this offence accounts for 39 % of all economic crimes, its share of the total estimated damage is 86 % and of the total proceeds, 94 %.

**Table 2.**  
**Economic crime in 2005: cases and material damage in million euros**

<b>Economic Crime 2005</b>	<b>No of Cases</b>	<b>%</b>	<b>Material Damage (€ml)*</b>	<b>%</b>	<b>Crime proceeds (€ml)*</b>	<b>%</b>
Negligence in business	200	2,7	9,6	3,8	0	0,0
Abuse in business authority	272	3,7	4,5	1,8	3,6	1,6
Illicit acquisition/use of loans	204	2,8	0,6	0,2	0,9	0,4
Illegal trade	1.076	14,6	0,0	0,0	1,0	0,4
Tax evasion <sup>14</sup>	156	2,1	5,8	2,3	5,5	2,4
Fraud	511	7,0	1,5	0,6	1,7	0,7
Abuse of official position	2.851	38,8	216,4	86,3	215,8	94,4
Business fraud	1.881	25,6	12,3	4,9	0,0	0,0
Accepting bribe	159	2,2	0,0	0,0	0,05	0,0
Offering bribe	38	0,5	0,0	0,0	0,01	0,0
<b>Total</b>	<b>7.348</b>	<b>100</b>	<b>250,7</b>	<b>100</b>	<b>228,5</b>	<b>100</b>

\* converted at an estimated rate of 83,19 dinar per 1 euro

Source: Ministry of Interior

## Assessing through gaps

What do the figures in the previous sections mean –assuming they approach reality– and to what should they be related? Do all these figures represent the ‘laundable’ income of wrong-doers? No, because ‘damage’ should not be equated to income to the wrong-doers. For example, with tax evasion fiscal damage as calculated by the Tax Office is usually larger than the illegal income of the fraudsters. In addition, laundering in the sense of *legitimizing* illegal income is rather a necessary

<sup>12</sup> Council of Europe Report “*Organised Crime Situation Report 2005*” Estimates material damage from economic crime in Serbia in 2003 in a range between 300 million and 500 million euros (page 80 of cited Report).

<sup>13</sup> Article 242 of the Serbian Republic Criminal Code in force until 2006.

<sup>14</sup> For some forms of tax evasion the estimated damage may be higher than the actual illegal income.

*consequential* activity for the middle and upper echelon criminal earners. The common man's economic crime may be substantial in accumulative terms but per earner-unit (person or household) it is too little for money laundering activities.<sup>15</sup> By means of daily household expenses the illegal profits simply trickle back unseen into the licit economy. Hence, without a proper frequency distribution broken down by unlawful income and earners, a total figure of illicit money tells us little about money laundering in the meaning of explicit legitimizing activities.

## **Resources and expenses**

Another question concerns the impact of this hypothetical economic crime figure in economic terms (apart from morals). This question relates to the issue of the Serbian 'grey economy', of which economic crime is obviously a component. As set out in the previous sections, many questions related to this issue do not have a satisfactory answer in Serbia: how large is the informal sector and its subcomponents, ranging from the almost white to the decidedly black; how do they relate to each other and what are the growth dynamics (is the grey economy growing or shrinking)? Bearing in mind these limitations, we nevertheless tried to make inferences on the grey economy and to relate economic crime to the economy in general.

First of all, the figures on economic crime set out in the previous tables may be related to an economic parameter such as national income: either gross or net national income. For the year 2003 the Yearbook 2005 of the Serbian Statistics Bureau<sup>16</sup> mentions a *gross* national income of approximately € 16.831,1 million and a *net* national income of approximately €14.323,10.<sup>17</sup> For illustrative reasons we assume that the economic crime damage in 2003 was the same as in 2005: € 250 million (table 2). We could then relate the economic crime damage to these income figures and arrive at a percentage of 1,5% and 1,8% respectively. However, as mentioned above, this inference would not be correct as the damage does not equal the illegal income which can be approximated by the figures for crime proceeds, which lead to slightly lower ratios. However, as usual the statistics relate only to *reported* crime. Again, the researchers must stress the uncertainties over how the figures were actually derived. For a start, the data provided by the Ministry of the Interior for crime proceeds is likely to be incomplete: it is quite unlikely that in-

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<sup>15</sup> As remarked before, technically, according to most legal money laundering definitions, any handling of illegal income is laundering.

<sup>16</sup> STAT.YEARB.SERB.2005

<sup>17</sup> In current 2003 dinars the figures are for gross national income 1.095.029,9 million dinars, and for the net national income of 931.859,8 million dinars. GDP in 2003 was 1.095.402,20 million dinars. (Chapter 6 of STAT.YEARB.SERB. 2005) with an average exchange rate in 2003 of 65,06 dinars to the euro.



stances of corruption (giving/taking bribes) produced almost no proceeds either in terms of the bribe paid itself or the unlawful advantage gained by the bribe giver.

The structure of the hidden economy phenomenon becomes even more complicated and extensive if we would include the incomes from other forms of crime: drugs, human trafficking, or gun running of which there are no 'income' data, however. We can also approach the issue from the angle of *household resources* and *spending*, with the objective to find differences, particularly negative ones. If more is spent than earned the difference must be bridged somehow, either by loans or by unrecorded incomes.

STAT.YEARB.SERB.2005, reports the data of income and spending obtained in 2004 by means of a Personal Consumption Survey among 4.328 households, selected representatively in rural and urban areas (table 8.1 of the Yearbook). The items of the questionnaire concerned the amount and nature of the average *monthly* income and monthly spending, including the objects of spending. The figures for monthly spending per *household member* of 7.565 dinars and resources per *household member* of 7.135 dinars reveal a monthly average deficit of 430 dinars per *household member*. These figures translate to monthly resources per *household* of 21.833 dinars, monthly spending *per household* of 23.149 dinars and a monthly deficit *per household* of 1.316 dinars (about € 18,10). Crudely translated in an annual figure, the average yearly deficit of households in the sample is still a modest 15.790 dinars (approximately € 218). However, we need also to consider:

1. The deficit represents a full 6% of available resources and, on an annual basis it is greater than the average 2004 net monthly salary reported by the Statistics Bureau (14.108 dinars<sup>18</sup>).
2. As shown in table 3, considering an estimated number of 2.584.891 households<sup>19</sup>, if we project the results of the interviewed sample to the whole of Serbia we may estimate an aggregate annual household deficit amounting to a respectable 40.814 million dinars (approximately € 562 million), that is, 0,05% of GDP in 2003. That would represent only a very small portion of the black economy which is estimated at 25-35 % of the GDP.

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<sup>18</sup> table 5.17 of STAT.YEARB.SERB.2005

<sup>19</sup> table 8.1 of STAT.YEARB.SERB.2005

**Table 3.**  
**Household sector cumulated monthly deficit 2004:**

Number of households surveyed:	4.328
Total Number of households estimated:	2.584.891
% of population covered by the sample:	0,17%
Average number of household members:	3,06

<b>Per Month figures:</b>	<b>Dinars</b>	<b>Euros</b>
<u>Household members:</u>		
Available resources per member	7.135	98,32
Spent resources per member	7.565	104,24
<b>Surplus (deficit) per member</b>	<b>(-430)</b>	<b>(-5,93)</b>
<u>Households:</u>		
Available resources per household	21.833	300,86
Spent resources per household	23.149	318,99
<b>Surplus (deficit) per household</b>	<b>(-1.316)</b>	<b>-18,13</b>
<b>Annual aggregate projections for whole of Serbia:</b>	<b>Dinars</b>	<b>Euros</b>
<u>Household members:</u>		
Estimated aggregate available resources	677.234.204.305	9.332.151.086
Estimated aggregate spent resources	59.837.383.270	9.894.565.237
<b>Surplus (deficit)</b>	<b>(-40.814.394.934)</b>	<b>(-562.414.151)</b>

\*average exchange rate 72,57 in 2004

In trying to understand how this deficit is financed one should recall that income is not the only resource available for spending. Also taken into consideration are: transfers (for example welfare benefits); the households' wealth (i.e. savings accumulated in the past); other sources such as gifts and, if speaking in terms of cash flows, also borrowings, net reimbursements of principal and interest.

Unfortunately the categories used by the surveyor do not clearly distinguish between resources that are owned and resources that are borrowed and, with regards to the former, between flows currently received that can be correlated to GDP (income and transfers), and resort to the stock of wealth, that was either accumulated in the past or whose current appreciation (capital gain effect) would not be recorded in GDP. Also, some of the definitions are not well drafted, so that it is quite unclear<sup>20</sup> whether all potential sources are included. Thus, we are not sure

<sup>20</sup> For example the Statistical Office defines savings as “*covering receipts from selling securities (stocks and dividends), borrowing repayment and cash decrease (mutual subsidy funds, deposits withdrawn from banks and other)*”. Selling of stocks is resorting to ones stock of wealth (negative saving) whereas dividends are a source of income (flow).

whether the survey captured all sources nor do we know if it also contained a question about how the interviewed households bridged this deficit.

The distribution of the deficit among households is an important factor in trying to find an explanation for the deficit. We cannot deduce much from an ‘egalitarian’ distribution, whereas a highly concentrated distribution could mean that a few persons have the ability to draw on ‘hidden’ sources to finance their expenses. These could also include concealed proceeds of crime, although this is only speculation. The survey data presented by the Statistics Office does not include any information about distribution other than geographically. With the exception of Vojvodina (that actually shows a *surplus*) there does not seem a large variance between regions.

It is difficult to relate these outcomes to other figures in the STAT. YEARB.SERB.2005 or in other open sources due to the different meanings of ‘households’, which in some statistics seem to comprise (personal/family) enterprises as well. Though we are not certain that other tables use the same definition of household, the Statistics Office household saving figures show that even with this spending deficit the saving deposit rate increases, though mainly in foreign currency. The total dinar saving at the banks increased from 714 million in 2000 to 4.233 million in 2003, while the *foreign* currency saving deposits increased from 3.008 million to 69.738 million dinars. Meanwhile the short term credits of financial institutions to households increased from 916 million dinars in 2000 to 11.264 million dinars in 2003. In the same period the long-term credits increased from 1.697 million to 17.274 million dinars. Putting these outcomes together, the plausible hypothesis is that the Serbian households saved more (in foreign currency) than they borrowed in dinars, while they spent more than they earned *without* (on average) eating into their savings. It is an interesting discrepancy for further research.<sup>21</sup>

Of course, this does not allow a straight conclusion of ‘money laundering’, unless all hidden incomes and their spending are equated with crime-money and laundering (see footnote 4). In our opinion, this would unduly stretch the meaning of this concept.

In any case, the ‘Wealth Effect’ of concealed (possibly illegally acquired) assets seems relevant for Serbia where the phenomenon of ‘capital resurfacing’ is notorious and the “previously held under the mattress” explanation is often given when depositing large sums for the first time. Indeed, Serbia passed the law taxing ‘extra-profit’ precisely to deal with the problem, and it has been argued that the implementation of the first money laundering law was allegedly delayed to allow such resurfacing without too much fuss. Explanations for so much ‘cash under the mattress’ commonly refer to the years of turmoil, lack of trust in the currency and in the banking system. Whilst there is some truth in these explanations, the idea of a

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More important, the definition would seem to exclude the selling of other assets (vehicles, jewellery, other valuables, and the like)

<sup>21</sup> Statistical Bulletin December 2004; tables 4-7. National Bank of Serbia.

prospering society in need of finding a safe haven for its surplus does not sit well with Serbia's recent past. If anything, the overarching issue many Serbians faced was how to make ends meet in a plunging economy. It should be investigated how many succeeded in making ends meet splendidly, for example by studying the expenditure patterns after basic needs have been satisfied.

## **The international money flows**

Another approach is to survey the flow of money, also from the perspective of potential financial gaps, either of payment surpluses or deficits, which cannot be accounted for by other parameters. Again, it goes without saying that such gaps should not be equated directly to 'laundering'. If there are gaps, an economic explanation must first be searched for. Without more information and an in-depth study of all the economic variables, any conclusive statement would be a jumping to conclusions. Therefore, we restrict ourselves to raising questions and making observations by way of hypothesis. To this end we first looked for the foreign payments and receipts the information of which was provided by the National Bank of Serbia for the years 2003-2005.

## **The Serbian Balance of Payments**

The National Bank of Serbia (NBS) prepares the balance of payment statistics from the information submitted for foreign currency transactions according to legal regulation. In the period under examination these were provided in the "Guidelines for the implementation of decision to the conditions for transfer and manner of arranging payments made, payments received and transfers under current and capital transactions in foreign currency and dinars".<sup>22</sup> The latest provisional figures for 2005 have been considered.

The execution of international payments is accompanied by many forms for identifying the transaction and (advance) payment for import or export or other purposes. According to the statistics published by the NBS, the balance of payments for the years 2003-2005 presents a negative balance, largely due to a structural deficit in the balance of trade. The gap between the import and export of goods tends to widen with the growth of the Serbian economy (from \$ 4.618 million in 2003 increasing to \$ 5.563 million in 2005). This deficit is only partly com-

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<sup>22</sup> "Foreign Exchange Law", FRY Official Gazette 25/2002 and 34/2002. The new Law on Foreign Exchange Operations introduced in 2006 (Law on Foreign Exchange Operations (RS Official Gazette no. 62/2006). has confirmed the NBS supervisory role on foreign exchange operations.

pensated in 2005 by a small surplus of exported services (\$ 17 million), remittances (\$ 3.370 million), grants from other countries and organisations (\$ 330 million). In addition there is an inflow of capital in the form of foreign direct investments (FDI): \$ 1.481 million) and loans (\$ 2.532 million) which of course will in the end lead to a reverse flow of interest and repayment.

For each country with which Serbia entertains economic relations (trade, investments, and the like) the NBS provided half-year data on total currency inflows and outflows for the period 2003/2005 (no figures were provided for the years 2000, 2001 and 2002). We interpreted these figures as representing the sum of the current account and capital account inflows/outflows.<sup>23</sup>

A sample of countries was then selected on the basis of the following parameters:

1. Size of flows in terms of monetary amounts and/or number of transactions;
2. Geographic location;
3. Unusual flows observed; and
4. Countries that are offer tax incentives and/or offshore facilities to non residents.

The cumulated 2003-2005 inflows (exports) and outflows (imports) for the selected countries in terms of euros are set out in the table 5. Figures are to be considered an estimate as individual currencies had to be converted into euros and, for our purpose we relied on the average rate (not weighted) for each 6 month period analysed.<sup>24</sup>

Before conducting any further analysis, the data from the sample was matched with official balance of payments statistics. However, it was immediately apparent that cumulated flows of the countries sampled are substantially larger than the total population itself, as shown in table 4. Any conversion of the official numbers into euros (or the reverse) would further highlight this finding.

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<sup>23</sup> The following terminology is used in this chapter  
*Overall inflows* (exports): the sum of the inflows (exports) of the current account and of the inflows (exports) of the capital account.  
*Overall outflows* (imports): the sum of the outflows (imports) from the current account and of the outflows (imports) of the capital account.

*Overall flows*: in general, the sum of current account flows and capital account flows.  
<sup>24</sup> An accurate conversion would have required calculating the average of the actual rate applicable to each and every transaction weighted by the size of the transaction itself.

**Table 4**  
**Comparison of sample and official balance of payments accumulated flows<sup>25</sup>**

<i>Accumulated 2003-2005</i>	<i>Overall Inflows (Receipts)</i>	<i>Overall Outflows (Payments)</i>
NBS Official balance of all payments cumulated 2003/2005 overall flows (current + capital +/- errors and omissions):	\$ 40,1 billion	\$ 36,3 billion
<b>Sample of 19 countries, cumulated 2003/2005 overall flows (current + capital +/- errors and omissions)</b>	€ 56,7 billion	€ 56,8 billion

When asked for clarifications, the NBS responded that the figures provided were not netted of the so-called *neutral transactions*. What are neutral transactions and why are they important for our research?

### Neutral transactions

The balance of payments records transactions taking place between one country and the outside world. The key concept that defines whether an actor is to be considered ‘domestic’ or ‘foreign’ is residence, not nationality. This means that the balance of payments is a record of transactions between *residents* and *non-residents*. There are other kinds of transactions that have an international element. Namely:

1. *transactions between residents* executed through a non-resident financial institution (for example: a resident in Belgrade making a payment to a resident in Novisad through a bank in Vienna); and
2. *transactions between non-residents* executed through a resident financial institution (for example: a resident in Italy making a payment to a resident in the Netherlands on a dinar account in Belgrade).

Such transactions should *not* be included in the balance of payments as they would be considered either domestic (1) or foreign (2). However, raw statistics collected for balance of payments accounting often do include them nonetheless, in which case they have to be subtracted to arrive to the final figures. (1) and (2) are also termed ‘neutral transactions’ as they would be entered *both* on the debit and on the credit side. For example, the payment effected by a resident in favour of another resident over a non-resident account would be recorded as an *outflow* (import) but also as an *inflow* (export). Hence, the net effect of neutral operations should in any case be nil. In practice this may not happen immediately, for example due to time lags in clearance, though statistically the net imbalance over a longer

<sup>25</sup> “Errors and Omissions” are included in the official balance of payments figures considered for the comparison with the sample.

time span should be quite small. Actually, these neutral transactions should be of little interest to our research. Reality, however, proved different.

Contrary to this expectation the statistics provided by the NBS showed a substantial impact of neutral transactions on overall inflows and outflows, given the large discrepancy between the figures in our sample and the balance of payments official statistics: 41,4 % of the payments current account + capital account *inflows* and 56,5 % of the payments current account + capital account *outflows*. It must be said that Serbia's regime of controls on foreign exchange means that a good proportion of neutral transactions actually consist of 'bureaucratic churn': transactions executed on a daily basis between financial institutions and the Central Bank itself. However, even when this factor is taken into consideration, the volume of neutral transactions still appears unusually high.

Considering that some international money laundering triangulation schemes may show up as transactions between residents or between non-residents, the NBS was asked if they could provide a list and description of transactions defined as *neutral* according to their methodology as well as a new set of data of net neutral transactions that could be more accurately matched with Serbia's balance of payments statistics. Due to time constraints this time we asked for balance of payments figures relating to the restricted (nevertheless interesting) sample of countries<sup>26</sup>:

1. Bosnia Herzegovina (Federation and Republica Serbsky);
2. Cyprus;
3. Hungary;
4. USA;
5. Russia; and
6. Switzerland.

Money flows with these countries expressed in the various currencies were converted into euros according to the method used for the conversion of the first set of statistics received.

For the six selected countries the new data was compared with the first set received (see table 5). As shown in table 5, the ratio of neutral transactions (including both transactions between residents and between non-residents) to non-neutral (balance of payments) transactions for the 6 countries in the sample is even greater than for the total Serbian balance of payments:

- **Overall inflows (exports):** neutral transactions (Column C) are 147% larger than normal resident/non resident transactions (Column A). The US and Switzerland record the highest ratios of neutral to non-neutral transactions (448% and 212% respectively).

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<sup>26</sup> It was specifically clarified that data for the countries listed had to be provided broken down by item of balance of payment (balance of trade, services, remittances, capital flows and the like) and currency.

- **Overall outflows (imports):** neutral transactions (Column C) are 69% larger than normal resident/non resident transactions (Column A). The US and Russia record the highest ratios of neutral to non-neutral transactions (again 448% and 98% respectively)

**Table 5**  
**Sample cumulate 2003-2005 balance of payments flows and neutral transactions**

<i>Euro Millions</i>	<i>Neutral transactions INFLOWS (A)</i>	<i>Balance of payment transactions INFLOWS (B)</i>	<i>Ratio: neutral / balance of payment INFLOWS (C)</i>
BiH (Federation + RS)	63,5	1.317,3	4,8%
Cyprus	185,7	643,1	28,9%
Hungary	34,9	332,7	10,5%
Russian Federation	1.137,3	699,9	162,5%
USA	3.542,5	770,6	448,0%
Switzerland	1.818,8	855,9	212,5%
<b>Total</b>	<b>6.693</b>	<b>4.619</b>	<b>147%</b>

Source: National Bank of Serbia

<i>Euro millions</i>	<i>Neutral transactions OUTFLOWS (A)</i>	<i>Balance of payment transactions OUTFLOWS (B)</i>	<i>Ratio: neutral / balance of payment OUTFLOWS (C)</i>
BiH (Federation + RS)	63,0	517,2	12,2%
Cyprus	225,9	2.188,2	10,3%
Hungary	31,0	1.116,0	2,8%
Russian Federation	1.040,6	1.056,6	98,5%
USA	2.933,6	654,2	448,5%
Switzerland	661,4	1.666,3	39,7%
<b>Total</b>	<b>4.955</b>	<b>7.198</b>	<b>69%</b>

Source: National Bank of Serbia

The breakdown of total ‘neutral transactions’ in its two components -transactions between residents and transactions between non residents deserves a further comment:

- *Transactions between residents:* these represent the greatest share of total neutral transaction. More interestingly they appear unusually large when compared to non-neutral transactions normally recorded in the bilateral balance of payments with the countries in the sample (164% of overall inflows and 64% of overall outflows). When analysing individual countries these ratios become even more remarkable. For example, for the US, transactions between residents



are 418% greater than overall balance of payments inflows from non-residents and 437% greater than overall outflows.

Furthermore, inflows and outflows show persistent and substantial imbalances in each and every year and on a 3-year cumulate basis, whereas one would expect that neutral transactions would tend to balance statistically. Over the 2003-2005 period overall, inflows relating to transactions between residents exceed outflows by almost 40%. Imbalances for some countries are even greater: For example, for Switzerland inflows exceed outflows by a ratio of 3 to 1, and for Cyprus the ratio is 2,6 to 1. On the other hand, inflows and outflows referred to BiH, Russia and, to a lesser degree, the US, do show a tendency to balance out.

- *Transactions between non-residents:* the weight of transactions between non-residents relative to non-neutral transactions is much smaller (12% for overall inflows and 5% for overall outflows). However, flows are still substantial enough. For example, between 2003 and 2005 non-resident transactions with the US recorded € 234 million of inflows and € 77 million of outflows. In the same period the outflows to Cyprus were € 176 million vis-à-vis inflows from Cyprus of € 57 million.

With no additional information available from the NBS on the different types (and size) of transactions between residents it is not possible to make further progress in the analysis. All that can be said is that the volume and pattern of *transactions between residents* and, to a lesser degree, of *transactions between non-residents* do appear unusual at first sight. On the other hand such transactions could be consistent with money laundering international triangulations schemes. Neutral transactions definitely represent an area deserving further investigation.

## **Triangulations**

A second interesting finding is that one of the top recipients of flows from Serbia appears to be Cyprus. Perhaps even more notable is that over 95% of the outflows from Serbia to Cyprus represent payment for the acquisition of *goods* and *services*. With over € 600 million of goods sold to Serbia in 2003, rising to € 837 million in 2005 (an increase of 38%), Cyprus appears to be one of the top exporters of goods to Serbia. This is, on the other hand, an unlikely circumstance considering that Cyprus is a small, largely service-based economy. An additional remark is that over 80% of the said imports are paid for in US dollars (an approximate equivalent of € 1.455 million).

This fast growing flow of goods apparently imported from Cyprus is made up by a comparatively small and declining number of transactions (a decline of 14%). Consequently, the average size of transactions is substantial and rising sharply

from € 59.435 in 2003 to € 95.304 (the 2003/2005 average being € 71.417). The average size of transactions in US dollars is particularly high: €180.912 in 2003 and a record of €271.913 in 2005. When comparing with the other countries in the sample, imports of goods from Cyprus appear to have the highest concentration of a small number of large transactions.

**Table 6**  
**Bilateral trade balance with Cyprus 2003 –2005: number and average size of transactions (NBS data)**

	2003	2004	2005	Total
<u>Tot. value transact.</u>	€	€	€	€
Export	77.891.926	93.067.693	158.325.047	329.284.666
Import	606.866.604	584.816.020	836.767.985	2.028.450.609
<u>N. of transactions:</u>				
Export	1.890	1.613	1.752	5.255
Import	10.226	9.397	8.780	28.403
<u>Average size:</u>				
Export	41.213	57.699	90.368	62.661
Import	59.345	62.234	95.304	71.417

*Source:* National Bank of Serbia

If there is such a large volume of transactions related to imports from Cyprus, these should be reflected in the Serbian customs data as well as in the Cyprus trade figures. However, corresponding figures could not be found. The Serbian Statistical Office reports imports of goods from Cyprus for \$ 40 million in 2004<sup>27</sup>, while the official 2004 Cypriot balance of trade statistics indicate an overall volume of goods exported of approximately € 317 million, of which € 187 million is to the entire EU and only € 1,4 million to Serbia and Montenegro!<sup>28</sup>

In order to explain these discrepancies we should begin by saying that the figures do not come from the same sources and actually reflect different concepts:

- a. the National Bank records payment declarations according to the Law on Foreign Exchange: the € 585.000.000 recorded as ‘imports of goods’ from Cyprus in 2004 must be intended as the flow of money that was *actually* paid to Cyprus on the basis of the *declared* purpose of the acquiring goods from Cyprus, that is, irrespective of whether the goods were actually purchased from Cyprus or from elsewhere and whether it was materially shipped to Serbia or not;
- b. the Serbian and Cypriot *balance of trade* statistics are compiled by the respective customs. These institutions record goods physically entering or leaving the country on the basis of the accompanying documentation (invoice, bill of lad-

<sup>27</sup> Source: STAT.YEARB.SERB.2005

<sup>28</sup> Source: Republic of Cyprus: Cyprus external trade statistics 2004. Issued by the Statistical Service of Cyprus.

ing, and the like) and, in the case of imports (in our case Serbia) according to the *rules of origin*.<sup>29</sup>

Rules of Origin can explain the discrepancies between Serbian and Cypriot customs data. For example, the Cypriot authorities might see off a shipload of computers heading to Serbia and thus record an export of goods to Serbia. Once the computers reach Serbian soil, however, the local customs might note that although the machines were assembled in Cyprus, 90% of the components were in fact manufactured in another country therefore, according to rules of origin, classify the incoming computers as an import from the other country in question.

On the other hand, a more plausible explanation for the discrepancy between the Serbian National Bank figures and Serbian Customs statistics (arrival of goods), is that the acquisition and/or payment by Serbia of goods produced elsewhere is ‘triangulated’, that is, routed through Cyprus. This explanation appears to be confirmed by the NBS which hinted that the main determinant of the discrepancy could be fuel from Russia, as part of these imports are invoiced from Companies in Cyprus and/or paid for on Cypriot accounts.

We are not concerned whether oil is indeed the main ‘culprit’. Of more importance is the fact that triangulating appears to be a widespread practice, a circumstance confirmed by other institutions interviewed (police, customs, tax administration and Foreign Exchange Inspectorate). The rationale of triangulations is hardly ever grounded on pure business motivations. Most often their purpose is to take advantage of the incentives offered by the Cypriot authorities and its network of treaties against double taxation. In most legal systems such triangulations amount to tax avoidance to say the least, and they can be downright illegal if they also entail transfer pricing or a full or part simulation of the transaction. The latter appears to be fairly common in the case of Serbia as, according to the cited institutions, the price paid by the Serbian importer is usually substantially higher than market value, whereas the price paid by the Cypriot supplier to the third party is usually in accordance with market prices. In certain instances the merchandise never materially reaches Serbia nor are the services rendered. These profits are withheld by the Cypriot entity (whose beneficiary remains undisclosed) so that the operation may constitute a mechanism for skimming corporate or income tax or corporate asset stripping.

The Foreign Currency Inspectorate of Serbia reported that a considerable amount of foreign currency was transferred abroad in 2005, “*most frequently, by importing and paying various services, the justifiability of which is difficult or al-*

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<sup>29</sup> Rules of Origin are devised for trade purposes in order to ascertain the country of effective origin of imported goods: that is where the products or its main components are actually extracted, manufactured or transformed.

most impossible to establish”.<sup>30</sup> The report cites 26 cases in 2005 of dubious marketing and other business services rendered by foreign companies for a total amount of € 33,6 million. No further action was taken in these cases as, according to the inspectors’ report, “*whether paid services have in fact been delivered, imported, their value is represented realistically, or whether this is a transfer of capital abroad, is in fact very difficult to establish*”<sup>31</sup>.

### ***Money comes home: remittances, loans and investments***

Not only are the money flows leaving the country of interest; there are also incoming money flows in the form of remittances. The largest flows of remittances to Serbia originate from Switzerland, the US and Cyprus (table 7). However, Cyprus comes up once again as a clear winner when one looks at the average size of remittances. Switzerland is traditionally a safe haven for capital; the US is the world economic powerhouse and host to a large community of Serbian expatriates.

**Table 7**  
**Remittances to and from Serbia 2003-2005**

<b>Remittances</b>	<b>CYPRUS</b>	<b>RUSSIA</b>	<b>USA</b>	<b>HUNGARY</b>	<b>CH</b>	<b>BiH(F+RS)</b>
<u>Total value of transactions</u>						
Receipts (EUR)	102.528.289	83.328.350	200.770.032	42.337.471	241.023.774	43.861.179
Payments (EUR)	2.105.470	2.168.543	21.100.153	2.490.196	11.805.557	9.466.448
<u>Number of transactions</u>						
Receipts	10.701	46.761	52.649	5.959	144.281	15.663
Payments	674	1.489	15.873	1.791	2.804	3.835
<u>Average size of transaction</u>						
Receipts (EUR)	9.581	1.782	3.813	7.105	1.671	2.800
Payments (EUR)	3.124	1.456	1.329	1.390	4.210	2.468

*Elaborations on data provided by NBS*

When we look at foreign direct investments and loans in the years 2003-2005, Russia ranks first (€ 244,4 million), followed by Cyprus (€ 107,9 million). The reverse of these investments and loans is the income they generate for the beneficiaries. This income paid abroad by Serbia went in the first place to the USA (€ 69,8 million, against an investment/loans of € 60,8 million), followed by Cyprus with €

<sup>30</sup> *Foreign Currency Inspectorate “Information on payment of marketing services imported into Serbia” 2005/2006*

<sup>31</sup> *Ibid*

36,5 million. Russia, the prime investor, was with a return flow of only € 8,4 million, somewhat poorly endowed.

Obviously, these statistics need a more in-depth analysis. In the first place we should know who is at the issuing and receiving end of the loans, investments and remittances. In the second place we should know how the interests and repayments are earned. That may shed light on the commercial rationality of these transactions. The available data did not allow such an analysis.

‘Groping in the dark’ produced a pattern of discrepancies. However, these raise primarily questions which may be projected against the framework of money-laundering, but that would be a jumping to conclusions. However, the inexplicable discrepancies justify at best the conclusion of a very opaque money and trade management. More plausible is the theory of triangulation, tax fraud and corporate asset skimming.

## **Economic and fiscal crime**

### **Methodological notes**

Economic crime, including fiscal offences and corruption, constitute traditionally and internationally a meagrely observed law enforcement sector. This concerns the *intensity* of law enforcement as well as the *information management* concerning detected and reported offences and their subsequent processing in the chain of investigation, prosecution and trial. Because of their very nature, various law enforcement institutions are involved in the detection and subsequent handling of the input and throughput: regulatory (administrative) agencies, penal law agencies at the subsequent criminal investigation and prosecution/trial phase. Usually each institution has its own data recording and processing system. Without a proper data management system in place, the likelihood that the different data systems will match is very slim. Actually they must be treated as different and incomparable databases.

Apart from this general characteristic, which Serbia shares with most jurisdictions, our data inspection per institution (police, Inland Revenue Service, prosecution) did not convince us that the figures could be used at face value. We have the impression that the databases are intended for rough workload measurement or case processing overviews. Apart from the well-known ‘dark number’ problem, the available figures of detected cases cannot be the building blocks for conclusive statements on economic/fiscal crime (let alone money laundering) without accompanying interpretation. Unless the database allows offender-offences connected

analyses, we cannot connect the offender frequency to the offence frequency tables.

As far as the volume of economic crime and its impact is concerned, unless there are independent victim reports, the figures obviously reflect (as usual) the efforts and priorities of the institutions. Concerning the (financial) impact of economic crime, additional comments about their use should be given. For example, as mentioned before, the reported damage in fiscal cases cannot be equated with the criminal income of the perpetrators. This underlines our warning not to use financial law enforcement figures for concluding statements about a particular phenomenon like money laundering.

### Facets and figures of economic crime and law enforcement

The police statistics recording damage inflicted by economic crime as well as the value of the illegally possessed property of economic crime from 2000 onwards is presented in table 8. It is not clear whether ‘the category ‘illegally possessed property constitutes a subset of the ‘material damage’.

**Table 8**  
**Value of damage and illegally possessed property 2000-2005 in euros**

	Number of offences	Material damage in €(average yearly exchange rate)	Value illegally possessed property: in €
2000	106.197	1.183.490.640	841.842.067
2001	121.847	168.070.106	153.894.626
2002	95.493	111.003.202	59.659.721
2003	90.409	110.620.051	83.598.241
2004	99.290	92.655.563	68.634.655
2005	102.056	265.904.141 <sup>32</sup>	248.715.677

*Source: Ministry of Interior*

Apart from the observation that the three frequency distributions show roughly a ‘U shaped’ curve, with two extremes in 2000 and 2005, the figures are difficult to interpret. Did the damage of economic crime and illegally possessed property almost triple from 2004 to 2005? Or is it a reflection of the exchange rate and should the financial data be presented in dinars? That would not account for the inflation rate, however.

It is also uncertain whether these damage and illegal possession figures include fiscal damage or which part is to be considered the illegal advantage of the perpe-

<sup>32</sup> For 2005 the estimated average exchange rate of € 80 has been used.

trators. Given the figures of the tax police over 2005 this seems highly unlikely: the recorded fiscal damage in that year amounts to € 109.074.469. If the damage recorded by the police does not include the fiscal damage, the total damage would be € 374.978.610. Related to the total public revenue of € 8.448.192.771 this amounts to 4,4 %. Given the uncertainty of the reliability status of the data and the reasonable assumption that the informal, untaxed, economy in Serbia is sizeable, this may be a gross underestimation, certainly in the light of the informal economy estimated in Western European countries.

## Tax evasion

The figures provided by the fiscal police on Tax evasion detected for the years 2004 –2005 are illustrated in table 9. Before analysing the figures in detail one should note that the Tax Police in its present status was set up in 2003. The sharp increase in evasion detected from 2003 to 2005 is a testimony to the growing capabilities of this unit.

**Table 9**  
**Tax evasion detected in 2004 and 2005**

Tax evasion detected (EUR)	2004		2005	
	Reported tax evaded*	Estimated unreported tax base**	Tax evaded*	Estimated unreported tax base**
<b>Taxes:</b>				
Excise	816.975	N.D.	409.697	N.D.
VAT	0	0	5.301.278	29.451.545
Sales tax goods	26.448.397	132.241.985	49.406.807	247.034.033
Sales tax services	937.604	4.688.021	1.858.924	9.294.621
Property transfers tax	0	0	56.027	1.120.548
Corporate income tax	304.292	3.042.924	732.684	7.326.841
Tax on financial transactions	0	0	5.412	1.804.039
Tax on personal income: salaries	4.556.113	32.543.667	8.337.402	59.552.873
Tax on personal income: other	0	0	1.438.364	14.383.636
Tax on games wins	0	N.D.	1.706	N.D.
<b>Social contributions</b>				
Pension contributions	7.067.075	64.246.140	11.605.773	105.507.028
Health insurance contributions	3.897.311	63.370.904	6.598.292	107.289.294
Contribution for unemployment benefits	377.519	50.335.822	755.748	100.766.385
Contribution for salary fund	766.482	N.D.	740.348	N.D.
Contribution for local revenues	16.756	N.D.	17.530.488	N.D.
Other	629.823	N.D.	113.954	N.D.
<b>Total</b>	<b>49.017.250</b>	<b>350.469.463</b>	<b>104.891.904</b>	<b>683.530.844</b>

\* Source: Ministry of Finance – Tax Police Reports (estimated Euro conversion of DNS)

\*\* Authors' own estimate based on average nominal tax rate according to the formula:

*Unreported taxable base = detected tax evaded / nominal tax rate (%).*

Of the estimated non-declared tax base of at least € 683.530.844<sup>33</sup> discovered in 2005, the pension, health and unemployment contributions represent the lion's share: € 313.562.707 or 46 %. We have no breakdown relating this figure proportionally to the perpetrators involved: the workers and/or the employers. Usually they are both knowingly involved: the employer doctoring his books (because of uncovered salary expenses) and the employee returning satisfied home with more to spend than his official salary. It would not be too imaginary to speculate how much of the spending deficit of € 183.795.474 of the household survey previously analysed is paid out of these illegal 'income supplements'.

From the angle of money laundering these 'income supplements' are of less importance than the illegal savings of the employers: these illegal savings have to be laundered or covered by means of documentary fraud.

When we relate the estimated tax evasion to the 2005 GNP of € 13.070,1 million the resulting ratio does not convey a really threatening fiscal doom: an evasion/income proportion of slightly less than 1 % is almost too good to be true.<sup>34</sup> Consider that estimates for tax evasion in Switzerland – a country with a reputation for being law abiding – are around 2% of GDP<sup>35</sup>, and evasion estimates in Italy, a notoriously less law abiding nation, are around 12% - 18% of GDP.<sup>36</sup>

As these figures would turn Serbia into the most tax compliant country in the European continent, and as this is not the most plausible hypothesis, one should raise the question of the dark numbers. How much tax evasion is undetected and how can be observed in a largely cash based economy?

It is unclear whether and to what extent these figures concern cases and suspects handed over to the Public Prosecution Office for further procedural processing. Table 11 illustrates the reports by Tax Police:

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<sup>33</sup> We could not estimate the tax base for all kinds of taxes. In some cases, such as "excise tax", calculation of dues is not based on a % of value but tax is a fixed monetary amount levied per physical unit of measurement (e.g. X amount per litre of alcoholic beverage). In other cases it was not possible to break the figures further according to applicable tax rate (e.g. 'other'). Consequently the estimated undeclared tax base is to be considered understated.

<sup>34</sup> Figures are indicative. Evasions detected in a given year usually refer in part to taxes due in previous years. Similarly, it is expected that a portion of taxes evaded in the current year will be discovered in future years.

<sup>35</sup> "Tax evasion in Switzerland. The Role and Deterrence of Tax Morale" – Lars Field & Bruno Frey, Institute for Empirical Research in Economics, University of Zurich, Working Paper No. 286, 2006.

<sup>36</sup> UIL Servizio Politiche Fiscali "Evasione Fiscale ed evoluzione strumenti di controllo" 2005.



**Table 10**  
**Activity of the Tax Police (Source Tax Police Reports)**

	<b>2003</b>	<b>2004</b>	<b>2005</b>
Number of reports filed	45	876	1.365
Number of violations	63	1.118	1.804
Number of persons involved	49	987	1.534
<i>of which: comp. owners or associates; entrepreneurs/self employed</i>	46 1	738 181	1.449 23

If (according to the law) all these cases would have been transferred to the Public Prosecution Office (PPO), this would imply workload input of 1.534 persons (1.363 reports) in 2005, suspected of tax fraud (and technically, subsidiary money-laundering). Indeed, the Tax Administration reports a feed back from Prosecution and Judiciary for the period 30.10.2003–31.03.2005. However, the numbers do not match. Of the total set of 306 cases in 2005 (66 from the previous year) 41 were refused or returned for further consideration. Of the remaining 265 cases 62 were rated ‘low priority’, leaving 203 for further processing. If we take a three years average, there is a workload of 122 tax cases (38 in 2003; 126 in 2004 and 203 in 2005: a steep increase).

The handling of tax evasion cases by the courts in the first instance does not reflect a large workload of tax fraud cases either. As the databases of the PPO and the courts do not match either (the numbers of the courts may stretch back to indictments input of several previous years), a direct comparison with the case processing of the PPO is not possible. Therefore we take the three year average of 73 cases of tax fraud handled yearly by the courts (2003: 55; 2004: 91; 2005: 74). That would mean that on average 49 cases per year should be on the ‘waiting list’ of the courts. Of the cases finally handled an average 74 % ends in a guilty verdict.

Whatever interpretation or meaning one wants to attach to this statistical exercise, we must observe that:

- the rate of *established* tax evasion as a general tax fraud category is low;
- there is a clear output-input difference between the case processing institutions, with a ratio of tax police detection versus court handling of around 5 %;
- the figures of other economic offences are difficult to interpret, because the underlying case processing mechanisms and reasons for handling or dismissing are unknown. Of the case/report input much is refused or sent back.

As the relation to economic/financial damage or criminal income per case is unknown, the seriousness of the cases cannot be rated or projected in a frequency distribution or a further breakdown. Consequently little can be said about crime money or money laundering.

## Corruption and abuse

A category of offences particularly relevant for our survey consists of public office related abuses: embezzlement, taking and giving bribes. Without speculating about the real size of corruption in the country the figure from the PPO may be illustrative of the limited priority given to this issue.

**Table 11**  
**Corruption case input and actively processed by PPO**

Year	2003		2004		2005	
	N	% handled	N	% Handled	N	% handled
<b>Embezzlement</b>	915	53	1146	42	995	43
<b>Bribe taking</b>	175	59	100	72	173	59
<b>Bribe giving</b>	117	37	162	59	166	41
<b>Total</b>	1.207	54	1.408	46	1.334	45

Source: Republic Prosecutors Office

Granted, because of lack of background, one can do little more than merely presenting these figures without additional interpretation: a proper content analysis of the criminal corruption files actually handled should shed light on such aspects as (lack of) evidence, on-going (or halted) investigations and the like. We do not know the outcome of the prosecution phase: the number of final decisions. We can only compare the case workload of the PPO with that of the courts in the first instance, compare the differences and observe a steady PPO-Court ratio of around 40 %. Again, we have to be parsimonious with interpretations, but these figures cannot convey a high-intensity anti-corruption policy.

## Phantom firms

There is little new about phantom firms: the hollow corporate shell destined to bust as soon as creditors want to collect their debts. For any fraudster setting higher aims than cheating rich old widows, it is the usual tool. If skilfully handled the chances of being caught as the background operator are slim. Look at the detention rate in the following table with an overall detention rate of 7 %, though there were also 'bad years' with a detention rate of slightly more than 10 %. Given the detected damage, though strongly reduced after 2002, there are reasons to believe that behind these phantom firms much wealth is changing into the wrong hands.

**Table 12**  
**Phantom operators, damage and success rate**

	<i>N.charges</i>	<i>No. of persons</i>	<i>Arrested</i>	<i>Detained</i>	<i>Damage in €</i>	<i>% detained suspects</i>
2002	225	409	64	14	€ 23.112.242	3,4
2003	135	240	34	25	€ 12.753.917	10,4
2004	104	201	38	24	€ 13.572.143	11,9
2005	79	154	17	8	€ 8.901.885	5,2
<b>Total</b>	543	1004	153	71	€ 58.340.187	7,0

*Source: Analytical Department of the Ministry of the Interior*<sup>37</sup>

We must assume that this table presents only a part of the phantom reality. A police report for 2002 mentions 619 identified phantom firms. These outfits skimmed taxes in an organised fashion and laundered money through the Novi Sad branch of a legally registered commercial bank from Belgrade. According to the 2002 police report, the activity of these phantom companies resulted in tax evasion in the amount of approximately 300 million dinars.<sup>38</sup>

Thus, in 2003 a case was reported in which three owners of several companies from Valjevo had used phantom companies to present an alleged sale worth more than € 3,3 million, evading taxes in the total amount of € 638.000. There are also cases of phantom companies involved in illegal trade, such as the combine that sold imported oil derivatives worth € 128.000; a company from Bujanovac, that illegally imported goods worth € 168.000. Another from Čačak, which sold imported petroleum and xiol worth € 200.000; 'DOO Interprom' from Pančevo, whose owner acquired illegal profits by selling goods through phantom companies in the amount of € 184.000.

Furthermore, the Tax Police Report of 2004 mentioned for 2003 the uncovering of 357 phantom firms engaging in tax evasion for an amount of 1.711 million dinars (approx. € 21,7 million). 168 people were involved and 141 criminal offenses reported by the tax police.

These are just illustrations, to which one should add the VAT fraud schemes, as in addition, this form of fraud requires such a phantom firm in the chain of buying and selling: the 'missing trader'. Naturally, money laundering is inherent to these scams, as the illegally obtained payments to the phantom firm have to be syphoned off as soon as possible, leaving only the empty shell for the creditors. (See the chapter of K. Pashev in this volume).

<sup>37</sup> The Administration has no other data on these companies.

<sup>38</sup> The report on the work of the Ministry of the Interior for 2002 taken from [www.mup.sr.gov.yu](http://www.mup.sr.gov.yu) pg. 4.

## The evasive illegal earnings

From our perspective of laundering, these economic phantoms render a precise attribution of criminal profits to categories of perpetrators difficult to achieve. We got a glimpse of the ‘loot’, but we do not know how it is being divided. This is important as a broad spreading of the criminal profits over many beneficiaries dilutes the loot such that a substantial part dissipates as daily household expenditure. However, lacking any database designed for cross-sectional analysis, we take the gross figures of illegal profits as provided by the Ministry of Interior and present the figure of the ‘illegal income’ as a hypothetical ‘launderable volume’. The methodological basis for determining these figures could not be determined either.

As can be deduced from table 13 the ‘abuse of official position’ (Article 242/395 new Code) ranks highest in every year, followed by abuse of business authority. Fraud, quite a general category, ranks third. Looking at the time series, one can observe that in the year 2000 Serbia was not only in a political, but in (financial) law enforcement turmoil too: large amounts of money (€ 841 million) appear to have come into the wrong hands. A new rise of financial wrongdoing can again be observed in 2005, mainly attributable to the abuse of the official position (€ 224 million).

**Table 13**  
**Illegal profits for various crime categories 2000-2005 in €**

offence	Abuse business & authority	Acq. Loans & benefits	Illegal trade	Fraud	Abuse posi- tion	Bribe taking	Bribe giving	<b>Total</b>
	€	€	€	€	€	€	€	€
2000	10.385.999	14.846	2.325.155	2.446.812	825.509.922	31.282	0	840.714.016
2001	22.401.357	95.145	5.402.334	8.005.116	98.612.872	22.060	0	134.538.884
2002	10.807.811	1.582.328	1.396.603	1.678.839	40.246.122	44.671	13.314	55.769.688
2003	5.061.993	155.694	5.874.299	4.586.095	56.393.898	119.868	147.802	72.339.649
2004	8.683.116	347.250	1.009.278	2.043.217	44.218.384	11.871	1.010.467	57.323.583
2005	3.737.264	941.833	1.045.757	1.594.337	224.377.904	52.098	8.940.448	240.689.641
<b>Total</b>	<b>61.077.540</b>	<b>3.137.086</b>	<b>17.053.426</b>	<b>20.354.416</b>	<b>1.289.359.102</b>	<b>281.850</b>	<b>10.112.031</b>	<b>1.401.375.461</b>

*Source:* Ministry of Interior

The average yearly exchange rates were taken from the STAT.YEARB.SERB.2005. This entails some inaccuracy: if major financial abuses occurred in a month with a low of high exchange rate, taking the average may lead to under- or overstating.

As remarked, this is a very crude picture because it is not offender related. This means that we cannot cluster economic transgressions around violaters who in the course of doing business bribed, defrauded as well as abused their position. However, we think the figures of sufficient impressive magnitude to warrant a full statistical indepth analysis.

This is also not the whole picture. We have not yet included tax evasion, or smuggling. Of other criminal acts, like the operations of phantom firms we do not

have illegal profit figures. The total illegal profits from tax evasion and smuggling in the time span 2000-2005 amount to € 30.492.742. However, comparison is not feasible due to the difference in reach of the articles applied and the related double counting. For example, corporate and personal income tax and social insurance contribution: the lower tax base of the manager and his employees is a consequence of tampering with the corporate books. All involved are individually liable to be imposed a *gross* tax correction to be recorded as tax fraud. If (for the sake of argument) we nevertheless add up all these illegal tax profits with those of table 13, we come to a five year illegal transfer of wealth of approximately € 1.432.000.000. Though this figure approximates suspiciously the Cyprus figure, it is pure coincidence: we do not know anything of the illegal income distribution. Other empirical research (Van Duyne and de Miranda, 1999; Van Duyne *et al.*, forthcoming) supports the hypothesis that the criminal income distribution is as skewed as the licit one, as can also be derived from the large sums of the abuse of the official position. One should also keep in mind that the opportunities for making illegal profits are all but equally spread in the underground economy (Smith, 2005), while in most illegal enterprises wages are dismally low (Djankov *et al.*, 2003).

Having come at the bottom of the (database) barrel of what is known about the criminal income, we will shift our attention to the money laundering instruments that are designed to do something about it.

## **Fighting money-laundering**

As far as the fight against money-laundering is concerned, Serbia has complied with the requirements of the FATF: there is a legislation against laundering and a Serbian FIU has been established, the Administration for the Prevention of Money Laundering (APML). Money-laundering was already penalised in 2001. This was a federal law, while meanwhile the federation has ceased to exist. The law also contained a number of flaws, for which reason a new law was designed that came into force in January 2006. Meanwhile the APML has been operative since 2002. What evidence about money-laundering has been brought forward since the start of the anti-laundering regulation and the institution of the APML?

When we compare the figures of the Ministry of Interior concerning the illegal profits (irrespective of their validity) with the reported suspicious transactions, we notice some discrepancy. For example, the Ministry of Interior recorded in 2005 € 240.689.641 as illegal profits (mainly from abuse of official position) while in the same year the Administration for the Prevention of Money Laundering (APML) recorded € 54.625.845 as suspicious transactions. Assuming a 'chain system' of detecting and reporting crime-for-profit and related financial transactions, a lot of

detected criminal income reports failed to reach the APML. As the APML is one of the receiving, analysing *and* forwarding links in that chain of processing illegal transactions, it is justified to have closer look at the available data.

The number of institutions, firms and entrepreneurs who are obliged to report financial transactions which exceed € 15.000 (or lower sums if the transaction is unusual) is large.<sup>39</sup> Therefore, the APML is not short of incoming unusual transaction reports. Indeed, the APML is the collection point of about 1.000 transactions reported *daily* and needless to say, it cannot possibly examine and re-examine all reports received to its full extent. Nevertheless, it processes all currency transaction reports and determines which of those should qualify as suspicious. Looking at the obliged institutions and other obligors we get the following frequency over the last four years.

**Table 14**  
**Reported transactions and obligors 2002-2003**

<i>Obligor</i>	<i>Number of reports</i>	<i>Sum in DNS</i>
Lawyers	3	3.694.320
Car dealers	1.433	1.659.208.842
Banks	332.092	693.989.950.360
Brokers	98	342.378.838
Casinos	2	6.427.866
Exchange office	1.622	3.006.263.172
Real estate agents	601	1.010.855.638
Insurance	3	3.527.600
Post	1.330	2.717.357.462
UJP	5.393	11.366.460.669
Zop	9.531	17.911.664.517
Others	315	644.983.650
<b>Total</b>	<b>695.303</b>	<b>1.445.773.550.342</b>

Zop, the old, socialist era, financial clearing house, reported only in 2002; UJP reported till 2004.

*Source:* the Administration for the prevention of money laundering

In terms of money volume, the banks are the main reporting bodies, followed by the Zop and UJP. The exchange offices rank fourth, followed by the car dealers.

When we look at the processing of the reports about cash transactions, we get the following picture:

<sup>39</sup> Missing is the important Privatization Agency, which is handling so much of financial interest, for the society and potential criminals alike.

**Table 15**  
**Cash and suspicious transaction 2002-2005 in €**

	2002	2003	2004	2005	Total
N. trans.reports	17.779	65.255	96.066	165.318	344.418
€	502.084.098	2.028.432.355	2.637.671.836	4.126.669.063	9.294.857.352
N. suspicious	14	120	259	280	673
€	135.833	4.723.869	11.272.858	54.625.845	70.758.406
% suspicious	0,007 %	0,2 %	0,3 %	0,2 %	0,2 %
<b>% of €</b>	0,003 %	0,2 %	0,4 %	0,1 %	0,7 %

*Source:* the Administration for the prevention of money laundering

We do not want to present these outcomes as a trend: four years (of which the first can be considered a ‘warming-up’) are too short for a trend analysis. Let us just sum up that on average 0,2 % of the reported cash transactions were eventually considered suspicious. This is a small proportion indeed. However, it should be noted that most European FIUs report also small proportions of unusual/suspicious transactions (Van Duyne, 2007).

Our question about the outflow (how many were reported to the police or prosecution) could not be answered. Though the APML stated during a presentation that it resolved 108 cases, it remained unclear what that means in terms of time (year), ‘outcome’ (suspicion of ‘laundering’ confirmed or rejected) or subsequent procedure (forwarding to the authorities or ‘archived’). The information about money-laundering cases of other law enforcement agencies is difficult to evaluate. The police reported ten cases related to illegal traffic, tax evasion, abuse of authority in the economy, kidnapping and fraud. The Novi Sad district prosecutor reporting 44 cases from 2002-2004, but how they were reported or whether they were forwarded by the APML remains unclear. It is not possible to come to an evaluative conclusion about the functioning of the anti-money laundering instruments and organisation. There is an overwhelming inflow of reports, transformed into a trickle of suspicious transaction output and a mere shadow in the subsequent law enforcement bodies of police and prosecution.

Surveying the present state of affairs, a concluding comment like “the anti-laundering system works” is by no means supported by the scarce facts and figures of unknown or at least undeterminable reliability. Unless the variables of the input (business sector, nature of the reported persons, reasons for suspicion, the nature of the transactions and the like) can be mutually related in a breakdown analysis, these figures have very limited value, even if reliable.

## Opacity prevails

It is difficult to deduce from the available data about crimes-for-profit a comprehensive picture which could be an approximation of the 'real' criminal profits and the laundering thereof. Granted, all countries face the problem of estimating the 'hidden economy' from uncertain parameters. As far as Serbia is concerned, this is aggravated by the circumstance of discrepancies in 'state bookkeeping'. At the moment such bookkeeping lacks transparency. The Serbian phantom companies are matched by state phantom databases. Consequently we do not even come near any insight into the phenomenon of money-laundering. While the economic damage may be around € 374.000.000 (or more), we do not know what part of it represents illegal income to be spent or saved (and laundered later). Is it the estimated € 560.000.000 deficit of the household spending? Or the € 250.000.000 illegally possessed assets according to the police reports?

Granted, our fact finding covered some of the darker economic and law enforcement years, when the unfortunate rule of Milosivic came to an end and the rule of law acquired new opportunities, albeit gradually. There is hope because of new legislation to stem the tide of (economic) lawlessness. However, the actual situation is still characterised by opacity in most of the economic and law enforcement areas.

This is not a legislative but a human factor circumstance. This was underlined by the experience of the authors: while groping for facts and figure they hit on a more fundamental void: lack of curiosity. The questions they raised were very fundamental and basic and concerned 'if A then B questions'. For example: 'if households spend more than they earn and save, then there are unaccounted funds'. Or: 'if more financial offences are detected, the suspicious transaction reporting should go up commensurate, followed by a higher input towards the PPO'. The authors met only a few individuals in the public agencies or in the academic community who were intrigued by such questions.

Improving this human factor entails improving the general regime of information management, the one feeding the other. In addition, also a public and political interest must be developed, which again depends on the availability of underlying facts and figures. Granted, this state of affairs is not unique for Serbia. Many jurisdictions are hardly capable of producing more than just a few crude statistics, whether it concerns money-laundering or the related economic and organised crime (Van Duyne, 2007). Indeed, opacity prevails; but in Serbia it is accompanied in a landscape of uncertain law enforcement concerning financial and economic crime.



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